Banking Regulation

Contributing editor
David E Shapiro

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GETTING THE DEAL THROUGH

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Luxembourg

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Vandenbulke

Regulatory framework

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

The 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 around 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), or the automatic and mutual exchange of information under the Common Reporting Standard (CRS), and is moving to offer the required reporting for international banking clients with cross-border interests. Bank secrecy rules have now been eased and automatic exchange of information has been in place since 1 January 2015 with more stringent reporting, transparency and monitoring requirements for banking activities.

A further trend is the continued diversification of activities into new markets in the financial sector. The government is also keen to strengthen the organisational rules of the depositary regime and reporting obligations for undertakings for collective investment in transferable securities (UCITS) and other investment funds, and ensure an adequate risk management policy at the level of the whole banking and 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 Capital Requirement Directive IV of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (2013/36/EU) (CRD IV), the Bank Recovery and Resolution Directive of 15 May 2014 (2014/59/EU) (the BRR Directive) 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 31 May 1999 governing the domiciliation of companies;
- Law of 12 November 2004, as amended, on the fight against money laundering and terrorist financing;
- 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 6 April 2013 on dematerialised securities;
- Law of 12 July 2013 regarding EU short-selling regulation;
- Law of 12 July 2013 relating to alternative investment funds managers;
- Law of 28 July 2014 regarding immobilisation of bearer shares and unit;
- Law of 23 July 2015 transposing into Luxembourg law Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013;
- 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 (the BRR Law) transposing into Luxembourg law the BRR Directive; and
- Law of 18 December 2015 on automatic exchange of financial account information in tax matters.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The Financial Sector Supervisory 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 and 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 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

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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).

As from 4 November 2014, a two-pillar mechanism known as the European Banking Union has been implemented under the form of a single supervisory mechanism (SSM) and a single resolution mechanism (SRM).

The SSM is detailed in the European Central Bank Regulation EU No. 468/2014 of 16 April 2014 and entrusts power over 'significant' eurozone banks to the European Central Bank (ECB). The three most significant banks in each participating member state qualify as 'significant' as well as other banks meeting certain criteria, both in quantitative and qualitative terms. As from 4 November 2014, the ECB became the direct supervisor of 120 significant banks of the eurozone. In Luxembourg, six entities are qualified significant and are therefore supervised directly by ECB. The CSSF is in charge of assessing, at least once a year, whether a bank satisfies any of the 'significant' criteria. The CSSF remains responsible for the supervision of less significant institutions under the oversight of the ECB.

The SRM was adopted in July 2014 and ensures, 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 SRM applies as from 2015 together with the Bank Recovery and Resolution Directive.

In Luxembourg, the BRR Law, which implemented the BRR Directive on 18 December 2015, designates the CSSF as the competent Luxembourg resolution authority and sets forth a rulebook for the resolution of banks and large investment firms with the view to improve bank crisis management in the aftermath of the 2008 financial crisis.

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.

The Luxembourg deposit guarantee and investors' compensation system has been amended by the new institutional framework stated by the BRRD Law. According to this new law, the Luxembourg Deposit Guarantee Fund (LDGF) based on a new public ex ante financing replaces the former Association for the Guarantee of Deposits, the former private ex post financing system.

Hence, any credit institution established in the Grand Duchy is required to adhere to the LDGF and, in a first stage ending in 2018, to fund the LDGF with contributions aiming to reach 0.8 per cent of the total guaranteed deposits. Thereafter, an additional cushion of 0.8 per cent is provided in the law that may be collected from the banks over a period of eight years, but may be extended depending on the economic context. This additional cushion will not be included in the mutual European deposit guarantee fund.

The LDGF 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 LDGF ensures reimbursement of all deposits of up to €100,000 held with the bank, covering both natural persons and legal entities, irrespective of their residence in the European Union and the currency of the account. The absence of discrimination between large and small or medium-sized companies is one of the major changes with the former deposit guarantee system. The BRRD Law also sets out a list of exclusions to the deposit guarantee including, among other entities, undertakings for collective investments, pension funds, public authorities and certain insurance companies. Besides this deposit guarantee limit of €100,000, the BRRD Law also provides that under specific circumstances, for instance in respect of deposits resulting from real estate transactions in relation to private properties or deposits related to social objectives, the LDGF may guarantee deposits up to €2.5 million. Other changes relate to the term of repayment of depositors, which is reduced from 20, under the former deposit guarantee scheme, to seven working days. The CSSF is now in charge of the deposit guarantee and investor's compensation systems through a new department, the 'Council of protection of depositors and investors'.

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 provides for a specific procedure in respect of the entering into of a group financial support agreement between a credit institution and any of its subsidiaries in any EU member state or any financial institutions covered by the consolidated supervision of the parent undertaking. This specific procedure was introduced into the Financial Sector Law by the Law of 18 December 2015, transposing the BRR Directive, and only targets agreements providing financial support that meet the conditions for early intervention, meaning that the credit institution benefiting from the financial support is experiencing difficult financial conditions. It requires the approval of the CSSF, which shall check that the agreement complies with specific principles, including: that each party must be acting freely and in its own best interest and that the relevant information from any party receiving financial support has been fully disclosed to the other parties. More generally, the CSSF will also verify that specific conditions are fulfilled relating generally to the impact of the group financial support agreement on the stability, liquidity or solvency of the banking group and more generally on the stability of the financial sector.

Apart from this specific procedure, 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). In particular, the CSSF exercises a prudential supervision on a consolidated basis on any Luxembourg parent company which holds directly or indirectly 20 per cent or more of the capital or voting rights of another credit or financial institution.

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 has imposed new organisational and technical constraints on financial institutions, who are subject to a whole set of new regulatory requirements, in particular following the implementation of the Capital Requirement Directive IV (CRD IV) package and its subsequent regulations. Unlike in other EU member states, stringent requirements for transparency and exchange of banking information is reshaping private banking activity in Luxembourg, which is being adversely affected and will certainly result in a decrease of 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. On 27 October 2014, the CSSF released circular No. 14/593, which has already been amended twice in 2015, replacing several previous circulars, detailing the reporting requirements applicable to credit institutions as from 2014 following the implementation of the CRR/CRD IV and SSM.

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

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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 European Market Infrastructure Regulation 648/2012 (EMIR) (as amended by Regulation 2365/2015 on OTC derivatives, central counterparties and trade repositories) has been in force since 12 January 2016. 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 and for trade repositories and applies to all financial and non-financial counterparties established in the EU that enter into derivative contracts.

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 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'.

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.

A summary of the EMIR obligations applicable to banks has been detailed in CSSF circular 13/557, with additional information provided in a CSSF Press release 14/11. In addition, as from 2014 new supervisory requirements entered into force pursuant to Regulation EU 575/2013 on prudential requirements for credit institutions and investment firms (CRR). The technical standards to be implemented are further detailed in the Circular CSSF 14/593 implementing Commission Regulation 680/2014 of 16 April 2014.

The BRRD Directive has been transposed into Luxembourg law by the BRRD Law and recast the guarantee deposit system as detailed under question 4. It also reshapes the Luxembourg legal framework applicable to the resolution and liquidation of credit institutions by reforming the regulations applicable to the restructuring of credit institutions encountering serious financial difficulties in order to allow the continuity of their core activities and avoid any systemic impact. Finally it amends the Financial Sector Law to comply with the provisions of the BRRD Directive in the case of reorganisation and winding-up.

On 1 August 2015, the FATCA law adopted on 24 July 2015 (the FATCA Law) became effective. Among other provisions, the FATCA Law implemented the intergovernmental agreement entered into on 28 March 2014 between the Grand Duchy and the United States in order to comply with the FATCA regulation in force in the United States. This Act requires that any foreign financial institution reports to the US tax administration any US account holders (and US beneficial owners of passive non-financial foreign entities). FATCA imposes a 30 per cent US withholding tax on US-sourced payments to foreign financial institutions (including banks, brokers, custodians and investment funds) that fail to comply with the FATCA rules.

Other new reporting obligations bearing on financial institutions have been implemented in Luxembourg such as the Common Reporting Standard transposed by the Law of 18 December 2015 on the Automatic Exchange of Financial Account Information (the AEoI Law) or the European Securities Financing Transactions Regulation (Regulation 2015/2365/EU).

Finally the AEoI Law, implementing the OECD standard on the automatic exchange of information entered into force as of 1 January 2016. The AEoI Law has been passed to counter tax evasion (around 100 countries already committed to participating in the automatic exchange of financial account information) and represents a big step to the globalised disclosure of income earned by individuals and organisations Concretely, financial institutions (FIs) in participating jurisdictions as defined in the OECD CRS will collect tax-relevant information about their clients by enhancing their due diligence procedures. Then, FIs will report this tax relevant information with respect to their clients (encompassing account holder, beneficial owner and potentially controlling person (together the 'investors')) who are resident in another participating jurisdiction to the local tax authorities. Subsequently, the local tax authorities of the FI will exchange the information with their counterpart in the participating jurisdiction where the investor is subjected to tax.

7 Are banks subject to consumer protection rules?

Banks are subject to consumer protection both enacted at the level of the European Union and at the Luxembourg national level. The adoption of the consumption code on 8 April 2011 (*code de la consommation*) has transposed in the Luxembourg internal regulation the EU Directive 2008/48/EC on credit agreements for consumers. This Directive aims to harmonise the laws, regulations and administrative provisions of the member states covering credit for consumers, in order to facilitate cross-border services. It increases the transparency of contractual conditions and improves the level of consumer protection. During the pre-contractual phase, the credit institutions must supply clear information on the main features of the credit offered in due course. Apart from an obligation to supply comprehensive pre-contractual information, creditors must supply consumers with adequate explanations so that the latter may choose a contract which corresponds to their needs and to their financial situation. In addition creditors must evaluate the solvency of their clients before concluding an agreement, while also respecting the right of consumers to be informed when their request for credit is rejected.

The contract must restate the main information relating to the credit offer chosen. Consumers may exercise their right to withdraw by notifying the creditor of their intention, without having to justify their decision. This must take place within fourteen days from the conclusion of the agreement. Consumers also have the right to make early repayment of their debt.

Consumers investing in financial products are protected by the MiFID Directive, the Markets in Financial Instruments Directive (Directive 2014/65/EC (MiFID2) which is aimed at substituting and repealing the MiFID1 (Directive 2004/39/EC) still in force. Building on the rules already in place, the revised MiFID, which will be applicable in 2017 and has not been transposed yet in Luxembourg will strengthen the existing protection of investors by introducing robust organisational and conduct requirements or by strengthening the role of management bodies.

Luxembourg courts remain competent to know any litigation in respect of consumer protection. However, the CSSF is competent to receive complaints by customers of entities subject to its supervision and to act as an intermediary with them in order to seek an amicable settlement to these complaints. The opening of the procedure is subject to the condition that the complaint has been previously dealt with by the relevant professional. Therefore, the complaint must have been previously sent in writing to the management of the professional. If within one month after having sent the complaint to the management, no satisfactory response is received or at least an acknowledgement of receipt, a request for out-of-court complaint resolution with the CSSF can be filed. CSSF Regulation 13-02 sets out the proceeding for out-of court complaints.

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 MiFID2 and MiFIR, and the 'packaged retail insurance-based investment products' (PRIIPS) regulation also imposes more documentary tasks and stricter formalities by introducing a mandatory 'key information document', currently required for investment funds qualifying as UCITS, for a broad range of investment products offered and distributed also by credit institutions. The PRIIPS regulation, which will be applicable as from 16 December 2016 and was published in the Official Journal of the EU on 9 December 2014, 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

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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 on-site and off-site supervision and created in 2013 a specific 'on site' department with the view to increase its control. 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 on-site 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.

As mentioned under question 3, the SSM entrusts power over 'significant' eurozone banks to the European Central Bank (ECB) meaning that the six most significant banks in Luxembourg are directly supervised by the ECB while the CSSF remains responsible for the supervision of less significant institutions under the oversight of the ECB.

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 on-site 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 2014 (the 2015 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 2014, the CSSF reiterated its emphasis on carrying out an important number of on-site inspections. Consequently, the CSSF carried out 138 on-site inspections at the premises of financial players in 2014. Generally, all on-site 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 on-site 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 on-site teams. In 2014, the CSSF carried out 27 ad hoc missions, of which 10 concerned banks on different topics including the excessive concentration of group products in customer portfolios or specific aspects of anti-money laundering and counter-terrorist financing. The other missions concerned specific risk analyses (eg, market risk or credit risk).

The CSSF imposed three administrative fines pursuant to article 63 of the Financial Sector Law and relating to credit institutions amounting to €75,000 on a credit institution because of shortcomings with regard to organisational requirements relating to internal control mechanisms.

Resolution

12 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 18), 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.

13 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?

The BRRD Directive as implemented in Luxembourg by the BRRD Law aims at establishing an effective recovery and resolution framework and at equipping the CSSF with common and effective tools and powers to address further banking crises. According to the BRRD Law, banks are required to produce a detailed recovery plans on an entity and a group basis. The CSSF has broad powers to remove impediments to the implementation of recovery plans, to draw up resolution plans at bank or group level and to require banks to take appropriate action to ensure that impediments be removed. Banks are required to hold capital equal to a percentage, to be set by the CSSF on an institution-by-institution basis, of the total of their liabilities,

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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).

14 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 liability 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.

Capital requirements

15 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 held by the banks with the total net cash outflows expected over the next 30 days. This requirement aims to ensure that banks maintain enough liquid assets to survive for 30 days in a stress scenario, as specified by the CSSF. On 23 July 2015, Luxembourg adopted a law transposing these capital requirements in compliance with the 1 January 2016 deadline under Directive 2013/36/EU (CRD IV).

Hence, banks must have total capital of at least 8 per cent of risk-weighted assets (RWAs). Following the transposition of CRD IV, the minimum requirement for Tier 1 capital has been increased from 4 per cent to 6 per cent, and the minimum requirement for common equity Tier 1 (CET 1) has been increased from 2 per cent to 4.5 per cent. CRD IV has also tightened the definition of common equity, and the definition of what amounts to Tier 2 capital has been simplified with all subcategories (such as upper Tier 2 and lower Tier 2) removed; the concept of Tier 3 capital has also been abolished. In line with Basel III, CRD IV has created 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 has been 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, has been established above the regulatory minimum capital requirement. The bank-specific countercyclical capital buffer requires banks to build up a buffer of capital during periods of excessive credit growth. The countercyclical capital buffer rate set by the CSSF as from 1 January 2016 is, according to CSSF Regulation 15-04, 0 per cent of RWAs of firms that have credit exposure in Luxembourg, but it may reconsider this rate if the financial conditions in Luxembourg were to change significantly. Banks that fail to meet the capital conservation buffer or the countercyclical capital buffer are 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 – it will be able to impose even higher buffers with prior approval from the Commission. If Luxembourg decided to impose a buffer of up to 3 per cent for all exposures, the buffer would have to be set equally for all exposures located within the EU.

In 2014, credit institutions started 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. The CSSF published in its circular 14/582 the European Bank Authority (EBA) guidelines on retail deposits.

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.

16 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 on-site 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 on-site 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.

In respect of ‘significant’ banks directly supervised by the ECB under the SSM, the SSM carries out on-site inspections (ie, in-depth investigations of risks, risk controls and governance with a predefined scope and time frame at the premises of a credit institution). These inspections are risk-based and proportionate. The need for an on-site inspection is determined by joint supervisory teams (JSTs). The scope and frequency of on-site inspections are proposed by the JST, taking into account the overall supervisory strategy and the characteristics of the credit institution (ie, size, nature of activities, risk culture, weaknesses identified). In addition to these planned inspections, ad hoc inspections may be conducted in response to an event or incident that has emerged at a credit institution and that warrants immediate supervisory action. If deemed necessary, follow-up inspections may be carried out to assess a credit institution’s progress in implementing remedial actions or corrective measures identified in a previous planned or ad hoc inspection.

In general, the purpose of on-site inspections is to:

- examine and assess the level, nature and features of the inherent risks, taking into account the risk culture;
- examine and assess the appropriateness and quality of the credit institution’s corporate governance and internal control framework in view of the nature of its business and risks;
- assess the control systems and risk management processes, focusing on detecting weaknesses or vulnerabilities that may have an impact on the capital and liquidity adequacy of the institution;
- examine the quality of balance sheet items and the financial situation of the credit institution;
- assess compliance with banking regulations; and
- conduct reviews of topics such as key risks, controls and governance.

17 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.

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In respect of 'significant' banks directly supervised by the ECB under the SSM, if regulatory requirements have been breached and banks or their management (or both) need to be penalised, the ECB may impose enforcement measures and sanctions. These include, for example, periodic penalty payments (ie, fines applied for each day of non-compliance). The ECB may also impose administrative penalties on banks for non-compliance with EU prudential requirements. In general, administrative penalties are calculated at up to twice the amount of the profits gained or losses avoided because of the breach, or up to 10 per cent of the total annual turnover in the preceding business year.

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

According to the BRRD Law, each credit institution (at entity and group level) needs to prepare a full recovery plan that sets out the measures it will take in different scenarios where it is at risk. This gives the resolution authority the information necessary to determine how the essential functions of the institution or group may be isolated and continued. Resolution authorities will also have powers to require an organisation to take steps to restore financial soundness or to reorganise its business.

In addition to the recovery plan, each bank shall prepare and propose to the CSSF, or the competent authority if it belongs to a consolidated group located in another member state, a resolution plan at an entity and group level setting out options for resolving the institution in different scenarios including systemic instability. The resolution plan will include details of how to apply the resolution tools and how to make sure the institution continues to provide critical functions. The CSSF shall review and approve the resolution plan if it satisfies to all the requirements set out by the BRRD Law, and if the CSSF identifies a significant impediment to a resolution, it has the power to request the institution to address or remove this impediment.

According to the Financial Sector Law as amended by the BRRD Law, the CSSF has powers to intervene if the financial situation or solvency of a bank is deteriorating. They may require an institution to implement recovery plan measures or require it to remove or replace management. If these measures are insufficient, a supervisor may request that a special manager be appointed to replace the management of the institution or EU holding company. The appointed special manager has in that case all the powers given to management by the company's constitutional documents and by national law. The manager's actions may include an increase of capital, a corporate reorganisation or a takeover of the institution by another viable institution.

According to article 61 of the Financial Sector Law as amended by the BRRD Law, when an institution is failing, the CSSF shall have the following minimum set of resolution tools:

- a sale of business tool: this enables authorities to sell part of the business without shareholder consent;
- a bridge institution tool: this allows authorities to transfer all or part of the business to an entity owed by the authorities, which continues to provide essential financial services pending onward sale or entity wind down;
- an asset separation tool: this enables the transfer of 'bad' assets to a separate vehicle or 'bad bank'; and
- a bail-in tool: this allows equity and debt to be written down and is intended to ensure that most unsecured creditors of an institution bear appropriate losses.

The scope of liabilities subject to the bail-in tool is very wide. All liabilities of a credit institution are subject to bail-in, unless excluded. Excluded liabilities are those with an original maturity of less than one month, secured and other collateralised liabilities (including liabilities arising from repurchase transactions (repos) and other title transfer collateral arrangements), insured deposits, liabilities arising from the holding of client monies or client assets, employee salary and benefit or other fixed remuneration liabilities, tax liabilities and liabilities to commercial or trade creditors for the provision of essential goods and services.

19 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 have undergone ground-breaking changes owing to the CRD IV package and the entry into force of the Law of 23 July 2015 implementing the CRD IV Directive. 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 15). 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 and which have already been partly issued.

Ownership restrictions and implications

20 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.

21 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

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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.

22 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.

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

See question 22.

24 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, and in the case of enforcement of a resolution plan by the CSSF as described under question 18 where the CSSF may take control of the bank and exercise the rights of the shareholders or the CSSF may sell the bank or part of the assets of the bank to a third-party without the shareholders consent. Furthermore, in the event of an insolvency, 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

25 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 20).

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).

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

The Luxembourg is keen to attract new banks and financial institutions with the view to expand the international banking activity of Luxembourg.

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. Other examples involve the Chinese banking sector which has also dramatically grown its activity in Luxembourg over the last few years. At the end of 2014, China's Bank of Communications was the country's sixth bank to establish a presence in the Grand Duchy.

Provided the conditions set out under question 20 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.

27 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 20. Further guidance to the approval of a change in control in a Luxembourg bank is given in Appendix II of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector.

See question 28 for further details on these guidelines.

28 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, the European Securities and Markets Authority and the Committee of European Insurance and Occupational Pensions 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

Update and trends

As described in the answers in this chapter, a number of legislative changes will come into effect in 2016 affecting directly the banking sector (the Bank Recovery and Resolution Directive, the Omnibus II Directive, the EMIR regulation, etc). Among those changes, the main hot topics are likely to be the Central Bank supervision and the Single Supervision Mechanism (SSM), which will involve a complete shift in banking supervision in Luxembourg and within the EU, and the Common Reporting Standard (CRS) (the mutual and automatic exchange of information) establishing a new reporting paradigm for reporting and identifying reportable accounts. The exchange of information will be further enhanced in 2017, requiring new adaptations from the banking sector. The CRS has already put an actual end to Luxembourg bank secrecy. This significantly impacts the client, the relationship manager and the private bankers. Finally, the MiFID2/MiFIR repealing and recasting the MiFID Directive shall impose new markets requirements, including those relating to position limits, algorithmic trading and transparency and also a new conduct of business requirement, that entail significant changes for banking institutions.

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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.

29 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.

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