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Official Spanish Chamber of Commerce in Belgium and Luxembourg

SFF spanish financial forum in Luxembourg

THE MAGAZINE OF THE SPANISH FINANCIAL FORUM IN LUXEMBOURG

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SUSTAINABLE FINANCE

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The first publication connecting professionals of the financial sector from Spain and Luxembourg

Editorial

José Luis Rodríguez Álvarez
Vice-President of the Official Spanish Chamber of Commerce in Belgium and Luxembourg and President of the SFF

The launch of the **SFF Magazine** is an additional step towards achieving our goal of **creating a space for the exchange of information, to share experiences and address current issues** for professionals in the financial and insurance sector both in Spain and Luxembourg.

This current situation is closely linked to the COVID-19 crisis: the pandemic has an unprecedented economic impact and the indicators point to a slow economic recovery. Even so, there are **opportunities and sources of growth as sustainable finance and digitalization**, which will set future trends in this sector.

This has led us to dedicate the SFF Magazine Dossier to sustainable finance. For this, in this first edition we count on the contribution of national organizations – AEB, Spainsif, Finresp, LSFI, LGX, LuxFLAG – focused on promoting the integration of sustainability criteria into finance. They provide different views on the initiatives developed by both countries. All this, in order to achieve the objectives of the Paris Agreement and the UN 2030 Agenda for Sustainable Development.

In this context of changes linked to the crisis, this first edition includes:

- The views of the directors of the Spanish banks established in Luxembourg in relation to digital banking and expectations of new generations;
- Business opportunities linked to non-performing loans;
- The adoption of the Spanish financial Sandbox in the framework of the Digital Transformation Law for the Financial Sector;
- The entry into force of the 2011/16/EU Directive on Administrative Cooperation (DAC6).

We hope you enjoy reading the first edition of SFF Magazine!

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About the **SFF**

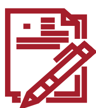
The **Spanish Financial Forum in Luxembourg** (SFF) is a Committee of the **Official Spanish Chamber of Commerce in Belgium and Luxembourg**. It was launched in 2019 at the initiative of professionals linked to the Luxembourg financial services industry.

Through the SFF, the Chamber aims to create both in Luxembourg and in Spain, a space for opinion and debate on economic and financial issues, where professionals working in companies related to the provision of financial services can share experiences, establish collaborations, exchange information on sector trends and develop business opportunities.

Organizational structure

More than 40 companies and over 100 professionals are involved in the SFF. Its organizational structure is composed of a President and four coordinators who lead respectively the following sub-sectors:

- Banking
- Asset Management
- Tax
- Insurance



Join the SFF

All financial services providers that are members of the Official Spanish Chamber of Commerce in Belgium and Luxembourg can apply for free to join the SFF.

Access HERE to more information about membership application and benefits offered by the Chamber to its members.

SFF Magazine

THE OFFICIAL PUBLICATION OF THE *SPANISH FINANCIAL FORUM IN LUXEMBOURG*

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The SFF Magazine is a quarterly and digital publication addressed to financial professionals linked to the Spanish, Luxembourg and Latin American markets. It is published in bilingual, Spanish and English edition.

Most of the content is provided by SFF members and financial stakeholders. If you are interested in participating in the next future editions providing contents, do not hesitate to contact us by sending an email to luxemburgo@e-camara.com. The Chamber also offers the possibility of advertising and sponsoring contents.

Digital banking for non-resident customers in Luxembourg and the new generations

The banking sector faces an immense challenge in delivering tailor-made and integral services to customers through an unique digital experience. In a global and interconnected world, the complexity lies in the fact that those who drive this change are the new generations, which are highly demanding consumers in their decision making process.

The directors of the Spanish banks established in Luxembourg share their vision on the new trends affecting the private banking sector from a cross-border approach.

Héctor Esteban Moreno

Managing Director, Bankinter Luxembourg

"The health and economic crisis caused by COVID19 has not only brought changes in our habits and routines, but is also going to **transform the way we develop certain business models** and how we interact with our customers.

Innovation is in Bankinter Group's DNA. In these times it has been very useful to us, bearing in mind that the Spanish banking sector is ranked second of the world in digitalisation. Over the last few decades, Bankinter has set several milestones in this area - it was a pioneer of **online banking**, there was the launch of the first **roboadvisor** in the Spanish banking sector, and even the first **100% digital mortgage** – to name but a few.

In Luxembourg, the evolution of digitalisation has been different. In this regard, I believe that the Luxembourg Private Banking market has still a great deal to do, and **Bankinter could contribute in this growth**. In the last year, we have implemented many initiatives to get closer to our customers by dealing with the special circumstances of 2020. Alternatives such as the digital signature or the replacement of face-to-face meetings and travel with online meetings, have been very successful. At Bankinter Luxembourg, we have allocated a considerable part of our investment budget to **reinforce technology**. This way we have adapted to the current times, but have also gone even further. Our intention is to persevere in it, hybridizing the digital with the face-to-face contact, which is key to maintain customer relationships.

There is no doubt that the pandemic has also been a catalyst of change in payment methods **by boosting mobile payments and restricting the use of cash** - a trend that is already unstoppable. In the payments industry, banks are facing competition from Fintech and Bigtech sectors. In my opinion, it should not be seen as a threat, but rather as an incentive to learn and expand in areas such as the best customer experience. As banking, and mainly the private banking industry, will always be able to **provide specialized business and fully personalized financial solutions**, this is an added value that is difficult to replace."

Paloma García Nieto
Managing Director,
Banca March Luxembourg Branch

"Due to the current situation, **private banking customers have prioritized their wealth management diversification in different jurisdictions**. In order to facilitate the transnationality for these customers, financial institutions have to adapt their customer on-boarding, operational and organisational processes.

For example, Swiss banks, the paradigm of private banking, seem to be relatively advanced in terms of services offered through digital banking compared to other European countries. Switzerland is a country known for the presence of major global wealth. This type of banking, which in principle is based on the close relationship between the customer and its financial adviser, seems to be aware of the added value of technological developments to our industry.

It could also be added the influence of **the new generations, our customers of tomorrow**. "*The pandemic has shown that digital banking is essential for consumers of all ages to manage their finances*" Allison Beer, Head of Digital - Chase. Millennials and Generation Z are the two age groups that use digital banking apps the most. A study shows that 99% of Generation Z and 98% of Millennials use these apps today. **Generation X and Boomers use such apps slightly less, 86.5% and 69.5%, respectively.** (Source CNBC)

How bankers in the future will interact and operate with new technologies, what current and future digital customers expect from their bankers, and **how technology might strengthen client loyalty**, are issues to consider now. These are our customers of tomorrow and on which all the industry's digitalisation and innovation efforts should be focused."

Álvaro Hermida Santos
Managing Director,
Caixabank Wealth Management

"CaixaBank Private Banking, in line with the bank's Strategic Plan, has been developing its omnichannel customer service model called "**Human Technology**" for years, which combines the experience and know-how of Private Banking managers with the advantages offered by new technologies to offer the best customer experience.

In Luxembourg, **our customers benefit from a dedicated team of professionals working together with their local financial advisor**, reinforced by a technological platform that allows them the interaction of both areas.

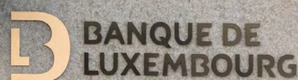
For us, the need to maintain a personal relationship between customer and the financial institution to provide services will always be paramount. We have to understand that **the new generations do not see technology as a tool to do their jobs better, but as something that is present in all aspects of their lives** and is evident in the way they relate to people, companies and institutions. And they will expect banks to be able to respond to this style as well. The most successful banks will be those that better listen to their customers and anticipate their needs anywhere and at any time."

Interview

Juan Carlos Durán
Senior Private Banker
at Banque de Luxembourg

Juan Carlos joined Banque de Luxembourg in 2007. At the beginning, he was involved in strategic and internal transformation projects, and later, he got into the financial management industry, starting with investment fund management, distribution and business development. After this experience, he decided to orient on private banking and is currently focused on Spanish-speaking client management and their families, and on the Spanish market development.

Juan Carlos studied engineering between Madrid and Paris.



Luxembourg is an important European financial center for private banking. How does Banque de Luxembourg position itself in this sector?

Today, **we are one of the largest private banks in Luxembourg**, with nearly 1,000 employees, an aggregate net banking product of EUR 280.7 million, more than EUR 1 billion in equity (as at 31 December 2019) and a solvency ratio of 27.19%, figures which convey solidity and security. From Luxembourg, our bank serves individuals, families and entrepreneurs. Most of them come from Europe and choose us because of our ability to take into account the diversity and complexity of their situations, as well as the way we carry out our activity.

Private banking has undergone a revolution in recent years. How did the sector adapt to the new generations? What trends do you think will determine the future?

Whether tangible or intangible, wealth is the result of a lifelong effort and sometimes even of several generations. I perceive that the new generations expect their investment manager to go beyond just financial aspects and take into account ethical criteria and concepts such as sustainability and social commitment.

For this reason, **Banque de Luxembourg has chosen to put responsible investment and sustainable initiatives at the core of its future strategy**. From now on, everything we undertake will be measured against the United Nations' Sustainable Development Goals (SDAs).

These new generations are sensitive to a whole range of labels relating to Socially Responsible Investment (SRI). But not only the new generations are affected by these issues, this paradigm is being adopted by society at large.

The two major levers of impact within a bank are savings and credit and, in this respect, at Banque de Luxembourg we assume our social responsibility and can stand with our clients who wish to invest their capital in more responsible projects, but also refuse certain financing on the basis of relative sustainable criteria. Thanks to these two elements, **we position ourselves as a player that gives priority to criteria relating to Corporate Social Responsibility (CSR).**

What advantages does Luxembourg offer to Spanish investors?

Luxembourg is ranked among the 10 countries in the world with a AAA rating and has a thriving economy. It is also one of the countries in the world where the sense of security is highest. The Grand Duchy boasts political and social stability unparalleled in Europe, as well as a pragmatic, dynamic and attractive legal framework for investors. The country offers a stable jurisdiction for its wealth, within Europe, designed to protect investors and customers.

The Luxembourg financial centre offers an international approach to Spanish investors, a high degree of diversification, its capacity for innovation, but above all its economic and political security and stability. **It is the leading private banking center in the euro area and ranks second worldwide in terms of managed assets**, with a modern and competitive legal and regulatory framework.

The current crisis has led to costumers who were generally reluctant to take the step of opening an offshore account to become comfortable with the idea of diversifying their assets in a stable and renowned jurisdiction such as Luxembourg.

How do you perceive that COVID-19 has affected investors' decision-making about their assets? What role does the financial advisor play in this new context?

Costumers who have been trusting us with their savings for many years have once again been satisfied with the quality and resilience of our management. Our investments in quality securities and our long-term prudent investment philosophy have enabled us to weather episodes of high volatility without panic.

At Banque de Luxembourg, we remain on the sidelines of trends as we place our priority on capital preservation and long-term performance. In addition, risk control is one of the key elements of our methodology.

Financial advisors act as catalysts behind these principles. We are trusted partner, who listen to the costumers and accompany them through the changes that any investment experiences over time and who respond to their concerns by providing answers, value and security.

What are the challenges facing the sector and Banque de Luxembourg in the next months?

The banking sector must not only contribute to financing the real economy, as they have done at the height of the health crisis, but can also help the world develop better by facilitating the transition to sustainable finance.

The challenge for the Banque de Luxembourg is, and always has been, to be closer to its clients. Currently, the crisis we are going through has shown that this does not require physical proximity. Thus, **the banker must reinvent himself and the way he offers his services.** During the crisis, I have not been able to travel to Spain to visit my costumers, so we have looked for alternatives. This reactivity has been highly appreciated by our costumers, and is in line with our values.

More than a challenge, it is a principle that we have been applying for 100 years : remaining faithful to our values and taking the time to listen to our costumers, because each costumer is a person, and each person is unique.

The banking sector must not only contribute to financing the real economy, as they have done at the height of the health crisis, but can also help the world develop better by facilitating the transition to sustainable finance.

BANQUE DE LUXEMBOURG

Dossier SUSTAINABLE FINANCE

Through the **Action Plan on sustainable finance** adopted in 2018, the European Commission set out the roadmap to **boost the role of finance in building a European economy** in order to achieve the goals of the Paris Agreement and the United Nations 2030 Agenda for Sustainable Development.

The financial sector has become aware of the important role it has to play in the fight against climate change as well as in the transition towards a decarbonized economy, and **European countries are adapting their national legislation to the European regulatory framework**, promoting the activity of the financial industry in long-term sustainable growth.

The COVID-19 crisis has only accelerated this process, and has placed sustainability, together with digitalization, as pillars of the economic recovery in Europe. Accordingly, the **Recovery Plan for Europe** recently adopted by the EU, will allocate 37% of the resources to the **green transition**. This plan involves an unprecedented injection of funding for Member States to address the economic and social impact of the COVID-19. As a consequence of the pandemic, it is also expected that governments bonds and public expenditure will increase, and **green bonds** and other financial products that consider **sustainable criteria**, are positioned as a key alternative for financing the post-pandemic era. The impact of the health crisis has generally raised public opinion awareness to focus on the need for a just and caring transition towards the protection of the environment and society as a whole, and to raise sustainable finance in the ranking of priorities.

This dossier analyses the initiatives developed in recent years, in the field of sustainable finance, by two countries that have an efficient and competitive financial sector committed to responsible transition: **Spain and Luxembourg**.

Leading stakeholders and professionals from the financial services industry in both countries also share their views on **how the new standards will affect the sector**, and the mechanisms envisaged for the implementation of the European taxonomy on sustainability.

Spain

Spain has a diversified, modern and competitive financial system, which is fully integrated into international financial markets.

Following the 2008 financial crisis, the Spanish financial system has undergone a **major restructuring process** that has established a much more demanding regulatory framework and improved the solvency of the main players in the financial sector. Proof of this is the leadership that the main Spanish credit institutions are playing in the technological transformation processes, becoming **world leaders in the future of banking**. These institutions play a particularly important role in the financial industry in Spain, due to the volume of their business and their presence in all segments of the economy.

Spain has a **leading position in the world of the sustainable finance industry**. The country ranks among the European leaders in the issuance of green bonds, and has the firm commitment of the Spanish financial institutions in this area, which have registered growing activity in recent years in terms of the volume of resources allocated to the financing of sustainable projects or companies. In addition, Spain has **many leading companies that promote the integration of sustainability issues into business**. Many of them are part of sustainability benchmark index, being leaders in strategic sectors such as renewable energies, infrastructures, water and waste management, electric mobility, etc.

From a regulatory perspective, Spain integrated ESG criteria in **occupational pension funds** for the first time in 2014, establishing that the statement of principles of the fund's investment policy had to mention whether extra-financial risks would be considered in the portfolio's investment decisions.

In 2018, with the **Action Plan for the implementation of the 2030 Agenda**, the Spanish government set the roadmap for the fulfilment of the 2030 Agenda in Spain. This document was the definitive starting point for raising awareness and involving the financial system in achieving the SDGs.

In mid-2020, the draft of the "*Climate Change and Energy Transition Law*" (**Ley de Cambio Climático y Transición Energética**) was presented, with a 2050 horizon. It included a new element in the national legal system by **considering climate risk specifically as a financial risk** and required its integration for those entities whose securities are admitted to trading on regulated markets, credit institutions, insurance and reinsurance companies and other companies depending on size criteria. This specifically implies their identification, measurement and management, and the need to include this information annually in a public report of the institution. The draft also envisages that every two years the Bank of Spain, the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds will prepare a **report on the assessment of the risk** to the Spanish financial system arising from climate change.

Sustainable financing via government projects is included in the so-called **Plan for the Recovery, Transformation and Resilience of the Spanish Economy** in the short term. This Plan guides the execution of around 72 billion euros between 2021 and 2023 and meets the EU Recovery Fund's priority that "green" investment should represent more than 37% of the Plan's total.

Spanish banking sector leads the commitment to mitigate the adverse effects of climate change

"Since the European Commission adopted the first Action Plan on sustainable finance in 2018, rapid progress has been made in this field and **the European banks have committed to becoming part of the initiative to mitigate the effects of climate change**. In parallel to this ambitious action plan promoted by the European Commission, we need to take into account that the momentum provided by the ECB in order to promote sustainable finance, as well as the publication of the **supervisory expectations linked to the risks arising from climate change**, published at the end of last year. In the same way, the European Banking Authority plans to publish the results of the consultation launched last year on ESG criteria and the impact on risk management, supervision and disclosure, at the same time that it should also be laying the foundations for stress tests in European banks.

In this context, the role that banks have traditionally played as financers of the real economy, puts them in the front line in **allocating private funds to the investment** that is essential for the transition from the current economic model to a sustainable model that respects environmental, social and governance needs.

In order to play this role and lead the change, **the Spanish banking sector has made a fundamental commitment to climate action by signing the Principles for Responsible Banking**, which have gone from just a proposal, to become a key initiative in which profitability is as important as the way in which it is achieved.
Under this framework, the main Spanish banks took a further step and joined the signing of the **Collective Agreement on Climate Action**, with which they commit to align their portfolios with the climate objectives of limiting global warming to below 2 °C, and to make efforts to do so below 1.5 °C. In parallel, three European countries (the Netherlands, Spain and Germany) have joined this initiative by signing sectoral agreements in which their banks publicly endorse their commitments to climate action. The Spanish case is paradigmatic as, due to COP25 in December 2019, **95% of the sector joined this initiative**.

The launch of **the Centre for Sustainable and Responsible Finance (FinRESP)**, promoted by the entire Spanish financial system and linked to the global network of

Juan Carlos Delrieu
Director of Strategy and Sustainability at the Spanish Banking Association (AEB),
and member of the Executive Committee of FinResp

sustainable finance (FC4S) endorsed by UNEP-FI, has given **new impetus in Spain to the development of sustainable finance** by becoming a meeting point for all those agents committed to promoting private capital and responsible investments for the necessary transformation of the productive industry, and in particular, Spanish SMEs.

However, the level of ambition of Spanish banks does not stop there. By endorsing its commitment to establish paths that will lead the way to achieving the long-term objectives set, BBVA has declared that it is prepared to reduce its exposure to coal-related activities to zero, halting the financing of companies in this business by 2030 in developed countries and by 2040 in the rest of the countries in which it operates.
Santander's ambition, for its part, is to achieve zero net emissions by 2050, which means no longer providing financial services to power generation customers with more than 10% of revenues dependent on thermal coal, and will eliminate all exposure to thermal coal mining worldwide from 2030.

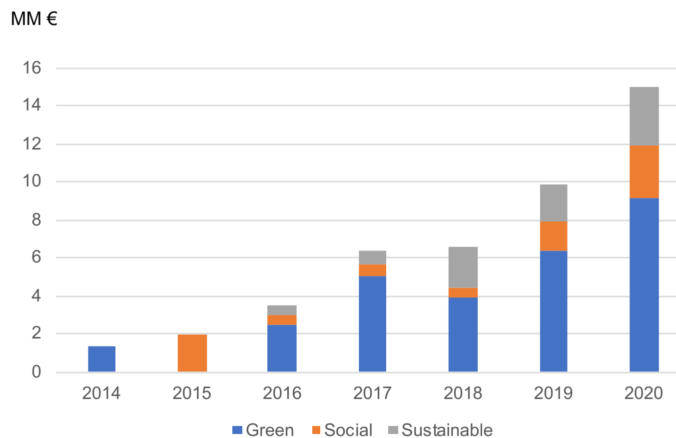
As the Spanish banks have already highlighted, the **involvement of the Board of Directors** is required in order to achieve these goals. That is the only way to progress and integrate sustainability in risk management and in the strategic agenda of the institutions. Also, it is essential to **work together with customers, supporting them in their transition to reduce carbon emissions** with advice and with the offer of a wide range of sustainable products and services."

The issuance of green, social and sustainable bonds increased by 54% in Spain in 2020

According to Climate Bonds Initiative's (CBI) data, **Spain ranked tenth in the world by issue of green bonds in 2020, and the fifth largest in the EU**. In this year, Spanish companies, banks, regions and public agencies issued green, social and sustainable bonds totaling EUR 15,024 million that means a 54% growth compared to the previous year according to the annual report of the **Spanish Observatory for Sustainable Finance** (OFISO).

Most of the placed bonds were green bonds (63.2%), while sustainable bonds accounted for 19.2% of the total figure. But it was only social bonds that gained weight within the total volume: they accounted for around 18% of the volume issued in 2020, compared to 14% in 2019. This increase is explained by the needs arising from COVID-19 to finance projects in the health sector, social services or employment, and are more usual among public bodies. Also, the growth of the sustainable bond market in Spain **has attracted more financial institutions to intermediation**, so that in 2020 up to 34 of them have participated in a placement, compared to 25 institutions a year before.

The perspectives are very positive, and it is expected that the most advanced Spanish companies and financial institutions in the field of sustainable finance will further consolidate their commitment and, foreseeably, their international action in this field, especially in Latin America and Portugal.



Source: annual report of OFISO

Pioneering initiatives in Spain

During 2020, Spain has been a pioneer in the green bond market with the development of the following initiatives:

- In January, the Spanish multinational company Telefónica issued hybrid green bonds, the first of this category within the telecoms sector worldwide.
- The Community of Madrid launched in April the first social bond dedicated to mitigating the effects of Covid-19.
- In May 2020, the Spanish bank BBVA became the first private financial institution in Europe to place a social bond aimed at mitigating the effects of COVID-19.

Sustainable investment in Spain continues recording positive growth and maturity indicators

Joaquín Garralda
President of Spainsif

spainsif

Spainsif is an association that was established in 2009 by stakeholders committed to promoting sustainable and responsible investment in Spain. Its main mission is to promote the integration of environmental, social and governance criteria in investment policies through dialogue with different social groups, contributing to sustainable development, as well as to raise awareness and promote changes in investment processes in the investment community, public administrations, companies and citizens in general. It is the meeting and reference platform for sustainable and responsible investment in Spain, and brings together financial institutions, management companies, SRI service providers, non-profit organisations linked to SRI and trade unions.

"Sustainable and Responsible Investment (SRI) in Spain has not only experienced a **significant increase** in recent years - according to our survey covering 65% of the total market, in 2018 ESG funds under management reached EUR 210,644 million, increasing to €285,454 million in 2019 (+36%) - but it has also experienced an **important change in terms of maturity level and the participation rate of Spanish asset managers** in the SRI market in Spain.

Regarding its maturity level, two indicators stand out: the increase in higher quality investment strategies - in terms of the integration of ESG criteria in the analysis and selection of investments - and the increase in the participation rate of retail investors within the group of SRI investors, which reached 19% of SRI in 2019 (+4%).

The competitive position of **international asset managers** in relation to ESG criteria is very relevant in the Spanish market, contributing significantly to the growth of ESG assets in the last year, as well as to the **quality of investment strategies**. Their main approach is to integrate ESG in their operational process, abandoning the strategy of simple exclusion of some specific sectors, which was initially the most widely used. Competitively, international managers have been a decisive incentive for Spanish managers to appreciate the importance of this market segment, which is expanding so greatly.

Finally, to give a global view, SRI accounts for 49% of all funds invested in Collective Investment Institutions and Pension Funds, with **Occupational Pension Funds** playing a decisive role, since just over 73% of their assets are ESG. It's worth highlighting the substantial increase in the percentage of ESG analysts and managers within the human teams of Spanish fund managers.

In addition to these asset investment data, it is necessary to add the **reporting requirements of the issuing companies** in relation to ESG aspects. As a result of the December 2018 law, all companies of a certain size - whether or not their shares are listed on the stock exchange - must publish their non-financial information on their website, with very detailed requirements, which must also be verified. Undoubtedly, these regulations have greatly expanded the integration of ESG factors in the strategic debates that take place within the Spanish business community.

In short, the current development of the Spanish SRI market and the regulatory framework will allow **the Spanish business environment to more effectively take advantage of the momentum of the Sustainable Finance Action Plan** approved in 2018 and the subsequent European Green Deal and Next Generation initiatives."

Sustainable Finance Disclosure Regulation: an opportunity for financial institutions to contribute to sustainable development

Mónica Bové Boyd
Director of Sustainability
Bové Montero y Asociados

Bové Montero y Asociados

The Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (**SFDR**) was adopted on 10 March. It has implied a substantial change in the **sustainable investment framework**, and has been the subject of much financial sector discussion over last year. The Sustainable Finance Disclosure Regulation is part of a larger EU proposal to **redirect capital towards more sustainable businesses, and represents a complete transformation of the provision of financial products**, both in the internal policies of financial operators and in the classification system for sustainable financial products.

Although almost 90% of investors would like to invest in sustainable products, most are not used to do it, according to a survey by Analistas Financieros Internacionales (Afi), Allianz Global Investors and finReg360. The new SFDR regulation aims to change this. Through the implementation of this regulation, investors will be better informed to take decisions on sustainable finance issues. They will also have more and better information when deciding on their investments and will be able to compare products offered by different institutions according more homogeneous criteria.

What is the SFDR regulation?

The SFDR requires all asset managers to include **sustainability risks in their investment decisions.** It also requires funds to be clearly categorised according to their sustainability performance. Institutions must specify their objectives, policies and methodologies (relating to sustainable principles) in prospectus, websites and annual reports. In addition, the regulation differentiates the disclosure requirements between those of institutions and those of financial products.

A key part of the new regulation is the **classification of funds**. Until now, each fund manager could use its own classification criteria. The Sustainable Finance Disclosure Regulation makes it mandatory to classify all investment products under management into the following three categories:

- Products that have sustainable investment as its objective (Article 9).
- Products that promote environmental or social characteristics (Article 8).
- Non-sustainable products (Article 6).

This classification aims to **improve transparency** and information in order to let end-investors understand **how sustainability influences their investment decision-making processes.**

The implementation of this regulation is a step forward in terms of transparency, and it has been a major challenge for the financial sector:

SFDR Implementation gap

The regulatory framework on sustainability reporting is between two levels. It means that all the package of standards on the SFDR regulation do not comes into force at the same time.

The first part, adopted since 10 March, requires Financial Market Participants to **specify on their websites and in their product prospectus whether or not they intend to consider sustainability when managing assets**. However, it does not go into how the information is detailed. At the second phase, the ways of communicating **this information will be homogenised by applying technical criteria for the regulation implementation**. Initially, it was envisaged that the second phase could be approved by the time the Regulation is applied (phase 1), but this has not been the case and the final standard is expected to enter into force at the beginning of 2022.
This gap in the application of the regulation in two phases will mean having to face an adaptation process - modifying the funds initially monitored and adjusting them to the requirements of phase 2 - with the uncertainty and costs that this entails for the financial sector.

Lack of taxonomy

Sustainable investment definition is a problem, since it can be interpreted in different ways. The EU taxonomy is a new regulation that aims to create a **harmonised concept of what really is "sustainable"**, by providing a common language and uniform criteria to identify which activities can be considered sustainable for the environment. But this taxonomy is still under development.
At the first phase, the SFDR regulation does not go into assessing what is or is not sustainable, but simply requires entities to define themselves in this regard. This, together with the lack of a defined taxonomy, leads to the **risk of greenwashing**.

Although the ideal situation would have been to have a fully developed taxonomy at the time of entry into force of the regulation, the fact that this was not the case does not limit the opportunity to move towards a homogenization of the standards and of the information provided to customers. When the taxonomy comes into effect, this work will be specified and improved. Meanwhile, progress towards this change should not be stalled

Cross-cutting nature of ESG criteria

One of the main challenges faced by financial institutions in complying with the regulation is the **cross-cutting nature of sustainability within the organisation** and the need to involve the entire institution in sustainable investment: senior management, the business area, the risk function, internal audit, compliance, etc. Furthermore, this new regulation affects the entire production chain of the financial industry, from marketing to management as well as to the design of financial products. Over last year, financial institutions have had to carry out an extensive process of classifying their funds, drafting new prospectuses, updating reports, and redesigning websites, among others, with the consequent investment in resources and time that this has entailed for the institutions. Although we understand the complexity and work involved for financial institutions in adapting their internal processes to this new regulation, we believe that their efforts will be rewarded, as the regulation is encouraging the financial sector to broaden its horizons, **redirecting its offer towards sustainable products that meet growing customer demand.**

Impact beyond the financial sector

The SFDR regulation, while directly affecting financial market participants, indirectly has an impact on other businesses as well. Companies, through the data they provide in sustainability reports and Non-Financial Information Statements (NFS), will have to **report on the contribution of their business to sustainability**. Investors will rely on this reported information to calculate the sustainable contribution of companies and advisors will assess which products fit with their sustainability policy. So everything is interconnected and the SFDR regulation cannot be isolated as simply affecting the financial sector.
In fact, **the European Regulation on Non-Financial Information, transposed in Spain with Law 11/2018 of 28 December, is currently under review within the European Union,** so that there is a correlation of information on sustainability in the reports issued by companies, with the regulations promoted by the EU within its Sustainable Finance Plan and with the Taxonomy.

The implementation of the SFDR regulation is an evolving process but it is a fundamental step towards finding appropriate ways to communicate sustainability and reduce uncertainty for companies, managers and end customers. With the entry into force of this new regulation, the financial sector, somewhat stigmatised in recent times, has a **great opportunity to contribute to sustainable development and to convince society** that its role in this race is very relevant and necessary.

Luxembourg

The Luxembourg financial centre gained momentum in the 1970s, replacing the steel industry as the driving force of the Luxembourg economy. The **country's strategic location**, in the heart of Europe and its traditional openness to cross-border integration quickly positioned it as an important international financial centre. Currently, its financial sector represents 25% of GDP, 11% of employment and 21% of tax revenue (2019 data).

Luxembourg boasts about having a developed legal and regulatory framework, a strong culture of investor protection and a highly experienced financial regulator. **Private banking, the insurance sector and the investment fund industry** are the key pillars of its financial services industry.

Luxembourg has long before Paris Agreement been a pioneer in the field of sustainable finance, mainly in the **microfinance industry**.As a founding member of the EU, the country has always played an important role in the definition of European policies and has actively participated in working groups focused on the financial sector.

It has also contributed to accelerate the expansion of sustainable finance as well as to **promote exchanges of experiences at the international level in this field**. So much so that Luxembourg was a founding member of the **FC4S**.

Thanks to close cooperation between the public, private, and civil society sectors, it has built a **friendly ecosystem**, which is adapted to raising international capital for responsible investments. Furthermore, **the country is home to the European Investment Bank**, the world's top green lender and an expert in public-private investment projects.

In 2018, the government of Luxembourg, together with the United Nations Environment Programme Finance Initiative (UNEP FI), worked on the development of a plan to **consolidate the country's experience in sustainable finance**, as well as develop new innovative initiatives in this field. This plan culminated in the launch of a **Roadmap** to achieve the goals of the Paris Agreement and facilitate financing for the achievement of the SDGs.

Some of the recommendations of this roadmap were integrated into the Coalition Agreement of the Luxembourg elected government in 2018-2023, including the creation of a **coordination entity for sustainable finance**. Thus, the **Luxembourg Sustainable Finance Initiative** (LSFI) was officially launched in January 2020 to promote the development of the local ecosystem and the definition of specific goals in line with the national roadmap. The LSFI's first official task has been to formulate a **Luxembourg Strategy for Sustainable Finance**, harnessing relevant activities already being carried out by all financial sector actors in close cooperation with the government and in line with the Roadmap's ambitions.

All of them are the backbone of this Strategy and guide the LSFI's Action Plan with a 2030 horizon, setting measurable and structured achievements over time.

"The **LSFI** and the **Luxembourg Sustainable Finance Strategy** have as their main goal to help the financial sector **transition towards increased sustainability, raise awareness and promote sustainable finance** and Luxembourg's role as an international sustainable finance hub.

The financial sector and the investors can play a crucial role through their investment decisions in shaping a more equitable and sustainable future. To achieve these objectives and as a result of the strategy, we have started by **raising awareness** through our website, newsletter and social media. We are also producing explanatory videos and mapping the existing initiatives to help the stakeholders navigate the sustainable finance landscape.

Besides, we are about to coordinate a **climate scenario analysis** of the financial industry to help the banking, insurance and investment funds sectors better understand where they stand with respect to the Paris Agreement goals."

Nicoletta Centofanti
LSFI Sutainability Adviser

Luxembourg Strategy for Sustainable Finance

In order to implement the Strategy, the LSFI's Action Plan is based on three main and interdependent pillars. For each pillar, the Strategy identifies actionable goals to be addressed in the short- (1 yr., by 2021), medium- (2-4 yrs., 2022-2024) and long-term (5-10 yrs., 2025-2030). These goals are flexible and open to the evolving requirements of the various public needs and private stakeholders' opportunities. To reach these objectives, the LSFI will be working in close collaboration with financial stakeholders, avoiding duplication of existing initiatives and ensuring areas of synergy.
The 3 pillars of the action plan are summarized be-

1 Awareness & Promotion

- Formalise and communicate an ambitious, tailor-made and clear sustainable finance strategy.
- Set up a coordinating entity.
- Raise awareness.
- Lead by example and ensure proof of concept.

Unlocking Potential 2

- Leverage financial sector expertise.
- Integrate sustainability into education and professional training.
- Develop expertise and best practices.
- Analyse and redesign the system of incentives and taxation.

3 Measuring Progress

Read the full strategy HERE

Source: *Luxembourg Strategy for Sustainable Finance*

Luxembourg has a platform dedicated exclusively to green, social and sustainable bonds

Luxembourg was a pioneer in the incorporation of sustainable finance into capital markets. In 2007, the Luxembourg Stock Echange listed the **world's first green bond** which was issued by the European Investment Bank. Green bonds have their own platform since the launch of the **Luxembourg Green Exchange** (LGX) in 2016, dedicated exclusively to green, social and sustainable bonds.

With more than 900 sustainable bonds totalling EUR 440 billion, **LGX plays a crucial role in facilitating sustainable investment across the world.** LGX is the world's leading platform for sustainable securities and helps reorient capital flows towards investment projects with positive social and environmental outcomes.

In 2020, LuxSE established the LGX DataHub, a centralised data hub of structured sustainability data, covering close to the entire universe of listed, sustainable debt securities worldwide. The **LGX DataHub** provides asset managers and investors with access to the data they need to build sustainable investment strategies and report on these investments. Also, the **LGX Academy** was launched in 2020 with the aim of promoting sustainability knowledge across the financial sector and training the new generations.

In February 2021, LGX added a section dedicated to **Climate Bonds-LGX Climate Aligned Issuers**. This section features companies that derive their revenues from environmentally friendly activities, and thereby highlights untapped investment opportunities in the broader sustainable investment universe.

Through its platform and its focus on awareness, education and data, LGX contributes to making sustainable finance mainstream across the world.

Almost 200 sustainable investment vehicles, from promoters from 16 countries, have obtained LuxFLAG labels

The **Luxembourg Finance Labelling Agency** (LuxFLAG) is an agency that aims to promote the raising of capital for sustainable investments by awarding a **recognisable label to eligible investment vehicles**. This independent and non-profit association was created in 2006 to reassure investors that the labelled investment vehicles invest in the responsible investment sector. The applicant may be domiciled in any jurisdiction that is subject to a level of national supervision equivalent to that prevailing in European Union countries. Labelling is available for **international investment vehicles**, regardless their country of domicile or issue.

LuxFLAG labels stand out because they are subject to **independent expert** assessment by a qualified eligibility committee and because they have earned recognition around the world. **LuxFLAG provides five different labels**: Microfinance, Environment, ESG, Climate Finance and most recently, a label for Green Bonds.

As of March 2020, 196 investment vehicles from promoters from 16 countries boasted LuxFLAG labels.

Label	Target Funds
Microfinance	MIVs (Microfinance Investment Vehicles) of all types
ESG	Any investment fund regardless of the sector
Environment	Funds that focus on the environment
Climate Finance	Impact funds that actively contribute to the Paris Climate target
Green Bond	Bonds investing in Green projects

Source: LuxFLAG / More information about criteria applied: https://www.luxflag.org/

Sustainable investments

In 2019, Luxembourg responsible investment fund assets accounted for 31% of funds and 39% of all assets under management (KPMG, 2019: “European Responsible Investing Fund market 2019“).

In order to support asset managers in launching new projects to mitigate or manage the effects of climate change, the government of Luxembourg, together with key industry players, has promoted the creation of the **International Climate Finance Accelerator** (ICFA). This accelerator offers various forms of support, including help in fund raising from institutional and public investors, as well as financial and operational support during the launch phase of a new fund structure.

In addition, the country has developed over the years a wide range of investment funds and is a **leader in their global distribution**, with funds offered in more than 70 countries around the world. This is one of the strengths that define it as a financial center, allowing promoters to create the structure they need, adapted to the nature of the investment and the target investors, and have the European passport for distribution.

simmons + simmons

Cathrine Foldberg Møller
Counsel | Avocat à la Cour
Simmons & Simmons Luxembourg LLP

Pablo López Romero
Associate | Abogado
Simmons & Simmons Luxembourg LLP

SFRD - The Luxembourg angle

The European Regulation relating to ESG disclosure – the SFDR – came into force on 10 March 2021 in all of the European Member States. This forms part of the EU's package of measures relating to Environmental, Social and Governance (ESG) issues. the European Union financial sector had to adequate their internal policies regarding the sustainability-related disclosures in order to comply with the SFDR Regulation (as defined below). Therefore, in this article we are going to explain the origin and key points of this new ESG policies that are applying in the European Union, and in particular their impact in the Grand Duchy of Luxembourg.

Big picture

Deriving from the new global sustainable development framework adopted by the United Nations General Assembly, the European Commission approved the 2030 Agenda for Sustainable Development having at its core the Sustainable Development Goals ("**SDGs**").

In the context of the European Union's plan to develop the SDGs, on 27 November 2019 the European Parliament and the Council approved the SFDR Regulation, as well as the regulations generally known as Benchmark Regulation and Taxonomy Regulation.

The SFDR has been adopted with the purpose of creating a more transparent and harmonised framework of requirements for the Financial Market Participants and Financial Products (as defined below and in the SFDR) regarding the disclosure and publication of sustainability-related information.

Key points

The main addressees of the disclosure and transparency requirements set in the SFDR are the following, broadly present in the Luxembourg financial market, defined as the "**Financial Market Participants**":

- investment firms and credit institutions which provide portfolio management;
- alternative investment fund managers (AIFMs); and
- management companies of UCITS management companies.

These Financial Market Participants need to apply the relevant requirements founded on publication and disclosure in three different levels:

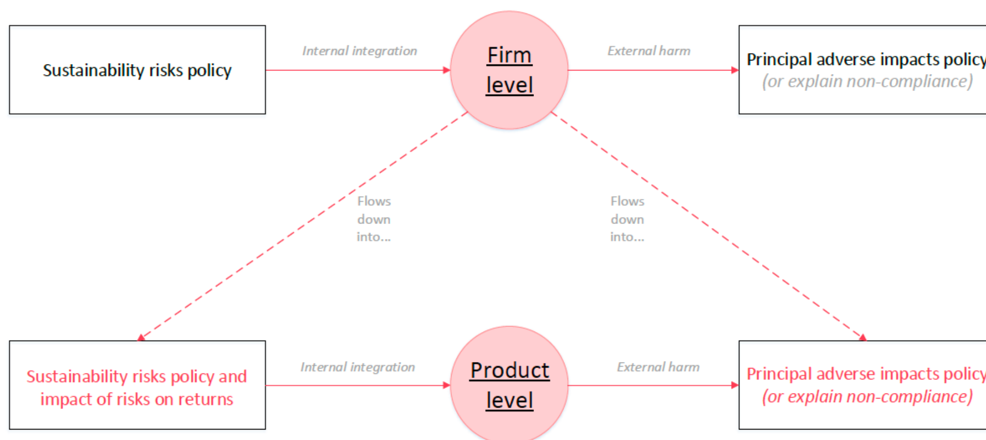
1. **Firm Level**: publication on their websites of their policies on the integration of sustainability risks in their investment decision making process and information about adverse sustainability impacts for their entity. This meant that the institutions had to update their existing investment policies or create new ones with a focus on ESG requirements. As for the adverse sustainability impacts, we talk about "**comply or explain**". The market was given a choice to ei-

ther implement a due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors or explain the reasons why it does not consider such adverse impact.

2. **Product Level**: the disclosure obligation at product level applies, **whether or not products with an ESG focus are offered**. Here again a business decision needs to be made for each financial product that is made available, to either: assess the likely impacts of sustainability risks on the returns of each financial product; or explain why it does not consider sustainability risks to be relevant to a particular financial product. investors are required to be provided with pre-contractual disclosures descriptions about the products being made available to them.

3. **Environmental or Social Products Level**: where financial products specifically promote ESG characteristics, the SFDR provides that Financial Market Participants are required to publish information about how those characteristics are met and if an index has been designated as a reference benchmark, information on whether and how index is consistent with those characteristics.

In addition to the specific disclosure obligations, it is also advisable for market participants to review their marketing documentation generally, to ensure that these do not contradict the mandatory disclosures. At first glance it may seem that the aspects of the SFDR only apply to asset managers of ESG products but a big part of the requirements applies much more broadly, and also captures for example banks offering portfolio management.



UCITS prospectus update: fast track procedure in Luxembourg

As the SFDR is directly applicable in all Member States of the European Union, there are only few national specificities worth raising from a Luxembourg perspective. One relates to UCITS and AIFs' prospectuses and the so-called **"fast-track" procedure** put in place by the CSSF (the Luxembourg Financial Regulator). Because these products need to be compliant with the SFDR requirements before the 10 March 2021, the CSSF made it possible to submit updated prospectus/issuing documents where the changes resulted directly the SFDR requirements. This allowed the market to ensure compliance with the relevant requirements before the deadline, without having to go through the normal procedure for prospectus approval.

What do we see:

There is a lot of divergence on approach across the market and some firms prefer the "explain" approach and opt for minimum compliance. At the other end of the spectrum you find the "SFDR-friendly" firms who have gone all the way and even further to comply with the requirements under SFDR. Because the regulation provides a certain degree of flexibility, market participants can decide how they want to profile themselves. What is certain is that this is only just the beginning and the future of finance will be founded on sustainability.

Expert views

The opinion of the SFF members

How is the financial services industry dealing with the new sustainability standards?

Juan Ramón Caridad
Sales Head Iberia, Latam & US Offshore
GAM Investments

"Bloomberg estimates that environmental, social and governance (ESG) assets could climb to more than a third of global assets by 2025. **Europe currently accounts for approximately half of the ESG asset base**, but 2020 saw a significant expansion in the US and in Asia, particularly Japan, and other south-east Asian countries could see the next wave of growth.

GAM placed sustainability at the heart of its corporate strategy in 2020. This has included strengthening governance as a firm and committing to publishing our first stand-alone Sustainability Report. We have also created a new Sustainability Committee, chaired by Stephanie Maier, Global Head of Sustainable and Impact Investment.

We are building a distinctive **new range of sustainable products and strategies**. Earlier this year we launched the **Sustainable Local Emerging Bond Fund**, and further products are already in the pipeline."

Álvaro Miguel Carbón Ripepi
Client Director, Distribution Continental Europe - Iberia / LatAm
GAM Investments

“From an investor and a regulatory perspective, the financial product ‘manufacturers’ and ‘distributors’ are confronted with a suite of **rapidly changing standards and expectations**. The EU has elevated sustainability to be a key goal in their political agenda.

Fundsquare, main data hub for Luxembourg domiciled funds, although not directly impacted by ESG, works with clients within the financial industry to **support their transition to these new standards.**

Our information and regulatory service offering is in direct compliance with evolving ESG guidelines, and we are currently enhancing our operations with the addition of new partnerships. The combination of Fundsquare’s data backbone and our partners’ value-added services present **a near complete coverage of the entire fund life cycle**. This privileged position allows us to properly apprehend to new ESG standards in data collection and dissemination to provide an enhanced client experience to our clients.”

Israel Cuesta, Senior Business & Relationship Development Manager, **Fundsquare**

“The ESG wave has also arrived at the fund industry. Indeed, this is a crucial factor Investment Managers need to take into account for future developments – in the overall European market and especially in Luxembourg and Spain.

While Investment Managers are still deciding whether to consider ESG or not, retail and institutional investors have made their position clear: **They are strongly in favor of ESG and are already placing it at the forefront of their decision to invest in a fund.**

Public Administrations are also taking a leading role on ESG, as it could be evidenced in the incentive provided to Luxemburgish funds that consider ESG in the form of a **lower taxation implemented by the local regulator**. Given this demand, **ADEPA has built a dedicated team to help clients navigate the world of ESG and position for the future**.”

Borja Sancho, Head of Spain Branch, **ADEPA Global Services Group**

“The new regulations have not brought any radical change in the Lombard International Assurance’s policies, which already considered sustainable criteria in its operations.

However, they have stimulated the implementation of internal procedures for the **promotion of investments that meet these criteria**, providing transparent information in this regard and monitoring compliance.

Soon we will also see the impact of these criteria reflected in a more attractive product offer that will exclude, for example, the possibility of investing in potentially “harmful” assets and allow us **to design together with our partners unit-linked products “that invest in sustainability”.**

This implies an effort today that will surely bear fruit: achieving a more sustainable wealth management, prioritising long-term value creation and the benefit of society as a whole.”

Marta García Cortés, Wealth Planner Spain and Portugal, **Lombard International Assurance**

Articles

» Structuring of investments in non-performing loans

» A Sandbox to conquer the European Fintech sector

» DAC6 in Luxembourg - Can a taxplayer also be an **“**intermediary**”**?

» Luxembourg: your safe haven!

Eduardo Trancho Olabarri
Senior Associate – Tax Advisor
Van Campen Liem

Structuring of investments in non-performing loans

Investment in non-performing loans and other non-performing receivables (collectively the **NPLs**) in Spain and other countries has become increasingly popular among investment managers in the past few years. This trend is expected to grow in the coming years, notably due to the adverse economic impact of Covid 19 over businesses' financial position and solvency.

Without entering into technical detail, NPLs could be defined as receivables (derived from loan agreements and other agreements) which, due to the difficult financial situation of the debtor, are transferred by the initial creditor (generally a bank or another credit institution) to a third party (which becomes the new creditor) at a substantially discounted price (i.e. at a transfer price which is substantially lower than the receivable's nominal).

The discount rate depends on several factors, such as the receivable's expected recovery value (i.e. amount of the receivable that the creditor reasonably expects to recover in view of the debtor's financial position).

In many NPLs investments, the receivable is in the process of a restructuring (i.e. amendment of its terms and conditions, such as an extension in maturity, more flexible interest payment terms, etc.) between the debtor and the initial creditor and such restructuring is pursued by the new creditor.

Investments in NPLs generally entail substantial risk and may generate profitability as follows:

- Interest accrued on the principal amount.
- Gain realized due to the debtor repaying the NPL at a value higher than the acquisition cost paid by the new creditor (this could potentially amount to the difference between the loan's nominal and the acquisition cost).
- Gain realized upon a transfer by the new creditor to another party of the NPL at a price higher than the acquisition cost paid by the new creditor (this could potentially amount to the difference between the loan's nominal and the acquisition cost).

Let's make a simple example:
SpainCo operates several hotels. Because of the travel restrictions implemented as from March 2020 SpainCo has seen a sharp decrease in its operating revenue and cash flows and is unable to repay a EUR 10M bank loan which becomes due in some months. Subject to the execution of certain guarantees, the bank is willing to transfer the EUR 10M loan to a third party (which will become the new creditor) at a price of EUR 8M (i.e. the transfer price is lower than the loan's nominal value). The new creditor and SpainCo (as debtor) will amend the terms and conditions of the loan to facilitate cash recovery.

Luxembourg is a renowned jurisdiction for the establishment of alternative investment funds and other investment vehicles, including those targeting NPLs. The choice of investment vehicle (and overall investment structure) will depend on the specific features of the investment. The main factors are generally as follows:

- Features of the NPL (i.e. type of receivable, acquisition cost, nominal value, expected cash flows, maturity, guarantees available, etc.).
- Investment strategy (i.e. expected holding period, expected exit strategy, etc.).
- States where the debtors under the NPLs are located.
- Nature and states of residence of the investors.

In Luxembourg several vehicles are generally available to make and hold investments in NPLs. The choice of investment vehicle and its implementation should be carefully reviewed by professional advisors, from a tax, regulatory, legal and financial accounting standpoint.

The following is a non-exhaustive list of Luxembourg vehicles available for investments in NPLs:

- Fund vehicles such as the Luxembourg Specialized Investment Fund (**SIF**) and the Luxembourg Reserved Alternative Investment Fund (**RAIF**) which can be established under several legal forms (i.e. companies, partnerships and contractual funds).
- Regular Luxembourg limited liability companies, partnerships limited by shares, limited partnerships and special limited partnerships.
- Securitization vehicles.

From a tax standpoint, investment managers will aim to structure the investment vehicle in a way that allows the vehicle to be as tax neutral as possible. For this purpose, the following items should be analyzed in detail:

- Taxation at source (i.e. tax implications on the interest payments and repayment of principal by the debtor, which may depend on the type of investment vehicle utilized).
- Taxation of the Luxembourg vehicle in Luxembourg.
- Luxembourg tax implications of distributions made by the investment vehicle to its investors.

From a cross-border tax standpoint, the provisions of Council Directive (EU) 2016/1164 (generally as amended by Council Directive (EU) 2017/952 – which is generally referred to as the **Anti-Tax Avoidance Directive**) as well as the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (**MLI**) should be carefully reviewed. In particular, the following items should be closely monitored:

- Potential impact of the so-called "interest-limitation rule" (**ILR**). Without entering into technical detail, under the ILR arm's length exceeding borrowing costs (roughly net interest expenses) incurred by a corporate taxpayer in a fiscal year should be tax-deductible up to the higher of (i) f EUR 3M and (ii) 30% of the taxpayer's taxable EBITDA. Financial undertakings, including (i) credit institutions, (ii) alternative investment funds managed by an alternative investment fund manager and (iii) securitization vehicles established in accordance with Regulation (EU) 2017/2402 should be excluded from the ILR.
- The so-called "anti-hybrid provisions" which intend to tackle mismatches generally leading to situations of double non-taxation or taxation without inclusion.
- Existence of an economic rationale to be in Luxembourg and an adequate level of substance.

Ongoing follow-up of the structures implemented is a key to the successful implementation of these investments.

A Sandbox to conquer the European Fintech sector

Rodrigo García de la Cruz
President
Spanish Fintech and Insurtech Association (AEFI)

In the midst of this pandemic, 2020 brought great news for the Spanish financial sector with the **final adoption of the financial Sandbox**, an initiative taken within the Digital Transformation Law for the Financial Sector. The Spanish Sandbox is configured as a controlled and non-deregulated testing space that identifies those projects that improve the provision of financial services, with very specific monitoring protocols established by the public bodies involved: Treasury, Bank of Spain, Directorate General of Insurance and Pension Funds and CNMV (Spanish supervisory body). In short, **a space to promote innovation in the financial services industry in a high security environment.**

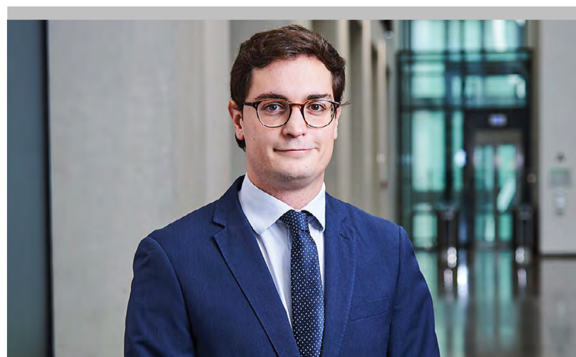
The road to get here has not been at all easy. It has been full of obstacles as a consequence of repeated electoral processes, a complicated regulatory framework and even the outbreak of a pandemic, but it is now an unstoppable process. In fact, the first Sandbox call for proposals closed on 23 February with **more than 60 projects submitted**, demonstrating the wish that Spanish entrepreneurs have to develop disruptive products and services and the interest of many foreign entrepreneurs to establish themselves in Spain.

The Sandbox is the result of hard work by the entire Fintech ecosystem, which has been working in the same direction over the last few years **to position Spain as one of the reference countries in this field**. The positive impacts will be two: **the creation of quality employment** - it is estimated that the Sandbox will generate almost 4,000 jobs in two years - and **the attraction of investment**, which could exceed EUR 500 million. Not only this, it will also boost competitiveness and technological development, facilitating the retention of Spanish talent in national companies that are committed to innovation in the financial industry. In fact, one of the competitive advantages of the Spanish Sandbox is that it allows the entry of projects within the European Union and, moreover, does not require European companies to have a tax domicile in our country, and will even allow the entry of projects from Latin America, which has similar regulations to Spain. Thus, Spain could position itself as a true Fintech bridge between the two continents. The UK reference is a very good guideline if we take into account the number of projects submitted, which have raised an average of over six million pounds. In fact, the Spanish Sandbox is designed with the same ambition, promoting cross-border and innovative projects.

The entry to the Sandbox is established under two possibilities: **exemption and non-subjection**. The exemption modality allows fintech and insurtechs to **enjoy a trial period in which they can gradually meet the requirements for obtaining an ordinary licence to operate in different markets**. In this way, they would not be required to comply with all these requirements from the start, which could be a clear obstacle to the economic viability and survival of many of these companies, but in successive gradual stages as they reach a certain stage of maturity. **Innovation would be an essential factor for the application of the exemption**. On the other hand, under the non-subject modality, the sandbox allows these companies that carry out activities not expressly regulated to date (e.g. ICOs, neobanks, cryptocurrency brokering) to start testing their products in a secure or controlled testing space, thus allowing them to launch this type of innovative products and services on the market supported by the regulatory bodies.

Finally, it should not be forgotten that the Sandbox also serves as **a useful tool for the legislator and supervisory authorities,** which will be able to continuously monitor these types of entities and/or activities, thereby warning of the main risks and benefits to be taken into account with a view to the future regulatory developments of those activities excluded from the current legislation.

The Sandbox is not important in and of itself, but for **its role as a catalyst to respond clearly and ambitiously to the challenges facing the new digital environment for the future**, especially in a scenario where it is necessary to develop new disruptive services to respond to a new normality in which we are involved.



Samara Brey
Senior Manager
Deloitte Luxembourg

Victor Sanlorien Cobo
Senior Consultant
Deloitte Luxembourg

DAC6 in Luxembourg — Can a taxpayer also be an "intermediary" ?

The international tax landscape has substantially changed over the last decade, and the fifth amendment to the 2011/16/EU Directive on Administrative Cooperation (DAC6) has prompted yet another shift in reporting obligations.

DAC6 aims to collect information on reportable cross-border arrangements (RCBAs) in order for Member States to close tax legislation loopholes more rapidly and react against harmful tax practices. This data, which EU Member States collect and share between them, require arrangements to be analyzed based on cumulative criteria to determine whether they are RCBAs and, therefore, require reporting to the tax authorities.

Based on DAC6's transposition into Luxembourg law, "intermediaries" or "relevant taxpayers" must report RCBAs to the Luxembourg tax authorities from 1 January 2021 (i.e., opening date of the reporting obligations which was deferred by six months due to COVID-19).

The cumulative criteria of RCBAs are:

i. A cross-border feature, i.e., the involvement of either two EU Member States or an EU Member State and a third jurisdiction;
ii. Specific EU covered taxes (including corporate tax, individual tax and inheritance tax); and
iii. Specific features known as "hallmarks".

Hallmarks that may be triggered in a typical alternative investment fund industry framework are:

- *B2* - arrangements that have the effect of converting income into capital, gifts or other categories of revenue, which are taxed at a lower rate or exempt from tax;
- *C1* - arrangements with deductible cross-border payments between "associated enterprises" under certain conditions; and
- *E3* - arrangements involving the intra-group cross-border transfer of functions and/or risks and/or assets with an impact on earnings before interest and taxes (EBIT).

Some hallmarks - *A*, *B* and some subcategories of *C* - are also coupled with a "main benefit test". This means that, for an arrangement to be reportable, the main benefit or one of the main benefits of the arrangement must be to obtain a tax advantage.

The obligation to report RCBAs lies primarily with EU intermediaries. If there is no EU intermediary involved, or all the EU intermediaries have legal professional privilege, the reporting obligation falls to the relevant taxpayer.

Intermediaries are divided into two categories. The first is defined as a person who designs, markets, organizes,

makes available for implementation, or manages the implementation of an RCBA. The second category is any person who knows or could be reasonably expected to know that they have undertaken to provide—directly or indirectly through other persons—aid, assistance, or advice regarding the activities mentioned above, based on all relevant facts and circumstances, available information and the relevant expertise and understanding required to provide these services. This definition is broad enough to not only include lawyers and advisers but also banks, trustees, insurance companies, asset managers and other service providers.

A relevant taxpayer is defined as "*any person to whom an RCBA is made available for implementation, or who is ready to implement an RCBA or has implemented the first step of such an arrangement.*" The notion of a relevant taxpayer (as for an intermediary) refers to the notion of a "person". This is explicitly defined as (a) natural persons, (b) legal persons, (c) associations of persons recognized as having the capacity to perform legal acts but lacking the status of a legal person and (d) any other legal arrangement of whatever nature and form, regardless of whether it has legal personality, owning or managing assets, which are subject to any of the covered taxes.

Unlike an intermediary, the definition of a taxpayer does not refer to a nexus within the EU. However, as for intermediaries, taxpayers must have a presence in Luxembourg for a reporting obligation to arise in Luxembourg.

In certain cases, mainly in the alternative industry, a taxpayer could also be considered as an intermediary; for example, a management company or a dedicated entity with a tax function that assists the wider group. Special attention must be given to roles and responsibilities to determine if a taxpayer could also be considered as an intermediary, as their obligations can differ. A detailed, case-by-case analysis is recommended.

DAC6 requires that EU intermediaries report RCBAs in a timely and efficient manner. However, due to legal professional privilege (which covers lawyers, auditors and accountants operating within the limits of their respective professions in Luxembourg), sometimes the obligation to report RCBAs can pass to other intermediaries that did not assist with the design of the RCBA (e.g., banks and asset managers) or directly to taxpayers.

The reporting clock starts when (i) an RCBA is made available; (ii) an RCBA is ready for implementation; or (iii) the first step in the implementation of an RCBA has occurred. When one of these trigger events takes place on or after 1 January 2021, intermediaries and relevant taxpayers must:

- Report the RCBA to the Luxembourg tax authorities within 30 days; and
- Notify other intermediaries or taxpayers in cases of legal professional privilege within 10 days.

Failure to comply with DAC6 obligations may result in penalties of up to EUR250,000 per RCBA in Luxembourg.

Given the involvement of different persons, short reporting period and penalties, entities must anticipate and establish RCBA identification processes to avoid intermediaries assessing the same RCBAs and to facilitate the reporting process. Taxpayers must pay careful attention to how intermediaries assess the hallmarks, as information gaps may lead to different undesired outcomes. Good governance is recommended, as is a coordination point where all assessments are received, compared, and eventually reported.

Compliance with DAC6 rules must be supported by documentary evidence in the case of tax audits. Therefore, it is essential that records of analyses and conclusions, whether internal or performed by external advisors, are properly documented.

Luxembourg: your safe haven! Solid, innovative and transparent

Article sponsored by OneLife

Luxembourg, officially known as the Grand Duchy of Luxembourg, is one of the smallest sovereign states in Europe, bordered by Belgium, Germany and France, and one of the least-populous countries in Europe. And Luxembourg is far more than that …

On the 2020 European Innovation Scoreboard, which assesses the performance of countries in the field of innovation based on 27 indicators, the Grand Duchy came 5th and joins the EU innovation leaders. In the Global Innovation Index 2020 rankings, Luxembourg is 18th and is together with China and Israel the country ranking third in terms of creative outputs (venture capital, research and development, entrepreneurship, or high-tech production).

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MAY 2021
New Webinar

PwC Luxembourg Initiative
2021, the year of the ESG business change

Sustainability has become a strategic matter and this year more than ever, will not only impact your investment performance, but also trigger some structural changes to the competitive environment. To accompany you on this journey and help you navigate these business changes, PwC Luxembourg launched an initiative called "**2021, the year of the ESG business change**". Each month, PwC experts will share insights on the various developments around sustainability and ESG in a variety of different formats. The latest article that was published gives insights on the Sustainable Finance Disclosure Regulation and its biggest business challenges. Moreover, you can already pencil in the date of their next event which is organised in collaboration with the wider PwC EMEA network on 11 May and will focus on the Taxonomy - Where do we stand and how can we get prepared for 1 January 2022?.

Contacts:
Olivier Carré, Financial Services Leader & Sustainability Sponsor, PwC Luxembourg
Nathalie Dogniez, EMEA AWM ESG Leader, PwC Luxembourg

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Official Spanish Chamber of Commerce in Belgium and Luxembourg ASBL

+32 (0) 2 5171740
+352 661 404 399

luxemburgo@e-camara.com
www.e-camara.com

Rue Belliard 20 - 1040 Brussels (Belgium)
4, Bld. Emmanuel Servais – 2535 Luxembourg

Contributors

- **José Luis Rodríguez Álvarez**, Vice-President of the Official Spanish Chamber of Commerce in Belgium and Luxembourg.
- **Héctor Esteban Moreno**, Managing Director, Bankinter Luxembourg.
- **Paloma García Nieto**, Managing Director, Banca March Luxembourg Branch.
- **Álvaro Hermida Santos**, Managing Director, Caixabank Wealth Management.
- **Juan Carlos Delrieu**, Director de Estrategia y Operaciones, Asociación Española de Banca.
- **Mónica Bové Boyd**, Directora del área de sostenibilidad, Bové Montero y Asociados.
- **Joaquín Garralda**, Presidente, Spainsif.
- **Nicoletta Centofanti,** Asesora de Sostenibilidad, LSFI.
- **Cathrine Foldberg Moller**, Counsel, Simmons & Simmons Luxembourg LLP.
- **Pablo López Romero**, Associate / Abogado, Simmons & Simmons Luxembourg LLP.
- **Juan Ramón Caridad,** Sales Head Iberia, Latam & US Offshore, GAM Investments.
- **Álvaro Miguel Carbón Ripep**i, Client Director, Distribution Continental Europe - Iberia / LatAm, GAM Investments.
- **Israel Cuesta,** Senor Business & Relationship Development Manager, Fundsquare.
- **Borja Sancho**, Head of Spain Branch, ADEPA Global Services Group.
- **Marta García Cortés,** Wealth Planner Spain and Portugal, Lombard International Assurance.
- **Juan Carlos Durán,** Senior Private Banker, Banque de Luxembourg
- **Eduardo Trancho Olabarri**, Senior Associate - Tax advisor, Van Campen Lien
- **Rodrigo García de la Cruz**, Presidente, Asociación Española de Fintech e Insurtech
- **Samara Brey**, Senior Manager, Deloitte Luxembourg
- **Victor Sanlorien Cobo**, Senior Consultant, Deloitte Luxembourg

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