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Luxembourg

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Introduction

As a leading financial centre in the European Union (the **EU**), Luxembourg offers a diverse range of financial services that connect investors and markets around the world. Luxembourg is a cross-border centre in banking, being home to over 125 international banks from 27 countries. With approximately a quarter of Luxembourg's economy depending on financial services, the significance of the financial sector also results in the development of financial regulation being an important policy consideration for the Luxembourg legislator.

Recent trends influenced by the COVID-19 pandemic

Facing the challenge of the COVID-19 pandemic, the financial sector of Luxembourg has shown its resilience and stability. Contrary to the financial crisis of 2008, banks are considerably stronger and in a much better liquidity position than 13 years ago. The extensive legal framework introduced since 2008 provides for a stable framework to offer a way out of the current crisis. From a prudential oversight point of view, banks have been able to withstand the economic shock of the pandemic. Luxembourg has remained attractive to global financial firms despite the general trend of consolidation sweeping across the European banking industry. As a trustworthy hub and reliable jurisdiction for international finance, Luxembourg benefitted from the relocation of certain United Kingdom-based entities willing to continue to operate within the EU and to insulate themselves from the effects of Brexit.

Recent trends relating to digitalisation

In line with the previous trend of digitalisation, COVID-19 also accelerated the growth in digitalisation of Luxembourg's financial sector. It can also be anticipated that the pandemic will further spur growth of digitalisation, including remote services and remote working. The increasing trend to deliver banking services online will also presumably decrease the number of bank branches. Moreover, the Luxembourg legislator's positive take on digital development has led to recent national legislative initiatives relating to the use of digital innovations in the financial sector. It is worth noting that in line with the positioning of Luxembourg as a Fintech hub and in order to face the challenges of technological innovation in the financial sector, the financial sector supervisory commission (*Commission de Surveillance du Secteur Financier*, the **CSSF**) has recently created an Innovation Hub, a dedicated point of contact for any person wishing to present an innovative project or to exchange views on the major challenges faced in relation to financial innovation in Luxembourg. Furthermore, the CSSF collects guidance and publications on a national and international level related to specific areas of Fintech, such as virtual assets, artificial intelligence, robo-advice and crowdfunding.

Sustainable finance driving change in the financial sector

Sustainable finance has also gained a significant role in the Luxembourg financial sector. While already an area of priority prior to the pandemic, 2020 saw an increased emphasis on sustainable finance as a response to COVID-19 in addition to the global growing sustainability concerns and transition of the financial sector towards sustainability. In this respect, Luxembourg is bidding to become a market leader in green finance.

Luxembourg was the first European country to launch a sustainability bond framework in September 2020. The sustainability bond framework, which meets the highest market standards, was also the first in the world to fully comply with the new recommendations of the European taxonomy for green financing. Following the establishment of the sustainability bond framework, Luxembourg has successfully issued its first sovereign sustainability bond for an amount of €1.5 billion with a 12-year maturity and bearing a negative interest rate of -0.123%. The bonds have been listed on the Luxembourg Green Exchange, the world's first dedicated and leading platform for green, social and sustainable securities.

By launching a sustainable finance strategy for Luxembourg and its financial centre in February 2021, the Luxembourg government has sent yet another strong signal of the country's determination to help mainstream sustainable finance. The strategy determines the general action plan, with the main objectives being to (i) support the financial sector's transition towards sustainability, and (ii) raise of awareness of, promote and develop Luxembourg's position as a hub for sustainable finance.

Updates relating to a call for increased transparency relating to the financial centre

In addition to COVID-19, Fintech and the focus on sustainable finance, the financial markets of Luxembourg have also been impacted by the increased focus on transparency. Scrutiny of the financial sector is likely to intensify following the recent publication of a series of articles in the international press, concerning the extent of fund ownership by foreign nationals in Luxembourg and the alleged shortcomings in the country's anti-money laundering arrangements. In response to this "OpenLux" investigation, the Luxembourg government emphasised that the country is fully in line and compliant with all EU and international regulations and transparency standards. The obligations relating to anti-money laundering are unlikely to decrease in the years to come, as the European Commission has recently published an action plan for a comprehensive Union policy on preventing money laundering and terrorist financing. The Commission action plan envisages, among other changes, a single EU rulebook and an EU-level supervisory authority.

Regulatory architecture: Overview of banking regulators and key regulations

National level

The national authorities responsible for the regulation and supervision of the banking sector in Luxembourg are the CSSF and the Central Bank of Luxembourg (the **BCL**), which are placed under the authority of the Ministry of Finance.

The CSSF

The CSSF is the authority responsible for the prudential supervision of the Luxembourg financial sector, as provided by the law of 23 December 1998, as amended. It operates under the authority of the Ministry of Finance and is responsible for authorisation and prudential supervision of credit institutions, investment firms, specialised professionals of the financial sector, support professionals of the financial sector, payment institutions and electronic money institutions.

Further, the CSSF is (i) the national resolution authority for the resolution of credit institutions and certain investment firms in the framework of the Single Resolution Mechanism and the Single Resolution Fund under EU Regulation 2014/806 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending EU Regulation 2010/1093 of 24 November 2010, and (ii) the resolution authority of failing national or transnational banks with the view to limiting their systemic impact as provided by the law of 18 December 2015 on the failure of credit institutions and certain investment firms (transposing EU Directive 2014/59 of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (the **BRRD**)).

Further, the CSSF is the competent authority for the application of Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (the **Prospectus Regulation (EU) 2017/1129**) and the law of 16 July 2019 on prospectuses for securities that implements certain provisions of the Prospectus Regulation (EU) 2017/1129 and provides for other requirements covering the national prospectus regime.

Its field of competence also encompasses the control of professional obligations regarding anti-money laundering and combatting the financing of terrorism (**AML/CFT**).

The CSSF is also in charge of the supervision of markets in financial instruments and their operators.

The BCL

The BCL is part of the European System of Central Banks and is specifically responsible for, *inter alia*: (i) the supervision of liquidity of credit institutions, in cooperation with the CSSF; (ii) control over the smoothness and efficiency of payments systems; (iii) the empowerment of financial stability; and (iv) the implementation of monetary policies.

The CAA

Credit institutions that are authorised to pursue insurance-related activities are also supervised for such activities by the *Commissariat aux Assurances* (the **CAA**), the authority that regulates and supervises the insurance, insurance mediation, reinsurance and management of complementary pension funds activities.

<u>The influence of supra-national regulatory regimes or regulatory bodies</u>

EU level

As part of the European Banking Union, the Luxembourg banking system is subject to the supervision of the European Central Bank (the **ECB**) within the framework of the European Single Supervisory Mechanism (the **SSM**). The ECB is specifically responsible for: (i) granting and withdrawing banking licences; (ii) assessing banks' acquisitions and disposals of qualifying holdings; (iii) ensuring compliance with EU prudential and governance requirements; (iv) conducting supervisory reviews, on-site inspections and investigations; and (v) setting higher capital requirements ("buffers") in order to counter any financial risks.

Since November 2014, the ECB is exclusively competent for granting licences, approvals of qualifying holdings and appointment of key function holders in all significant credit institutions, established in the Member States participating in the SSM. The ECB's role in such significant credit institutions includes the supervision of solvency, liquidity and internal governance.

It is worth nothing that the supervision of less-significant institutions incorporated under Luxembourg law and branches of non-EU institutions remains under the scope of competence of the CSSF. Further, the CSSF remains the main authority for the supervision of, among others, (i) compliance with professional obligations regarding AML/CFT, and (ii) regulations for consumer protection.

The key legislation and regulation applicable to banks in Luxembourg

The principal rules and regulations applicable to the financial and banking sector are embodied in the law of 5 April 1993 on the financial sector, as amended (the **LFS**), which implements, among others, EU Directive 2013/36 of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (**CRD IV**). Notably, the LFS regulates: (i) authorisation of credit institutions and access to professional activities in the financial sector; (ii) professional obligations, prudential rules and rules of conduct; (iii) prudential supervision of the financial sector; (iv) prudential rules and obligations in relation to recovery planning, intra-group financial support and early intervention; and (v) the power of the CSSF to impose fines and sanctions.

In addition to the LFS, the main laws and regulations that govern banking activities in Luxembourg include the following:

- the law of 23 July 2015 implementing CRD IV and amending, among others, the LFS;
- EU Regulation 2013/575 of 26 June 2013 on prudential requirements for credit institutions and investment firms (the **CRR**, together with CRD IV commonly referred to as the **CRD IV Package**);
- the law of 18 December 2015 on the resolution, reorganisation and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes implementing the BRRD;
- the law of 10 November 2009 on payment services, as amended;
- the law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the **AML/CFT Law**), which implemented the latest provisions introduced by Directive (EU) 2015/849 of 20 May 2015 and Directive (EU) 2018/843 of 30 May 2018 (commonly referred to, respectively, as the **Fourth and Fifth AML Directives**);
- the law of 23 December 1998 establishing the CSSF; and
- the law of 17 June 1992 on annual and consolidated accounts of credit institutions, as amended.

Further, being a member of the Eurozone, regulation of the banking sector in Luxembourg is also subject to specific pieces of Eurozone legislation, including regulations and directives transposed into national law and guidelines provided by the European Banking Authority (the **EBA**). In this respect, EBA Guidelines EB/GL/2015/20, to be read in conjunction with CSSF Circular 16/647, on limits on exposure to shadow banking entities that carry out bank-like activities outside a regulated framework (and developed in accordance with article 395(2) of the CRR), should be mentioned. The EBA Guidelines apply to all institutions subject to part four (Large Exposures) of the CRR, which shall comply with the aggregate exposure limits or tighter individual limits set on exposures to shadow banking entities carrying out banking activities outside a regulated framework (including special-purpose vehicles engaged in securitisation transactions).

From the international level, Luxembourg is influenced by supra-national regulatory regimes and regulatory bodies. Moreover, Luxembourg is a Member State of (i) the Organisation for Economic Co-operation and Development (the **OECD**), establishing norms and better

policies for a wide range of subjects, such as corruption and tax avoidance, and (ii) the Financial Action Task Force, which sets standards and recommendations and promotes effective implementation of legal, regulatory and operational measures for the fight against money laundering and terrorist financing.

In addition, the CSSF is one of the bank supervisors that are members of the Basel Committee on Banking Supervision, the primary global standard-setter for the prudential regulation of banks.

The European Commission, the ECB and the OECD are members of the Financial Stability Board (the **FSB**), which is an international organisation that monitors and makes recommendations for the global financial system and has a direct impact on domestic banking legislation.

Finally, the Luxembourg regulatory framework applicable to banks is complemented by Grand Ducal regulations, Ministerial regulations and CSSF regulations and circulars issued by the CSSF on various matters related to the financial sector with a view to providing more guidance on how legal provisions should be applied and issuing recommendations on conducting business in the financial sector. Of particular relevance is CSSF Circular 12/552 on the central administration, internal governance and risk management of banks and professionals performing lending operations, as amended.

Recent and proposed changes to the regulatory architecture in Luxembourg

Recent changes to the regulatory architecture

It is worth noting that changes to the regulatory architecture are mainly driven by initiatives taken at the EU and international levels. The following is an overview of the most recent changes affecting the banking regulatory architecture in Luxembourg.

On 25 March 2020, the Luxembourg Parliament (*Chambre des Députés*) passed the law establishing a central electronic data retrieval system related to payment accounts and bank accounts identified by an International Bank Account Number (**IBAN**) and safe deposit boxes held by credit institutions in Luxembourg and amending, among others, the AML/CFT Law. Such central register is managed by the CSSF with the main objective to allow, in due course, the identification of any natural or legal persons holding or controlling payment accounts or bank accounts identified by IBAN, as defined by EU Regulation 2012/260 of 14 March 2012, as well as safe deposit boxes held by credit institutions.

On 10 July 2020, the law on Professional Payment Guarantees was enacted (the **PPG Law**). The PPG Law introduced a new regime of personal guarantees granted in the professional context as an alternative to the suretyship (*cautionnement*) provided by articles 2011 *et seq*. of the Luxembourg Civil Code and the first demand guarantee (*garantie à première demande*) and related legal uncertainty, as the latter is not governed by Luxembourg law but has been developed by market players and recognised by case laws, even though it remains subject to requalification by Luxembourg courts. The aim of the PPG Law is to increase the attractiveness of the Luxembourg financial environment with a specific tool for financial operators that enhances contractual freedom and legal certainty. The professional payment guarantee would be an additional security that could be included in the security package granted to credit institutions in the context of financing or refinancing transactions.

On 7 December 2020, the CSSF published Circular 20/759, amending CSSF Circular 12/552 on central administration, internal governance and risk management of banks and professionals performing lending operations, as amended. The Circular transposes,

among others, the EBA Guidelines on internal governance and the joint EBA and European Securities and Markets Authority Guidelines on suitability assessment of the members of the management body and key function holders.

Proposed changes to the regulatory architecture

On 6 August 2018, a draft bill (n°7348) relating to inactive accounts, inactive safes and unclaimed insurance contracts amending the law of 23 December 1998 establishing a financial sector supervisory commission, as amended, and the law of 7 December 2015 on the insurance sector, as amended, was lodged with the Luxembourg Parliament. The bill of law aims to create a Luxembourg legal regime for inactive accounts, inactive safes and unclaimed insurance contracts in order to strengthen the protection of clients and establishes professional obligations for banks and insurers. Inactive accounts, inactive safes and unclaimed insurance contracts are currently governed in Luxembourg by the provisions of the Luxembourg Civil Code and applicable contractual provisions. Through this bill, Luxembourg intends to provide itself with a specific legal framework in this area, following the examples of France and Belgium. The draft bill includes three main components, which are the following: (i) a prevention component that sets out a series of measures in order to prevent account inactivity; (ii) a consignation component at the *Caisse de Consignation*, which provides for the obligation to consign assets after prolonged inactivity; and (iii) a restitution component laying down the provisions for the restitution of consigned assets. The draft bill is still pending with Parliament and, at this stage, it remains uncertain whether the bill will be enacted by the end of the current year.

On 5 February 2021, a draft bill (n°7761) was submitted to the Luxembourg Parliament with the aim to modernise the procedure of regulatory license for entities of the financial sector by granting directly to the CAA and the CSSF the power of approval and withdrawal of the authorisation with respect to the entities subject to their respective supervision. The changes proposed by the draft bill reflect the evolution of the EU laws increasingly advocating the allocation of powers of approval to the national competent authorities in charge of prudential supervision. The amendments proposed by the draft law reflect expectations and best practices established by international institutions, such as the Basel Committee on Banking Supervision and the International Monetary Fund, aiming at ensuring that the licensing regime reflects the increasingly widespread European and international licensing practices.

On 27 July 2020, a draft bill of law (n°7638) was submitted to the Luxembourg Parliament with the main aim of transposing into Luxembourg law (i) EU Directive 2019/878 of 20 May 2019 amending CRD IV as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (**CRD V**), and (ii) EU Directive 2019/879 of 20 May 2019 amending the BRRD as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and EC Directive 1998/26 of 19 May 1998 (**BRRD II**). The draft bill will amend the LFS, introducing the possibility for the CSSF to impose capital recommendations in addition to capital requirements. Provisions of the draft law also introduce an obligation for third-country banking groups to set up a single intermediate EU parent undertaking established in the EU.

Recent regulatory themes and key regulatory developments in Luxembourg

Change to the regulatory regime following the financial crisis

European banking regulation has undergone a continuous evolution since the financial crisis of 2008 and the adoption of a certain number of directives and regulations as a response

to the financial crisis. The main legislation taken in this respect could be summarised as follows:

- CRD IV;
- the CRR;
- EU Regulation 2013/1024 of 15 October 2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, and EU Regulation 2013/1022 of 22 October 2013 amending EU Regulation 2010/1093 of 24 November 2010 establishing a European supervisory authority (the EBA) as regards the conferral of specific tasks on the ECB pursuant to EU Regulation 1024/2013, together establishing the SSM; and
- EU Regulation 2014/806 of 15 July 2014, as amended, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending EU Regulation 2010/1093; and the BRRD, together establishing the Single Resolution Mechanism.

These regulations were part of a logic of risk reduction in the banking sector within the EU and the Eurozone. The gradual establishment of a Banking Union at the level of the EU with its unique supervision and resolution mechanisms marked the starting signal for risk pooling through the establishment of euro area-wide safety nets, including the Single Resolution Fund.

Regulatory developments relating to Brexit

On 14 December 2020, the CSSF published Regulation 20-09 amending CSSF Regulation 20-02 of 29 June 2020 on the equivalence of certain third countries with respect to supervision and authorisation rules for the purpose of providing investment services or performing investment activities and ancillary services by third-country firms. As specified in the CSSF press release of 24 December 2020, the Regulation includes the United Kingdom of Great Britain and Northern Ireland in the list of jurisdictions deemed equivalent for the application of the national third-country regime.

Regulatory developments relating to Fintech

The Luxembourg legislator has taken significant initiatives in the area of digitalisation of banking and financial activities and more specifically in the implementation of technological innovations in the field of capital markets. Two distinct laws passed in 2019 and 2021 allowed the use of new technologies in the issuance, holding and circulation of securities.

The law of 1 March 2019 (the **Blockchain I Law**) amended the law of 1 August 2001, as amended (the **General Securities Law**), allowing the use of secure electronic mechanisms for the holding and circulation of securities. The Blockchain I Law represented a milestone in the digitalisation of capital markets in Luxembourg as it acknowledged for the first time the issuance of security tokens, a specific category of crypto assets defined in the parliamentary works as assets stored in a blockchain that represents the securities.

In an effort to extend and refine the scope of application of the Blockchain I Law, the Luxembourg Parliament passed the law of 21 January 2021 (the **Blockchain II Law**), which amended the law of 6 April 2013, as amended (the **Dematerialised Securities Law**) and the LFS, as amended. The Blockchain II Law extended the possibility to use secured electronic registration systems, such as distributed ledger technologies and databases, to the issuance of dematerialised securities. Following the Blockchain II Law, EU credit institutions and investment firms are allowed to take the role of central account keeper, and to hold and

manage securities issuance accounts with such technologies through secured electronic registration systems such as distributed ledger technology (e.g., blockchain) and databases.

The Blockchain I Law and Blockchain II Law filled a gap in a fundamental area of the Luxembourg legal framework, providing legal certainty to financial market participants and making the Luxembourg environment Fintech-oriented. By implementing the principle of digital neutrality, the legislator acknowledged not only the use of digital ledger technologies such as blockchain, but created an open-ended system enabling the smooth introduction of future technological developments in the securities market.

In parallel with the legislative initiatives, the CSSF has constantly monitored the Fintech sector, establishing a significant debate with market participants with respect to regulatory issues related to technological innovations. In this respect, on 14 March 2018, the CSSF issued a warning highlighting the risks linked with virtual currencies and specified that undertakings for collective investment funds addressing non-professional customers and pension funds are not allowed to invest directly or indirectly in virtual currencies.

Following the entry into force of the law of 25 March 2020 implementing the Fifth EU AML Directive and amending the AML/CFT Law, no virtual asset service provider may be established in Luxembourg without being registered with the CSSF.

Further developments are expected in the Fintech legal framework at the European level. On 24 September 2020, the European Commission published a proposal for a regulation on Markets in Crypto-Assets (the **MiCA Proposal**). The MiCA Proposal is part of a broader initiative, i.e., the EU Digital Finance Package, which also encompasses a retail payment strategy aiming at enhancing the digitalisation of EU retail payments.

Bank governance and internal controls

Key requirements set out in the LFS relating to the central administration and internal controls of credit institutions are specified in CSSF Circular 12/552, as amended. In a nutshell, Luxembourg regulation requires credit institutions to have robust internal governance arrangements, effective risk management processes, adequate internal control mechanisms, sound administrative and accounting procedures, remuneration policies and practices allowing and promoting a sound and effective risk management as well as control and security arrangements for information processing systems.

More precisely, the following general requirements apply to boards of directors of banks, committees, remuneration and internal control.

Management and central administration

The central administration of a credit institution must be established in Luxembourg. The authorised management of credit institutions must be composed of at least two members (the so-called four eyes principle) who must be empowered to effectively direct the business. The managers must produce evidence of their professional repute. In addition, they must have already acquired an adequate level of professional experience through the performance of similar activities and assessed on the basis of a *curriculum vitae* and/or any other relevant evidence. The good repute of the members of the bodies performing administrative, management and supervisory functions is assessed on the basis of police records and any evidence that shows that the persons concerned have a good reputation and offer every guarantee of irreproachable conduct. The prudential approval procedure sets out the fit and proper approval process for the appointment of key function holders

and members of the management body in credit institutions. Recent amendments to CSSF Circular 12/552 have enhanced the provisions with respect to the diversity and independence of the management body.

Committees

Banks may be required to put in place various committees, such as an audit committee or a risk committee, which oversee certain areas of the bank's operations. The obligations relating to committees depend on the size and scale of the bank.

Remuneration policies

The aim of the procedures and arrangements implemented in relation to remuneration is to help ensure that risks are managed in an efficient and durable manner. Credit institutions must comply with the requirements concerning the governance arrangements and remuneration policies of CRD IV, as transposed into the LFS. Furthermore, credit institutions must comply with the disclosure requirements of the CRR, the criteria set out in the relevant EU regulatory technical standards, the EBA Guidelines on remuneration policies and best practices and the applicable CSSF circulars. In addition, the aforementioned draft bill n°7638 introduced by the Luxembourg Parliament and transposing CRD V into national law will further amend requirements relating to remuneration policies of credit institutions. The proposal imposes, *inter alia*, an obligation to guarantee a gender-neutral remuneration policy and sets new thresholds relating to the principle of proportionality. In addition, credit institutions will be required to comply with obligations relating to disclosure of remuneration policy deriving from EU Regulation 2019/876 of 20 May 2019 (**CRR II**). Most of the rules provided under CRD V and CRR II will be applicable as of June 2021.

Internal control environment

CSSF Circular 12/552, as amended, requires banks to have dedicated internal control functions, such as a risk control function, a compliance function and an internal audit function. The internal control functions are permanent and independent functions, each with sufficient authority. The degree of the measures required is subject to the principle of proportionality, meaning that more complex, riskier and significant institutions must have in place enhanced internal governance and risk management arrangements.

Luxembourg regulation requires that the organisation chart of the credit institution is established based on the principle of segregation of duties, pursuant to which the duties and responsibilities will be assigned so as to avoid making them incompatible for the same person. The goal pursued is to avoid conflict of interest and to prevent a person from making mistakes and irregularities that would not be identified.

Outsourcing of functions is generally permitted under the conditions laid down in the LFS and relevant CSSF circulars. However, outsourcing must not result in non-compliance with the rules of CSSF Circular 12/552, as amended. The general outsourcing requirements include, *inter alia*, that the outsourcing institutions comply with the following requirements: (i) strategic or core functions cannot be outsourced; (ii) the institution retains the necessary expertise to effectively monitor the outsourced services or tasks; (iii) the institution ensures protection of the data concerned in accordance with Regulation (EU) 2016/679 of 27 April 2016 on General Data Protection; and (iv) the institution applies the relevant provisions of the LFS on professional secrecy. Outsourcing does not relieve the institution of its legal and regulatory obligations or its responsibilities to its customers. Furthermore, the final responsibility or the management of risk shall lie with the outsourcing institution.

In addition to the general requirements, the Circular provides for specific requirements relating to IT outsourcing.

Bank capital requirements

The regulatory capital and liquidity regime currently applicable to banks in Luxembourg derives mainly from the CRR, CRD IV and numerous underlying local regulations, circulars and circular letters adopted by the CSSF. It is worth noting that following the procyclical mechanisms that contributed to the origin of the financial crisis of 2008, the FSB, the Basel Committee on Banking Supervision and the G20 made recommendations to mitigate the procyclical effects of financial regulation. In December 2010, the Basel III Framework, which consisted of new global regulatory standards on bank capital adequacy, was issued by the Basel Committee on Banking Supervision. In June 2013, the Basel III Framework was implemented into the CRR/CRD IV Package at the EU level.

Capital and liquidity requirements

Share capital

Credit institutions in Luxembourg are required to have a subscribed and fully paid-up share capital of at least €8.7 million. The capital base cannot be less than the amount of the prescribed authorised capital.

Own funds

In addition to the share capital requirement, credit institutions must maintain and satisfy at all times a total capital ratio of 8% of their risk-weighted assets, composed of 4.5% of Common Equity Tier 1 capital (**CET1**) (as defined in the CRR), 1.5% of Additional Tier 1 capital (as defined in the CRR) and 2% of Tier 2 capital (as defined in the CRR).

In addition to other own funds requirements, credit institutions in Luxembourg are required to hold and maintain the following buffers:

- a capital conservation buffer of CET1 equal to 2.5% of their total risk exposure amount;
- an institution-specific countercyclical capital buffer of CET1 (equivalent to their total risk exposure). The CSSF is responsible for setting the countercyclical buffer rates applicable in Luxembourg, on a quarterly basis. According to CSSF Regulation 20-03 of 30 June 2020, a countercyclical capital buffer rate of 0.50% applies to credit institutions as from 1 January 2021;
- a Global Systemically Important Institutions (**G-SII**) buffer, being a mandatory capital surcharge built up of CET1 and applied at the consolidated level of the identified banking groups' additional capital requirements for systemically important banks. The capital surcharge may vary between 1% and 3.5% depending on the degree of systemic importance of the relevant bank. According to the publicly available information, there is no bank established in Luxembourg identified as a G-SII;
- an Other Systemically Important Institutions (**O-SII**) buffer. In this respect, the CSSF takes its decisions after consultation with the BCL and after requesting the opinion of the *Comité du Risque Systémique*. The CSSF and the BCL have jointly developed a calibration methodology designed to translate the systemic importance of the institutions into O-SII buffer rates; and
- a systemic risk buffer for systemic banks of at least 1% based on the exposures to which the systemic risk buffer applies, which may apply to exposures in Luxembourg as well as to exposures in third countries. No maximum limit applies to this buffer.

Liquidity and funding requirements

In order to ensure the stability of financial institutions, the following liquidity and funding standards (adopted in the EU and designed to achieve two separate but complementary objectives) apply to credit institutions in Luxembourg:

- a Liquidity Coverage Ratio, which aims to improve the short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for 30 days. Financial institutions are required to hold at all times liquid assets, the total value of which equals, or is greater than, the net liquidity outflows that might be experienced under stressed conditions over a short period of time (30 days). Net cash outflows must be computed on the basis of a number of assumptions concerning runoff and drawdown rates; and
- a Net Stable Funding Ratio (**NSFR**) aims to ensure the resilience of financial institutions over a longer time horizon of one year by promoting a sustainable maturity structure of assets and liabilities. Financial institutions are required on an ongoing basis to raise stable funding at least equal to their stable assets or illiquid assets that cannot be easily turned into cash over the following 12 months. Following the amendment of the CRR by CRR II, the NSFR will be applicable for all credit institutions as of 28 June 2021.

Compliance with the rules relating to bank capital and liquidity requirements is under the control of the CSSF and the ECB. In addition, financial institutions are subject to periodic reporting requirements.

As a response to COVID-19, the EU adapted its requirements relating to the CRR. By introducing EU Regulation 2020/873 of 24 June 2020 amending the CRR and CRR II, applicable since June 2020, the EU legislator introduced, among other changes, an extension by two years of the transitional arrangements for International Financial Reporting Standard 9 and the deferred application of the leverage ratio buffer provided under CRR II by one year to January 2023.

This regulatory framework has substantially contributed to the strengthening of the regulations applicable to the banking system in the EU and rendered institutions more resilient to possible future shocks. Although comprehensive, those measures did not address all identified weaknesses affecting institutions. Hence, CRR II, CRD V and BRRD II have been enacted at the EU level with the aim to address issues raised in relation to the provisions of the CRD IV Package that proved not to be sufficiently clear and have been subject to divergent interpretations, or that have been found to be overly burdensome for certain institutions. One of the key changes that the aforementioned draft bill of law n°7638 (which aims to transpose CRD V and BRRD II into national law) would bring relates to additional capital requirements. The proposal introduces a possibility for the CSSF to impose capital recommendations in addition to capital requirements. In addition, the draft law aims to modify the modalities relating to the determination of minimum capital requirements and eligible instruments specific to each institution, to ensure an efficient application of the bail-in tool.

Rules governing banks' relationships with their customers and other third parties

Regulation relating to customers

Banks' relationships with their customers and third parties deriving from deposit-taking, lending activities and investments services are mainly governed by:

- the law of 30 May 2018 on markets in financial instruments, transposing, among others, Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending

Directive 2002/92/EC and Directive 2011/61/EU and Regulation (EU) 600/2014 of 15 May 2014 on markets in financial instruments, as well as several delegating acts, which provide for a harmonised protection for (retail) investors in financial instruments;

- Regulation (EU) 1286/2014 on key information documents for packaged retail and insurance-based investment products (the **PRIIPs Regulation**) applicable since 1 January 2018. The PRIIPs Regulation requires that all packaged retail and insurance-based investment products (**PRIIPs**) manufacturers provide a key information document to retail investors in order to enable retail investors to understand and compare the key features and risks of the PRIIPs;
- the law of 17 April 2018 on key information documents for PRIIPs implementing the PRIIPs Regulation designates the CSSF and the CAA as the competent supervisory authorities regarding supervision and compliance with the requirements of the PRIIPs Regulation; and
- the provisions of the Luxembourg Consumer Code related to the protection of consumers also affect banks' dealings with their customers. Following these provisions, banks must, among others, comply with obligations relating to information that should be provided to customers, rules on advertising, the content of credit agreements and the prohibition of unfair business practices. Before granting a credit, the solvency of the customer needs to be evaluated.

Customer complaints handling

In addition, the CSSF is competent to receive customer complaints against the entities subject to its supervision. Provided that, *inter alia*, the customer complaint has been previously dealt with by the relevant professional without a satisfactory result, the customer may request for an out-of-court resolution from the CSSF. The CSSF then acts as an intermediary with the parties in order to seek an amicable solution. The CSSF acts in its capacity as alternative dispute resolution entity and Luxembourg courts remain competent to handle litigations relating to consumer protection.

Protection of depositors and investors

Following the entry into force of the law of 18 December 2015 on the failure of credit institutions and certain investment firms, the following compensation schemes have been created:

- an Investor Compensation Scheme (*Système d'Indemnisation des Investisseurs Luxembourg*), being the recognised Luxembourg Investor Compensation Scheme as referred to in Directive 97/9/EC and chaired by the CSSF. The main purpose of the Investor Compensation Scheme is to ensure coverage for the claims (funds and financial instruments that its members hold, manage or administer on behalf of their clients) resulting from the incapacity of a credit institution or an investment firm. In case the relevant criteria are met and the institution holding the investor's assets is no longer able to fulfil its commitments, investors are repaid by the Investor Compensation Scheme. The repayment covers a maximum amount of €20,000 per investor; and
- a Deposit Guarantee Fund (*Fonds de Garantie des Dépôts Luxembourg*), being the recognised Luxembourg Deposit Guarantee Scheme referred to in Directive 2014/49/EU of 16 April 2014 on Deposit Guarantee Schemes. The main purpose of the Deposit Guarantee Fund is to ensure compensation of depositors in case of unavailability of their deposits. It collects the contributions due by participating credit institutions, manages the financial means and, in the event of insolvency of a member institution, makes the repayments as instructed by the *Conseil de protection des déposants et des investisseurs*,

the internal executive body of the CSSF in charge of managing and administering Luxembourg compensation schemes. It is worth noting that membership to the Deposit Guarantee Fund is compulsory for all credit institutions and Luxembourg branches of credit institutions having their registered office in a third country. In case the relevant criteria are met and the institution holding the depositor's assets is no longer able to fulfil its commitments, depositors are repaid by a Deposit Guarantee Scheme. The repayment covers a maximum amount of €100,000 per person and per bank.

Restrictions on inbound cross-border banking activities

Any person wishing to conduct inbound cross-border banking activities in Luxembourg that fall under the rules of the LFS must obtain the necessary authorisation as stipulated in the LFS. However, credit institutions authorised by a competent authority within the EU/EEA may rely on the European banking passport mechanism. Pursuant to the principle of mutual recognition of authorisation, these authorised institutions are allowed to carry out a number of activities in Luxembourg, subject to having completed the necessary formalities with their home state authorities, which in turn will notify the CSSF.

The regulatory framework on AML/CFT

Banks must comply with the professional obligations arising from the AML/CFT Law and other applicable regulations, and more specifically customer due diligence obligations, adequate requirements relating to internal managements and cooperation requirements with the authorities.

Luxembourg has also strengthened its obligations relating to AML/CFT by transposing certain provisions of the Fourth and Fifth AML Directives, aiming to prevent money laundering and terrorist financing through the implementation of (i) a register aiming to identify ultimate beneficial owners of companies registered with the Luxembourg Trade and Companies Register, which has been effective since 1 March 2019, and (ii) a central register of beneficial owners of fiduciary and similar arrangements, which entered into force on 10 July 2020. These new laws require, *inter alia*, that companies registered with the Luxembourg Trade and Companies Register, trustees, and fiduciary agents, obtain and retain data relating to beneficial owners and to certain other persons specified in the respective laws. Registration of certain data collected by the relevant company, trustees and fiduciary agents to the relevant central register is mandatory; failing this, criminal sanctions are provided by these laws.

The AML/CFT Law also enacts the core principle of a "risk-based approach" whereby professionals have to take appropriate measures to identify and assess the risks of AML/CFT with which they are confronted, taking into consideration risk factors such as those related to their customers, countries' geographic areas, products, services, transactions or delivery channels.

The CSSF has the supervisory and investigatory powers to carry out its statutory mission to ensure that all persons subject to its supervision comply with the professional AML/CFT obligations. In addition, the CSSF has broad sanctioning powers. It may, for example, issue warnings or administrative fines against persons subject to its AML/CFT supervision. Monitoring risk in relation to anti-money laundering continues to be a high priority of the CSSF's supervision, and the CSSF staff in charge of the AML/CFT supervision is constantly increasing. Recent changes to the AML/CFT legislation also provide for a stronger cooperation framework between different supervisory authorities both on a national and an international level.

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