Luxembourg, the Chinese access to European business ventures

It is not big news that China has gained a significant role in the global economy over the last decades. Its impressive growth increased the enriched Chinese business community's appetite to outward foreign direct investments (FDIs).

Whereas initially the United States of America represented the favourite foreign jurisdiction to direct their investments, over the last few years Europe has become the main target of Chinese FDIs.

Over the period 2009 - 2011, the Chinese FDIs to the European Economic Area (EEA) increased by 30 times. At the beginning of 2013, a total of 7,148 Chinese enterprises were active all over the EEA.

The interest in EU acquisitions is also driven by the Chinese appetite to the solid European technologies. As a clever business development strategy, in fact, Chinese players aim at acquiring high-tech intensive EU companies, so as to obtain industrial know-hows also on the purpose of importing them to China. Germany, France and the UK are the favourite hi-tech environments in the EEA.

Interestingly, data prove the usual point of access to Europe is Luxembourg: an appropriate jurisdiction to efficiently invest in EU, and thus a gateway to Europe.

China chooses Luxembourg: a few impressive data

In 2013 over RMB 216 bn assets under management have been recorded – i.e. over EUR 26 bn.

As the largest Euro bond centre, Luxembourg has been the first to list a Dim Sum bond[1] back in 2011. In terms of investment funds' business, over 10 promoters set up RMB-denominated Luxembourg sub-funds.

[1] A bond denominated in Chinese Yuan and issued in Hong Kong. Dim sum bonds are attractive to foreign investors who desire exposure to Yuan-denominated assets, but are restricted by China's capital controls from investing in domestic Chinese debt. The issuers of dim sum bonds are usually entities based in China or Hong Kong, and occasionally foreign companies.

With RMB 73 bn in loans and 79.4 bn in deposits at the end of the first quarter 2014, Luxembourg has confirmed to have the largest pool of RMB in the Eurozone and the European largest RMB securities settlement centre and bond listing jurisdiction.

The signature of a Memorandum of Understanding between the People's Bank of China and the Luxembourg's Central Bank in June 2014 that on September 16 2014 has had as direct consequence the choice of the ICBC as the RMB clearing bank in Luxembourg.

However it is the banking sector that provides the best sample of the Chinese commitment to Luxembourg. In fact, the Grand Duchy hosts the European headquarters of 2 of the main Chinese banks (and among the top worldwide for capitalization): Bank of China, established in 1979, and ICBC, established in 1999.

Their successful stories inspired the China Construction Bank that in October 2013 opened a Luxembourg branch; whereas during the next year the number of Chinese banks having their EU hubs in Luxembourg should arrive to 6.

All this represent the so-called "Chinese strategy": by starting from the Luxembourg seat, they envisage the development of the banks' branches in the rest of Europe.

Why does Luxembourg represent the ideal point of entry for Chinese investments to Europe?

- *Advanced banking system, hosting main credit institutions and electronic money institutions (EMIs)*

  The establishment of a foreign bank or a credit institution in Luxembourg grant the European passport and allows clients the access to European investments.

  Besides the EU passport, a bank established in Luxembourg enjoys the universal bank principle provided by the Law. Under conditions, credit institutions can offer all the traditional banking services such as acceptance of deposits, lending activities, issuance of electronic money, investment services (asset management, investment advice and other services in the scope of the law on the financial sector).

  More in particular, in respect of the electronic money for online payments, Luxembourg has implemented a lighter regime applicable to EMIs.

  In general, by aiming at a full harmonisation of the EU credit institutions, a Luxembourg EMI or credit institution (e.g. the Luxembourg subsidiary of a Chinese bank) can conduct their business within the EEA on the basis of their Luxembourg authorisation, provided the compliance with a notification procedure.

  All the above-mentioned advantages have been well understood by Alipay, the main Asian e-payment player that should establish its European headquarters in Luxembourg, in 2015.

- ∞ *It is the largest European investment fund centre and 2nd largest worldwide*

  The amount of assets hitting Luxembourg funds is impressive and its growth seems to never stop.

  The Luxembourg Investment Funds Association (ALFI) recorded EUR 2.48 trillion net assets under management as at May 2013 and 3 trillion as at September 30 2014.

- ∞ *One of the most advanced investment platform worldwide, offering a huge variety of investment vehicles*

  Depending on the objectives and characteristics of the targets and of the investors, Luxembourg provides:

  - ✓ *The best solution for retail funds for a Chinese sponsor:*

    By being provided with a European passport, the UCITS (Undertaking for Collective Investment in Transferable Securities) is the ideal retail fund for a distribution within EU.

    The majority of Luxembourg UCITS are put in place by extra-EU sponsors that aim at distributing in the EU territory as well as worldwide.

    It is certainly beneficial for a Chinese sponsor to opt for Luxembourg instead of offshore solutions for the marketing potential of a Luxembourg fund vis-à-vis a Cayman Islands fund or a BVI fund. An onshore structure provides more security to investors and ensures a larger investments' collection. All this makes a Luxembourg fund widely recognised as more acceptable.

    Moreover, asset managers focusing on Chinese investments might go for a UCITS to gain exposure to Chinese assets via the Qualified Foreign Institutional Investor (QFII)[2] scheme.

    In fact under certain conditions, UCITS would be eligible to a scheme that allows foreign players to invest in Chinese products. In other words, Asian asset managers would find much easier to market their "local" products to EEA investors.

    UCITS has a few restrictions in terms of scope of investment and a few ratios to comply with (e.g. a required risk diversification, and certain ratio of liquidity).

  - ✓ *The best fund solution for alternative investments for Asian inbound or outbound targets:*

[2] The term "qualified foreign institutional investor" (hereinafter referred to as the QFII) means any overseas institutional investors that has been approved by the China Securities Regulatory Commission (CSRC) to invest in China's securities market and that has obtained investments quota from the State Administration of Foreign Exchange (SAFE). An appropriate scheme/system subject to conditions has been implemented by the Chinese financial authorities in order to approve such "foreign" investments.

Over the last years, Luxembourg developed efficient instruments in the benefit of those players targeting alternative investment classes.

Either in the private equity, real estate or hedge funds domains, Luxembourg offers lightly regulated structures, such as the SIF and the SICAR.
(So as to have full details on those vehicles, please refer to our publications available via info@archon.lu).

By way of sample, we point out the role of SIF in connection with Chinese and Asian investment opportunities.
The SIF is a lightly regulated vehicle dedicated to institutional, professional and sophisticated investors. By being less restrictive in terms of investment restrictions, the SIF is the most flexible investment vehicle in the Luxembourg instruments' array.

In this sense, and thanks to the compartmentalisation, a sponsor can combine a number of different investment strategies as from private equity targets to listed companies.
Moreover the same SIF portfolio might be diversified including Dim Sum bonds, one single Hong Kong domiciled Renminbi Qualified Foreign Institutional Investor (RQFII) fund[3], by taking advantage of the recent developments in the HK funds' market.

In conclusion, the implementation of the AIFM Directive provides funds with a EU passports in relation to the alternative investment asset classes, creating huge opportunities for Chinese asset managers to access the EU market via Luxembourg.

∞ *Luxembourg international tax aspects: leader in the cross-border corporate structuring of outbound and inbound Chinese investments*

Luxembourg tradition in the international tax structuring is well recognised among professionals worldwide.

The SOPARFIs, Luxembourg tax residents companies, fully subject to corporate taxes, allow the benefit of the EU Directives and the Double Tax Treaties (DTT) in place between Luxembourg and over 70 different countries.
Under certain conditions, the Luxembourg participation exemption grants the minimization of the tax burden at Luxembourg level and on the repatriation of the investment target's proceeds.
Thus on the purpose of using non-regulated structures, the Luxembourg SOPARFI is widely applied as holding jurisdiction for Chinese investors in EU and extra-EU targets.

[3] RQFII is a scheme launched in December 2011 and allowed a small number of Chinese financial firms to establish renminbi-denominated funds in Hong Kong for investment in the mainland. The aim was to allow overseas investors to use offshore renminbi deposits to invest in mainland securities markets. Over the years the scheme's scope was so widened that as from March 2013, also international banks and asset managers with a presence in Hong Kong became eligible. This paved the way to a number of new products' investment strategies.

Moreover the ratification of the Luxembourg – Hong Kong DTT increased the available structuring opportunities for Chinese players.

Conclusions

As the market proves, China is currently facing a more mature phase, by consolidating its development and looking for further opportunities abroad.

Luxembourg remains the location of choice to access the EU markets for these Asian players.

The establishment of the major Chinese banks in Luxembourg as a step in the strategy of development throughout Europe testifies the central role of the Grand Duchy in Asian projects.

We expect a constant assets' inflow to Luxembourg from China, which would benefit from the financial and structuring opportunities the Grand Duchy can offer in view of the Chinese global development.

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