GETTING THE DEAL THROUGH

Banking Regulation

in 26 jurisdictions worldwide

2014

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Getting the Deal Through is delighted to publish the seventh edition of *Banking Regulation*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 26 jurisdictions featured. New jurisdictions this year include Canada and Russia.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are referring to the latest print edition or to the online version at www.gettingthedealthrough.com.

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Luxembourg

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Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

According to its government programme, the newly formed Luxembourg government is strongly committed to further strengthening the competitiveness of the Luxembourg economy by sustaining the long-term stability and development of its financial centre.

The EU regulatory context heavily influences domestic legislation, which has to comply with new legislative developments at EU level either in terms of supervision or liquidity.

The governmental programme emphasises the importance of the financial services sector to the Luxembourg economy, of which the banking sector represents more than 60 per cent of the workforce. Luxembourg is also committed to contributing to more financial transparency, inter alia, in the context of the US Foreign Account Tax Compliance Act (or FATCA), and is moving to offer the required reporting for international banking clients with cross-border interests. Bank secrecy rules will be revisited to increase legal certainty and to account for changes at international level.

A further trend is the continued diversification of activities into new markets in the financial sector.

2 Summarise the primary statutes and regulations that govern the banking industry.

The primary statute governing the banking sector is the law of 5 April 1993, as amended, on the financial sector (the Financial Sector Law). This law governs the Luxembourg financial services sector as a whole, and the banking sector in particular, regulating access to professional activities, the duties and rules of conduct of the financial sector, organising the prudential supervision of the financial sector or the deposit guarantee schemes, and indemnification systems in respect of credit institutions.

The Financial Sector Law incorporates the European banking directives of 14 June 2006 (2006/48/EC), which address the taking up and pursuit of business of credit institutions, and the Markets in Financial Instruments Directive of 24 April 2004 (2004/39/EC) (MiFID).

Other relevant regulations include:

- Law of 17 June 1992, as amended, relating to the accounts of credit institutions;
- Law of 23 December 1998, as amended, establishing a supervisory commission of the financial sector (the 1998 Law);
- Law of 12 November 2004, as amended, on the fight against money laundering and terrorist financing;
- Law of 16 March 2006 relating to the introduction of the international accounting standards for credit institutions (the 2006 Law);
- Law of 9 May 2006 on market abuse transposing the Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 into Luxembourg law, as amended by the law of 26 July 2010 on market abuse;
- Law of 13 July 2007 on markets in financial instruments (the 2007 Law);
- Grand-Ducal Regulation of 13 July 2007 relating to organisational requirements and rules of conduct in the financial sector;
- Law of 10 November 2009 on payment services;
- Law of 27 October 2010 on the strengthening of the legal framework on the fight against money laundering and terrorist financing;
- Law of 28 April 2011 on capital requirements, transposing the Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 into Luxembourg law;
- Law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public;
- Law of 21 December 2012 relating to family office activity;
- Law of 21 December 2012 implementing directive 2010/78/EU of the European Parliament and the Council dated 24 November 2010 (the 2012 Law);
- Law of 6 April 2013 on dematerialised securities
- Law of 27 June 2013 on mortgage banks amending the Financial Sector Law dated 5 April 1993;
- Law of 12 July 2013 regarding EU short-selling regulation; and
- Law of 12 July 2013 relating to alternative investment funds managers.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The Financial Sector Superviory Committee (CSSF) is responsible for the prudential supervision of Luxembourg-based credit institutions. Its supervision also extends to professionals in the financial sector ((PFS) including investment firms, specialised PFSs, support PFSs), alternative investment fund managers, undertakings for collective investment, pension funds, SICARs, securitisation undertakings issuing securities to the public on a continuous basis, regulated markets and their operators, multilateral trading facilities, payment institutions and electronic money institutions. The CSSF also supervises the securities markets, including their operators.

The Banque centrale du Luxembourg (BcL) is in charge of all monetary and financial competences pertaining to a national central bank within the scope of the European System of Central Banks (ESCB). The main tasks assigned to the ESCB include the promotion of the financial stability, the definition and implementation of the monetary policy at EU level, the conduct of foreign exchange operations, the holding and management of official foreign reserves and the smooth operation of the payment systems. The BcL provides services to the financial sector (information collection, including statistical figures for preparing European monetary policy) and opens account only with monetary and financial institutions.

At EU level, the new European Banking Authority (EBA) was established on 1 January 2011 as part of the European System of Financial Supervision (ESFS) and took over all existing responsibilities and tasks from the former Committee of European Banking Supervisors (CEBS). These regulatory competences were formally accepted by Luxembourg by means of the Law of 21 December 2012 implementing Directive 2010/78/EU dated 24 November 2010 (Omnibus I Directive).

At the EU level, a two-pillar mechanism known as European banking union is intended to be implemented under the form of a single supervisory mechanism (SSM) and a single resolution mechanism (SRM). The SSM is detailed in Council Regulation EU 1024/2013 of 15 October 2013 and entrusts power over significant eurozone banks to the European Central Bank (ECB). The three most significant banks in each participating member state will qualify as significant as well as other banks meeting certain criteria, both in quantitative and qualitative terms. From November 2014, the ECB will become the direct supervisor of the significant banks of the eurozone. The SRM will ensure, where a bank subject to the SSM faces severe financial difficulties, that its resolution will be managed efficiently, with minimal costs to taxpayers and the real economy. The European Council has agreed the general approach of the SRM, which is expected to be adopted in 2014 with the start of implementation in 2015.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Any credit institution established in the Grand Duchy is required to adhere to the Luxembourg deposit guarantee and investor compensation scheme: the Association for the Guarantee of Deposits (AGDL), established in accordance with the Laws of 11 June 1997 and 27 July 2000 implementing EU Directives 94/19/EC and 97/9/EC.

As of 31 December 2013, the AGDL covers the aggregate deposits of each bank client of up to a value of €100,000 (or equivalent if denominated in foreign currency). In the event of the bankruptcy of a member bank the AGDL ensures reimbursement of all deposits of up to €100,000 held with the bank, covering both natural persons and small and medium companies complying with the following conditions: (i) employing fewer than 50 employees and (ii), having an annual turnover of less than €8.8 million and a balance sheet total below €4.4 million. Besides this deposit guarantee, claims arising out of investment transactions of a maximum of €20,000 are also protected under the deposit guarantee provided by the AGDL. The circular issued by the CSSF (Circular 13/555) requires banks to implement a 'single customer view' process, allowing banks to obtain a complete view of the total balances due per customer, by 31 December 2013. The management of the banks is required to confirm its compliance with these requirements on an annual basis.

The Luxembourg state is the sole shareholder of the Banque et Caisse d'Epargne de l'Etat (BCEE), which is ranked among the safest banks in the world. The state also holds a stake interest of 10 per cent in the Banque Internationale à Luxembourg (BIL), along with Precision Capital, a holding company held by the state of Qatar. During the 2008 financial crisis, the Luxembourg government was not required to recapitalise any Luxembourg banks. During that period, only three banks (Glitnir, Landsbanki and Khaupting banks) were declared bankrupt and their liquidations did not call for government intervention. Beyond its anchor interest in the BCEE, the state has not expressed a wish to expand its interests in the banking sector and is not expected to do so imminently.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The Financial Sector Law does not provide for any restrictions, requirements or preconditions for intra-group transactions among Luxembourg-regulated credit institutions and related subsidiaries.

Such intra-group transactions remain, however, subject to the scrutiny from the CSSF with a view to managing and preventing liquidity risks (Circular CSSF 09/403).

6 What are the principal regulatory challenges facing the banking industry?

The banking industry has to face the new wave of regulatory and reporting obligations resulting from the 2008 financial crisis, mainly imposed by the EU regulations. This will impose new organisational and technical constraints on financial institutions, who will be subject to a whole set of new regulatory requirements, in particular following the implementation of the Capital Requirement Directive IV (CRD IV) package. Unlike in other EU Member States, stringent requirements for transparency and exchange of banking information is expected to reshape private banking activity in Luxembourg, which will be adversely affected and will certainly decrease its activities in coming years.

On 17 July 2013 the CRD IV package was transposed – via a regulation and a directive, and the new global standards on bank capital (Basel III) – into EU law and entered into force. The new rules apply from 1 January 2014 and address some of the vulnerabilities shown by banking institutions during the financial crisis back in 2008: the insufficient level of capital (both in quantity and in quality) resulting in the need for unprecedented support from national authorities, by setting stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. Furthermore, the CRD IV package unifies capital requirement standards throughout the EU, thereby creating a common ground for comparison.

The European legislative framework on short selling and certain aspects of credit default swaps (CDSs) fully applies as from 1 November 2012. It is binding in its entirety and directly applicable in Luxembourg. The provisions governing short selling and certain aspects of credit default swaps in Europe are set out in a variety of EU Regulations (eg, Regulation No 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps, Regulation (EU) No 826/2012 of 29 June 2012 supplementing Regulation (EU) No 236/2012 and Regulation (EU) No 827/2012 of 29 June 2012 laying down implementing technical standards).

The coming year will see European Market Infrastructure Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories coming into full action (EMIR). The purpose of EMIR is to introduce new requirements to improve transparency and reduce the risks associated with the derivatives market. EMIR also establishes common organisational, conduct of business and prudential standards for central counterparties (CCPs) and for trade repositories and applies to all financial and non-financial counterparties established in the EU that enter into derivative contracts.

As from 12 February 2014 EMIR also requires that all financial and non-financial counterparties report details of their derivative contracts – regardless of whether traded OTC – to a trade repository. This reporting obligation applies to derivative contracts that were entered into before 16 August 2012 and remain outstanding on that date, and those entered into on or after 16 August 2012.

It is also expected that the clearing obligations via CCPs will kick in during 2014.

The Law dated 12 July 2013 on Alternative Investment Fund Managers (the AIFM Law) transposed EU Directive 2011/61/EU on

Alternative Investment Fund Managers (AIFMD) into Luxembourg law. The AIFM Law, introducing a new supervisory regime for the responsible managers of alternative investment entities, also affects the banking and financial services sector, insofar as the depository in charge of the safekeeping of the AIF and qualifying as a credit institution, investment firm or – under certain conditions – the newly created 'PSF' category of 'depositary' under the Financial Sector Law has to be appointed for each alternative investment fund. In this context it is noteworthy that the AIFM Law introduced a new type of PSF (professionals of the financial sector), defined as a 'professional depository for assets others than financial instruments'.

7 How has regulation changed in response to the 2008 financial crisis?

A spectrum of substantial measures were taken by the Luxembourg legislator and the CSSF in the aftermath of the global financial crisis, among these the capital guarantees granted by the government as well as the enhancement of client fund protection under the AGDL.

In December 2012 the CSSF issued a new circular on central administration, governance and risk management requirements for Luxembourg credit institutions and investment firms. CSSF Circular 12/552 updated and replaced a number of existing CSSF circulars and came into force on 1 July 2013, except for certain specific provisions (eg, composition of management boards, specialised committees and policies), which were applicable from 1 January 2014. The Circular addresses the following key areas:

- composition, roles and responsibilities of the board of directors, supported by specialised committees;
- qualification, independence and prerogatives of internal control functions – risk management, compliance and internal audit, and the roles and responsibilities of the finance, accounting and IT departments as key contributors to appropriate internal governance;
- the importance of transparent decision-making; and
- risk culture and alert mechanisms, including whistleblowing.

At the end of January 2013, the EBA announced the key components of the forthcoming 2014 EU-wide stress test that will be conducted on a wide sample of EU banks. Its implementation will be among the first occasions on which the ECB will act in its new supervisory role over the eurozone banks.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

There is a clear trend towards further tightening and enhancing the existing regulatory framework for banking business in the EU. By way of example, the current MiFID regime will be updated, extended and strengthened via MiFID II and MiFIR, and the upcoming 'Packaged retail investment products (PRIPS)' regulation will also impose more documentary tasks and stricter formalities by introducing a mandatory 'key information document' (KID), currently required for investment funds qualifying as UCITS, for a broad range of investment products offered and distributed also by credit institutions. The PRIPS regulation also goes to show that EU regulatory initiatives address legal loopholes and inconsistencies among sector regulations with a view to achieving a level playing field within the financial sector in its entirety, covering insurances, asset management, financial intermediaries and banking.

In line with the US Volcker Rule, stricter rules will be introduced in the EU for the largest banks, banning proprietary trading in financial instruments and commodities as from 2017. According to the draft regulation on structural measures improving the resilience of EU credit institutions EU financial regulators will have the power to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading entities within a banking group. Along with this proposal, the European Commission will adopt accompanying measures aimed at increasing transparency of certain transactions in the shadow banking sector.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The supervision of banks by the CSSF aims to ensure the security of public savings by monitoring the solvency and prudent management of banks, ensuring financial stability and proper functioning of the banking system as a whole, and protecting the reputation of the financial sector by censuring unacceptable conduct. The CSSF monitors the application of laws and regulations with respect to quantitative standards that pertain to minimum equity capital, the ratio between own funds and risk exposure, limitations of risk concentration on a single debtor or maximum groups of associated debtors, liquidity ratio, limitation of qualified participation interest, and qualitative standards that relate to structure, organisation, risk exposure, and internal control or management of the banks.

With regard to the means of supervision and ongoing surveillance of the banks, the CSSF relies heavily on reporting provided by the external auditors of the credit institutions. Reporting made in the form of management letters or a long-form report provides a broad range of operational information that the CSSF could not otherwise obtain.

The CSSF also implements a regime of both onsite and off-site supervision. It may make any request it deems necessary to carry out its supervisory duties, including inspection of the books and records of the banking entities. Although the CSSF used to conduct relatively few onsite supervisory visits, their numbers have increased drastically in recent years. Occasionally, the CSSF organises inspections to address specific concerns detected in a bank. The CSSF also relies on qualitative and quantitative reports prepared by the banks' internal auditors. The reports are drafted according to guidelines and methodologies that it has issued via specific circulars.

10 How do the regulatory authorities enforce banking laws and regulations?

When the CSSF identifies deficiencies, it may limit its action to simple monitoring, addressing a letter emphasising the inventoried deficiencies and shortcomings in the management, convening the bank's management, or undertaking onsite inspections. It also may use its powers of injunction and suspension. To ensure compliance with the laws and regulations of the financial sector, the CSSF has at its disposal various means of intervention, including:

- injunction to remedy identified deficiencies;
- suspension of persons, suspension of the voting rights of certain shareholders, or suspension of activities of the entity;
- imposition of administrative fines on persons in charge of administration or management;
- requesting that the courts order that payments be suspended and that the entity be placed under controlled management; and
- requesting that the courts order the winding up and liquidation of an undertaking.

Furthermore, the CSSF may report any infringement of the Financial Sector Law to the public prosecutor subject to criminal sanctions, including:

- persons or entities carrying out activities in the financial sector without a licence;
- persons or entities carrying out the activities of company domiciliation without being so entitled; or
- persons attempting fraud.

In addition, credit institutions and their management, either natural or legal persons, can be sanctioned or fined when they:

- fail to comply with applicable laws, regulation, statutory provisions, or instructions;
- refuse to supply the CSSF with the information requested or when the supplied information is revealed to be incomplete, inaccurate or false;
- prevent or hinder inspections carried out by the CSSF;
- do not meet the rules regarding the publications of financial statements;
- fail to act in response to CSSF injunctions; or
- act in a manner to jeopardise the sound and prudent management of the credit institution.

Each of these events may entail the CSSF imposing fines ranging from €250 to €250,000 or prohibiting them from participating in the profession.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In its annual report for 2012 (the 2013 report was not yet available at the time of writing) the CSSF disclosed what regulatory interventions it had carried out during the course of that year.

In 2012 the CSSF reiterated its emphasis on carrying out more onsite inspections. Consequently, the number of people involved in such inspections has substantially increased, allowing the CSSF to carry out 158 inspections at the premises of financial players in 2012. Generally, all onsite inspections are followed by observation letters sent to the controlled banks. In the event of more serious flaws, the CSSF analyses whether there is a need for an injunction procedure or a non-litigious administrative procedure in order to impose administrative sanctions pursuant to article 63 of the Financial Sector Law.

Ad hoc control missions are onsite inspections intended to investigate a specific – or even worrying – situation relating to the professional itself. The particular situation will have, in principle, already been documented during the off-site prudential supervision. Such missions may either be planned in advance or occur unexpectedly. The nature and scale of ad hoc missions may vary significantly and subsequently determine the composition of the onsite teams. In 2012, the CSSF carried out 35 ad hoc missions. As regards banks, three were organised under the lead of foreign authorities and two related to aspects of undertakings for collective investments (UCIs). The other missions concerned specific risk analyses (eg, market rate risk or interest rate risk). With regard to one of the missions, the matter is currently being analysed in order to determine whether a non-litigious administrative procedure should be initiated so as to impose an administrative sanction.

In 2012, the CSSF imposed nine administrative fines pursuant to article 63 of Financial Sector Law, among these seven, each amounting to €10,000, on persons in charge of the management of credit institutions and two (one of €50,000 and the other of €100,000) on credit institutions themselves. These fines were imposed due to non-compliance with the professional obligations regarding the fight against money laundering and terrorist financing, for non-compliance with the obligations regarding internal control or for providing support for a transaction aimed at circumventing foreign legislation. A formal reprimand was given to a credit institution for serious breach of the obligation to implement an adequate internal control mechanism. Moreover, in 2012, the CSSF filed three complaints with the state prosecutor related to the illegal exercise of banking and financial activities by unauthorised entities.

12 How has bank supervision changed in response to the 2008 financial crisis?

A strong tendency to build up and strengthen central control mechanisms at EU level, set to replace or supplement to a large extent the supervision by national regulators, can be seen. On 29 June 2012 the European Council decided to create an SSM for banks in the euro area in exchange for the ability to directly recapitalise banks in distress via the ESM (European Stability Mechanism). A proposal for a European regulation conferring specific tasks on the European Central Bank (ECB) as regards the prudential supervision of credit institutions was published on 14 December 2012 providing for the transfer of an important number of the national authorities' competences in prudential supervision to the ECB, including the authorisation and withdrawal of authorisation of banks and the authorisation of qualified shareholders.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Luxembourg law does not provide for specific rules or statutory provisions on the nationalisation of credit institutions and other PSFs. For the time being the legal framework for situations of financial distress (see question 20), along with the temporary lending or the availability of changes in control in distressed banks (eg, the takeover of Dexia BIL by the Qatari sovereign fund) have so far been sufficient to tackle cases of imminent or occurred bank insolvencies.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Currently, Luxembourg regulations do not provide for a specific resolution regime akin to the 'living will' rules under US legislation. This may well change in the foreseeable future, as the upcoming Basel III regulations and the future EU Directive on recovery and resolution of credit institutions and investment firms foresee the introduction of such resolution regimes in the European Union (see question 3).

The future EU Directive on recovery and resolution of credit institutions and investment firms aims at establishing an effective recovery and resolution framework across the European Union and at equipping the relevant authorities of the member states with common and effective tools and powers to address further banking crises. According to this Directive EU banks will be required to produce a detailed recovery plans on entity and group basis. National regulatory authorities will also have broad powers to remove impediments to the implementation of recovery plans, will draw up resolution plans at bank or group level and may require banks to take appropriate action to ensure that impediments be removed. Banks will be required to hold capital equal to a percentage, to be set by the national resolution authority on an institution-by-institution basis, of the total of their liabilities, and creditors and counterparties may be subject to temporary moratoria and other restrictions on enforcing security and exercising contractual termination rights.

With regard to Luxembourg bank management guidelines, reference is made to CSSF Circular 12/552 on central administration, governance and risk management requirements for Luxembourg credit institutions and investment firms (see question 7).

15 Are managers or directors personally liable in the case of a bank failure?

Luxembourg law does not provide for a specific liability or responsibility regime for managers or directors of failed credit institutions;

hence, the general rules under the Law of 10 August 1915 on commercial companies (Commercial Companies Law) apply in cases of bankruptcy or insolvency of credit institutions. The Commercial Companies Law stipulates the liability of managers and directors with regard to the company for the execution of their mandates and any related wrongdoing or misconduct. This general liability regime applies to any corporate company established as a public limited company.

16 How has bank resolution changed in response to the recent crisis?

The current bank resolution regime, as it stands, has not been adapted or amended in response to the financial crisis of 2008. The draft EU Directive on Recovery and Resolution of credit institutions and investment firms was, however, proposed not least as a reaction to the banking turmoil back in 2008 providing precautionary measures and imposing an effective recovery and resolution framework across the European Union (see question 14).

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Since January 2014, credit institutions have been subject to CRD IV and the capital requirement regulation. Banks are therefore required to comply with the prescribed liquidity coverage ratio (LCR) and report it to the Luxembourg authorities on a monthly basis. The LCR compares the stock of high-quality liquid assets (HQLA) held by the banks with the total net cash outflows expected over the next 30 days. This requirements aims to ensure that banks maintain enough liquid assets to survive for 30 days in a stress scenario, as specified by the CSSF. Until the LCR becomes binding in 2015, the old liquidity ratio of at least 30 per cent still applies.

Due to the CRD IV package the current capital adequacy requirements in place will undergo certain changes. Currently, banks must have total capital of at least 8 per cent of risk-weighted assets (RWAs). Whereas this percentage does not change under CRD IV, the minimum requirement for Tier 1 capital is, however, increased from 4 per cent to 6 per cent, and the minimum requirement for common equity Tier 1 (CET 1) is increased from 2 per cent to 4.5 per cent. CRD IV also tightens the definition of common equity, and the definition of what amounts to Tier 2 capital is simplified with all subcategories (such as upper Tier 2 and lower Tier 2) removed; the concept of Tier 3 capital is abolished. In line with Basel III, CRD IV creates five new capital buffers: the capital conservation buffer, the countercyclical buffer, the systemic risk buffer, the global systemic institutions buffer and the other systemic institutions buffer. The capital conservation buffer is designed to ensure that firms build up capital buffers outside periods of stress that can be drawn down as losses are incurred. A capital conservation buffer of 2.5 per cent, comprising CET 1, is established above the regulatory minimum capital requirement The bank-specific countercyclical capital buffer will require banks to build up a buffer of capital during periods of excessive credit growth. The countercyclical capital buffer rate to be set by the CSSF must be between 0 per cent and 2.5 per cent of RWAs of firms that have credit exposure in Luxembourg, unless the CSSF considers, in the light of its economic conditions, that the countercyclical capital buffer rate should exceed 2.5 per cent. Banks that fail to meet the capital conservation buffer or the countercyclical capital buffer will be subject to constraints on discretionary distributions of earnings. Luxembourg is able to apply systemic risk buffers of 1 per cent to 3 per cent for all exposures and up to 5 per cent for domestic and third-country exposures without having to seek prior approval from the Commission – they will be able to impose even higher buffers with prior approval from the Commission. If Luxembourg decides to impose a buffer of up to 3 per cent for all exposures, the buffer has to be set equally on all exposures located within the EU.

In 2014, credit institutions will also have to start reporting elements of the net stable funding ratio (NSFR), which aims to ensure that banks maintain stable sources of funding for more than one year relative to illiquid assets and off-balance sheet contingent calls. Although not binding until 2018, the NSFR is likely to be modified or altered during the course of the coming years.

In addition to the liquidity ratio, banks are also required to meet strict criteria regarding risk management in general. Banks must implement processes to identify, measure, manage and report liquidity risks to which they are exposed and adopt internal guidelines to plan and manage their liquidity requirements, including liquidity buffers.

18 How are the capital adequacy guidelines enforced?

According to article 53 of the Financial Sector Law, the CSSF has full supervisory and investigatory powers to ensure the enforcement of the capital adequacy provisions including access to all relevant documents, questioning of any person and onsite inspections or investigations. The CSSF may also enjoin institutions to cease any practices that it considers contrary to the capital adequacy provisions and it can request the freezing or confiscation of assets. In addition, the CSSF may request approved external auditors to provide information on a financial institution or require them or suitable experts to carry out onsite verifications or investigations on a financial institution. It may even request temporary banning of professional activity against persons subject to its prudential supervision, as well as restricting or limiting the business, operations or network of banks. Furthermore, in the event of non-compliance with the capital adequacy requirements, the fines mentioned above (see question 10) can be imposed by the CSSF on the administrators of the bank or any other persons subject to its supervision.

19 What happens in the event that a bank becomes undercapitalised?

According to article 59 of the Financial Sector Law, the CSSF, when noting that the bank does not meet its capital adequacy commitments, must charge the bank, by registered letter, to remedy the capitalisation deficiency within such period as its sets out. If, at the end of the time limit imposed by the CSSF, the required level of capitalisation is not reached, the CSSF may, inter alia, suspend the board members or managers of the bank, suspend the exercise of voting rights of shareholders whose functions or influence may be detrimental to the restoration of the capital adequacy requirements, or both. Such decisions adopted by the CSSF take effect with regard to the person in question from the date on which they are notified by registered letter or served by a bailiff as a writ. Where, as a result of a suspension order by the CSSF the administrative, executive or management body of the bank no longer has the minimum number of members prescribed by law or by its articles of incorporation, the CSSF must fix the period by registered letter within which the institution concerned must replace the suspended persons and fill the vacancies. The CSSF may disclose to the public any suspensive measure unless such disclosure would disrupt the financial markets or to be disproportionately detrimental to the parties involved.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Financial Sector Law provides for a suspension of payments procedure in the event that a bank becomes insolvent. Pursuant to article 60-2 of the Financial Sector Law a bank (or the CSSF) may apply for a suspension of payments declaration to the Luxembourg District Court in the event of an acute shortfall in liquidity or a similar insolvency situation (eg, creditworthiness is undermined or the bank's ability to meet its commitments in full is compromised). This procedure brings about a temporary suspension of all payments by the distressed bank and prohibits all acts and decisions unless authorised by the administrators. The judgment ordering suspension of payments lays down the conditions and procedures applicable to the suspension of payments, applicable for a maximum of six months.

The Financial Sector Law further provides that a bank may be dissolved and wound up if it has become apparent that the previously ordered suspension of payments has not been sufficient to rectify the situation or the establishment's financial position has been undermined to such an extent that it can no longer meet its commitments to creditors and stakeholders. Only the CSSF or the public prosecutor may apply to the competent district court for an order to dissolve and wind up a bank. When ordering the winding up, the district court must appoint an official receiver and one or more liquidators. It will also determine the manner in which the winding up is to be carried out.

One or more administrators are appointed by the district court to control the management of the bank's assets. The judgment granting the suspension of payments is published in the Luxembourg official gazette and in two national newspapers and one foreign newspaper with a sufficiently large circulation. Additional publications and a notification by the CSSF to the relevant national regulatories authority are required for banks with branches abroad.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The capital adequacy guidelines for credit institutions governed by Luxembourg are about to undergo ground-breaking changes due to the CDR IV package. The CRD IV package provides new rules on capital requirements for credit institutions and investment firms and aims to put in place a comprehensive and risk-sensitive framework and to foster enhanced risk management among financial institutions (see question 17 above). Full implementation of the reform package is foreseen by 1 January 2019. In addition to provisions addressed to national authorities, such as authorisation, shareholder control and supervisory measures and sanctions, the directive also covers qualitative provisions on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP). As well as disclosure obligations, the Regulation on prudential requirements for credit institutions and investment firms contains quantitative requirements, including own funds and capital, liquidity and leverage ratio requirements. The CRD IV package will be supplemented by more than 100 technical regulatory standards, technical implementation standards and guidelines, the development of which will be overseen by the EBA.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Natural and legal persons are acceptable as shareholders in a bank. The authorisation of a new shareholder acquiring a qualifying interest in the bank is subject to the prior communication to the CSSF of the identity of the shareholders and of the amounts of those holdings. 'Qualifying holding' means any direct or indirect holding in the bank that represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the bank in which the participation is taken.

Authorisation is subject to the condition that the shareholders with a qualifying holding fulfil the required conditions to ensure sound and prudent management. The concept of sound and prudent management must be assessed in light of five criteria listed in article 6 of the Financial Sector Law: the professional standing of the shareholders, the professional standing and experience of any person who will direct the business of the bank after obtaining authorisation, the financial soundness of the shareholders, the compliance with the prudential and supervisory requirements at group level, and the risk of money laundering and terrorist financing. Moreover, the authorisation of the new shareholder is subject to the condition that the structure of its direct or indirect stakeholders be transparent and organised in such manner that the CSSF, as responsible authority for the prudential supervision of the bank and, where applicable, of the group to which it belongs, be clearly identifiable. This transparency requirement will allow the prudential supervision of the CSSF and any other competent regulatory authorities to be exercised without hindrance and in the most efficient way. The CSSF requires that the group structure of the shareholder-to-be allow the exercise of effective supervision, as well as the effective exchange of information and a clear allocation of responsibilities among the competent regulatory authorities.

In order to obtain approval as a shareholder with a qualifying participation in the bank natural persons and, in the case of legal persons, the members of the administrative, management and supervisory bodies and the shareholders or members with a qualifying holding must produce evidence of their professional standing. Professional standing is assessed on the basis of police records and of any evidence showing that the persons concerned have a good reputation and offer every guarantee of irreproachable conduct.

In order to assess the professional standing of the persons indicated above, the natural and legal persons concerned must fill in, sign and send to the CSSF the 'Declaration of honour' document, available for download from the CSSF website. Moreover, a natural person must transmit a copy of his or her identity documents, a curriculum vitae and an extract of his or her police record to the CSSF. Legal persons must also transmit a copy of their coordinated articles of association, an extract from the trade and companies registry and the annual reports (balance sheet and profit and loss account) for the past three years.

23 Are there any restrictions on foreign ownership of banks?

Participations in Luxembourg banks may be held by foreign residents or nationals. Whereas no legal or regulatory restrictions in this regard exist under Luxembourg law, the direct and indirect shareholding structure of the bank must nevertheless stay transparent and at all times be organised in such a way that the CSSF is not compromised in the exercise of its regulatory supervision. Hence, if the laws, regulations or administrative provisions of a third country governing one or more natural or legal persons with which the bank has close links prevent the CSSF from effectively exercising its supervisory functions, the acquisition by the respective foreign investors will be denied. Likewise, an authorisation is refused if difficulties involved in the enforcement of these provisions prevent the CSSF from effectively exercising its supervisory functions.

24 What are the legal and regulatory implications for entities that control banks?

There are no specific regulatory implications for controlling entities of Luxembourg-regulated banks. The obligations to report annually the identity of the shareholders of the bank to the CSSF are incumbent on the CSSF-regulated bank itself – no action is required from the shareholders themselves in this regard. As communicated by CSSF Circular 12/553 of 24 December 2012 the respective reporting table (B4.5 'Analysis of shareholdings') was updated. The identity of the shareholders must be communicated to the CSSF when these persons hold, directly or indirectly, at least 10 per cent of the capital or the voting rights attached to the shares of the bank (no longer 5 per cent).

Direct action is, however, required when shareholders intend to augment their participations in Luxembourg-regulated credit institutions. As stated in article 6 of the Financial Sector Law shareholders further increasing, directly or indirectly, their qualifying holdings, as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 per cent, 33.33 per cent or 50 per cent, or so that the bank would become their subsidiary, are required to first notify such decision to the CSSF in writing indicating the size of the intended (increased) holding and relevant supporting information.

Likewise, natural or legal persons must inform the CSSF if it has taken the decision to reduce its qualifying holding so that the proportion of voting rights or capital held would fall below 20, 33.33 or 50 per cent, or so that the credit institution would cease to be its subsidiary.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Please refer to question 24 above.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

In the normal course of events the bankruptcy of a bank does not affect the shareholders, apart from the financial consequences (devaluation) for the participation held in the bank's capital. In the event of an insolvency, however, shareholders that control and influence the bank in undue manner – acting, in other words, as de facto managers – may be deemed personally accountable for the bankruptcy and consequently be held responsible for the debts of the bank if the conditions set out in article 495 of the Luxembourg Commercial Code are met. In particular, a controlling entity may be declared specifically liable if it, under the protection of the bank, acted in its own interests, disposed of the bank's property as its own or improperly pursued, for its own benefit, an operating deficit when it was clear that this would lead to a suspension of payments. Moreover, the court may order such controlling entity to bear all or part of the debts of the bank if its gross negligence contributed to the bank's insolvency (article 495-1 of the Commercial Code).

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The authorisation of a new shareholder acquiring a controlling interest in the bank follows the rules set out for the acquisition of a qualifying interest (see question 22).

Where the shares of bank are admitted to trading on a regulated market, acquisitions are also regulated by the general provisions on takeover bids and changes of control pursuant to the Law on Takeover Bids dated 19 May 2006, implementing the EU Directive 2004/25/EC as amended. In this case, additional conditions must be met (eg, due and timely information concerning the bid and disclosure to the CSSF).

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The majority of Luxembourg banks are part of international banking groups or otherwise held by foreign entities. The acquisition of BIL, as well as KBL European Private Bankers SA by an investment group owned by the state of Qatar, may be cited as more recent examples of foreign investment in the Luxembourg financial sector.

Provided the conditions set out under questions 22 are met, in particular when the seamless regulatory supervision by the CSSF is ensured, there are no legal impediments or regulatory entry barriers for foreign acquirers.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

Please refer to the preconditions and requirements of the CSSF authorisation process described in detail in question 22. Further guidance to the approval of a change in control in a Luxembourg bank is given in the Appendix II of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector.

Please see question 30 for further details on these guidelines.

30 Describe the required filings for an acquisition of control of a bank.

According to article 6, paragraph 6 of the Financial Sector Law, the CSSF is obliged to make publicly available a list specifying the information that is necessary to carry out an assessment of the planned acquisition and which must be provided to it at the time of notification. The CSSF complied with this statutory obligation by referring to the requirements list attached as Appendix II to the Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC, as published by CEBS, ESMA and CEIOPS on 11 July 2008.

According to this requirements list, the following pieces of information and documentary proof must be provided to the CSSF for the approval of an intended acquisition of control in a Luxembourg-regulated credit institution. Natural persons planning to acquire a Luxembourg regulated bank are obliged to provide the following:
- name, date, place of birth and address;
- a complete and detailed curriculum vitae;
- information on any relevant criminal records, investigations or proceedings, relevant civil or administrative cases and disciplinary actions, investigations, enforcement proceedings or sanctions by a supervisory authority with respect to the acquirer or any company he or she has ever controlled or directed;
- information on any previous assessment of reputation conducted by a supervisory authority;
- details of sources of revenue, assets and liabilities of the proposed acquirer and pledges and guarantees he has granted;
- a description of his or her professional activities;
- ratings and public reports on the companies controlled or directed by the acquirer and if available, on the acquirer him or herself; and
- a description of the financial and other interests or relationships of the acquirer with current shareholders of the bank, its board members, etc.

For legal persons acting as acquirers the following is required:
- evidence of business and the registered name and address of the head office;
- registration of legal form;
- an up-to-date overview of entrepreneurial activities;
- detailed shareholding structure of the acquirer or organisational chart of the group the acquirer may be part of and information on any shareholder agreements and group companies that are supervised by a supervisory authority;
- complete and audited financial statements for the three most recent financial periods; and
- information about the acquirer's credit rating and its group's rating.

In addition, information has to be provided on the target bank, the aim of the acquisition and the shareholding in the bank's capital already owned by the proposed acquirer.

Furthermore, the CSSF must be informed about the funding of the share purchase (on any private resources financing the acquisition, the transfer of funds, access to capital sources and financial markets, borrowed funds, etc).

Finally, the guidelines also contain a list of information to be provided to the CSSF in the event of a change of control of a bank or the acquisition of qualifying holdings by acquirers.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

Pursuant to article 6, paragraph 7 et seq of the Financial Sector Law, the CSSF must promptly and, in any event, within two working days of receipt of the notification, acknowledgement receipt thereof in writing to the proposed acquirer. The CSSF has a maximum of 60 working days from the date of sending the acknowledgement of receipt of the notification and all the documents required to be attached to the notification to carry out the assessment; the CSSF must indicate the date of expiry of this assessment period in the acknowledgement of receipt it sends to the proposed acquirer. The CSSF may request any further information that is necessary to complete the assessment during the assessment period if necessary, but no later than the 50th working day of such period. The request must be made in writing and must specify the additional information needed. For the period between the date of request for further information by the CSSF and the receipt of a response thereto by the proposed acquirer, the assessment period must be interrupted, but the interruption may not exceed 20 working days. Any further requests by the CSSF for completion or clarification of the information will be at its discretion but may not result in further interruption of the assessment period. The CSSF may extend the interruption to 30 working days if the proposed acquirer is situated or regulated in a third country or is not subject to regulatory supervision according to the applicable EU Directives (ie, Directives 2006/48/EC, 92/49/EEC, 2002/83/EC, 2004/39/EC, 2005/68/EC and 85/611/EEC). If the CSSF, upon completion of the assessment, decides to oppose the acquisition, it must inform the proposed acquirer in writing within two working days and not outside the assessment period, and provide the reasons for that decision. If the CSSF does not oppose the acquisition within the assessment period in writing, it will be deemed approved.

Update and trends

On the horizon of regulatory challenges for the Luxembourg banking sector is already looming the follow-up directive to the Markets in Financial Instruments Directive 2004/39/EC dated 21 April 2004 (MiFID II). The MiFID II reform will herald many changes to the trading rules in the EU, requiring trading to take place on regulated platforms, and introducing a trading obligation for derivatives to complement the clearing requirement already embodied within EMIR. Limits on the positions held in commodity derivatives will be introduced, as well as trading controls for algorithmic trading. MiFID II will also strengthen investor protection, extending the scope of appropriateness tests for products to retail investors, and reinforcing the role of senior management in product governance. The new framework makes a distinction between independent and non-independent advice and limits the receipt of inducements. It also gives ESMA the powers to restrict or ban the marketing and distribution of certain financial instruments. The reform also introduces access rights to EU markets for third-country firms, based on an equivalence test.

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