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Regulatory framework

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

For decades, the financial markets have occupied a fundamental position within Luxembourg's economy, having an enormous effect on the public budget and employment market. With respect to the banking sector, Luxembourg's government pursues a continuous policy of diversification of activities, in particular in the field of banks issuing mortgage bonds, securitisation and venture capital. Furthermore, the government sets a high value on international competitiveness by helping to develop the local financial market into a centre of excellence in the following areas: classical banking activities, insurance, investment funds, family offices, pension funds and the stock exchange.

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

- Law of 17 June 1992, as amended, relating to the accounts of credit institutions;
- Law of 5 April 1993, as amended, on the financial sector (the 1993 Law);
- 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; and
- Law of 21 December 2012 implementing directive 2010/78/EU of the European Parliament and the Council dated 24 November 2010 (the 2012 Law).

3 Which regulatory authorities are primarily responsible for overseeing banks?

The Financial Services Commission (CSSF) is the competent authority for the prudential supervision of credit institutions, other professionals of the financial sector, collective investment schemes, pension funds, SICARs (investment vehicles whose principal object is investing in risk-bearing capital issued by domestic and foreign companies), auditors, providers of family office services, and so on.

The CSSF ensures that the banks comply with a certain number of standards laid down in legal and regulatory provisions, as well as with existing professional standards. These standards are either quantitative or qualitative. The limitation of large risk exposure, the capital adequacy ratio and the liquidity ratio represent the most important quantitative standards. Professional experience and repute of the managers, repute of the administrators, the quality of the shareholders and their transparent structure, accounting and administrative organisation, internal audit procedures, risk management and monitoring systems constitute the main qualitative standards.

On 1 January 2011, the European Banking Authority (EBA) officially came into being. It took over all existing tasks from the Committee of European Banking Supervisors (CEBS). The EBA's competencies have been fully recognised by Luxembourg since the implementation of the Directive 2010/78/EU dated 24 November 2010 (Omnibus I Directive) by the Law of 21 December 2012. These competencies comprise the prevention of regulatory arbitrage between national supervisory authorities, strengthening international supervisory coordination including where there is consolidated supervision, promoting supervisory convergence and providing advice and guidelines to EU banks.

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.

According to the Laws of 11 June 1997 and 27 July 2000 implementing Directives 94/19/EC and 97/9/EC, every credit institution must participate in the Luxembourg deposit guarantee and investor compensation scheme. This scheme has been provided by the Deposit Guarantee Association Luxembourg (AGDL) to customers of Luxembourg banks and investment firms and is recognised by the CSSF. Pursuant to the Law dated 19 December 2008, amending article 62-2 of the 1993 Law, the scheme covers the aggregate deposits of each depositor, the currency in which they are denominated up to a value equivalent to €100,000. This means that in the event of insolvency of a bank that is a member of the AGDL, the latter protects all cash depositors by guaranteeing the reimbursement of their deposits up to €100,000. The guarantee covers both natural persons and small European corporate bodies (fulfilling two out of the following three conditions: up to 50 employees; turnover not exceeding €8.8 million; and balance sheet total not exceeding €4.4 million).

Independently from this deposit guarantee the AGDL also protects all investors by guaranteeing the reimbursement of their claims arising out of investment transactions up to the amount of €20,000.

Circular CSSF 13/555 implements the decision made by the board of directors of the AGDL to introduce a 'single customer view' file in the framework of the deposit guarantee in order to be able to quickly (within three days) deal with a request to communicate the total amount of deposits, the payout delay for such amount being 20 days (a proposed Directive of the European Commission dated 12 July 2010 provides for a payout delay of one week).

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.

There are no formal restrictions regarding transactions between Luxembourg financial institutions and their affiliates. However, to avoid tax implications, the price should always be established on a market-value basis (the arm's-length principle as laid down in article 9 of the OECD Model Tax Convention on transfer pricing in cross-border transactions).

According to point 12 of Circular CSSF 09/403, the supervisory activities of the CSSF also encompass the control of intra-group transactions of credit institutions and investment firms in order to prevent liquidity risks. If the CSSF holds that such transactions are not compatible with the principles of sound and prudent liquidity management, it may order the respective financial institution to limit such transactions.

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

In the past few years, several important new provisions have been introduced into Luxembourg banking regulations.

However, most of the principal regulatory challenges stem from European legislation which is either directly applicable or has been implemented and is therefore similar to the applicable rules in other member states.

New challenges will arise with the implementation of the so-called CRD IV package, which was supposed to happen from 1 January 2013, but has been delayed. Under the CRD IV package, banks will be required to hold more capital in order to withstand eventual future shocks without state aid. There will also be new powers for supervisors in order to monitor banks more closely and to increase their ability to sanction banks when they incur risks. In addition, a single rule book for banking regulation will be established which will be directly applicable in all member states, in order to concentrate the legislation on this matter to create more transparency and facilitate the enforcement of these legislations. This regulation also stipulates detailed prudential requirements for credit institutions and investment firms, such as capital, leverage ratio, liquidity, etc, and a directive which will replace the current Capital Requirements Directive, introducing new elements such as enhanced governance, sanctions for risk-taking, enhanced supervision, etc.

In an analysis by the Basel Committee on Banking Supervision dated January 2013, the committee found that CRD I, CRD II and CRD III (together Basel II.5) have not been implemented in the same way in the member states. Therefore, the standards for banks are not the same in all member states under Basel II.5 and a comparison between the banks of different member states proves difficult. Directive CRD IV introducing Basel III will unify these standards and create common grounds for comparison.

On 14 March 2012, the Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps entered into force. The aim of this regulation is to unify the legislation in the member states in order to resolve the market disorder caused by the differing reactions of the member states, to reduce systemic risks and to establish more transparency by establishing a notification but not a publication regime. In Luxembourg, the CSSF is the entity to which notification of significant net short positions in relation to issued sovereign debt which reach or fall below certain thresholds for this issuer has to be made. In this respect, the CSSF released a circular (Circular CSSF 12/548) on 30 October 2012 in order to provide practical details and guidance to the regulation.

On 16 August 2012, Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties (CCPs) and trade repositories (TRs) (EMIR) entered into force. EMIR mainly introduces a clearing obligation for eligible OTC derivatives in order to reduce the counterparty and the operational risks. The European Supervisory Market Authority is in charge of determining the eligibility for the clearing obligation and will accordingly use these criteria: the degree of standardisation of the OTC contract and operational processes, liquidity and the volume of OTC contracts, availability of fair, reliable and generally accepted pricing information. The CSSF has published a circular (Circular CSSF 13/557) to further explain the impact, obligations and exemptions of EMIR.

On 1 October 2012, the 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 entered into force. This law confers squeeze-out rights to majority shareholders and sell-out rights to minority shareholders (meaning a shareholder or a group of shareholders holding more than 95 per cent of the capital conferring voting rights and 95 per cent of the voting rights of a company) of any company having its registered office in Luxembourg and whose securities fulfil certain criteria (securities admitted to trading on a regulated market, or which have been admitted to trading but no longer trade, or have been subject to a public offering with the publication of a prospectus), which had only been possible as a result of public takeover bids on securities issued by companies admitted to trading on a regulated market before. The role of the CSSF under this law is to enforce this law and to take adequate measures in case of a breach. In this respect, the CSSF has to be notified of changes in the composition of the shareholders of a company, can comment and object to the squeeze-out or sell-out price and generally request all information necessary to fulfil its role.

According to the law of 21 December 2012 relating to family office activity, banks are, among some other professionals of the financial sector, without prior authorisation from the CSSF, entitled to provide advice to families on financial structuring and planning, administrative and financial follow-up, the coordination of service providers in relation to wealth preservation for individuals, families or family units (so-called family office services). Entities carrying out foreign exchange cash operations as per article 28-2 of the 1993 Law are not allowed to exercise such family office activities.

Important regulatory challenges will be introduced by the draft bill No. 6,471 implementing Directive 2011/61 dated 8 June 2011 on Alternative Investment Fund Managers (AIFMs) which also affect credit institutions and investment firms. Article 19 of the draft bill stipulates that a depository has to be appointed for each alternative investment fund (AIF) upon signature of a written contract. The depository is in charge of the safekeeping of the AIF and has to be a credit institution as defined in the 1993 Law with either its statutory registered office in Luxembourg or its affiliate in Luxembourg if established in another member state. Article 19(3)(i) of the draft bill stipulates that only credit institutions and investment firms that comply with further conditions as defined in article 19 (3) of the draft bill may be depositories for AIFs established in Luxembourg.

The draft bill introduces new rules concerning the roles, responsibilities and organisational obligations applicable to the depository, such as the obligation to report to the CSSF all information necessary for the supervision of the AIF. The main functions and responsibilities of a depository concern the safekeeping of assets and transferable securities; only specific functions can be delegated to a third party. According to article 19(12) of the draft bill, the depository is responsible to the AIF or the investors for any losses caused by it or a third party to which it has delegated its functions and has to refund any lost financial instruments for which it was responsible or the corresponding amount for as long as it cannot prove that the loss is not its fault. Even in cases of delegation, the depository's liability remains. The manager of the AIF is not allowed to delegate any of its functions to a depository.

The draft bill will also introduce two new articles (articles 26-1 and 28-8) to the 1993 Law to create two new statuses of professionals of the financial sector, called 'professional depository for assets others than financial instruments' and 'manager of uncoordinated UCIs' which replace the former status of 'professional engaging in the management of UCI other than UCIs established in Luxembourg and other than UCTIS'.

By the Law of 21 December 2012, the frame for cooperation between the CSSF, other surveillance entities in other member states, the European Supervisory Authorities and the CBRS has been defined. The 2012 Law also places an obligation on the CSSF to furnish the European Authorities with the information necessary for the accomplishment of their missions.

7 How has regulation changed in response to the recent crisis in the banking industry?

In the light of the recent global financial crisis, the Luxembourg government has taken some crucial measures aimed at stabilising the financial sector, such as governmental investments, governmental guarantees and the increase of the depositor protection scheme.

The regulatory framework has been strengthened and enlarged. The CSSF has also reacted to the financial crisis and intensified its supervisory activity. Among other things, it has published Circular 09/392 on prudent valuation of acquisitions and the raising of participations in entities of the financial sector and Circular 10/466 on the information to be published by credit institutions governed by Luxembourg law and branch offices of credit institutions governed by non-EU countries in critical situations.

In addition, the CSSF requires credit institutions and investment firms governed by Luxembourg law and all branches of non-EU credit institutions and investment firms to conduct a series of stress tests aimed at testing the resilience of Luxembourg financial institutions in the event of financial turmoil. These stress tests are based on the CEBS Guidelines on Stress Testing published on 26 August 2010. The CSSF published Circular 11/506 on this matter. The only Luxembourg bank of the 71 European banks that took part in the EU-wide Stress-Testing Exercise, 2011 is the Banque et Caisse d'Epargne de l'Etat, Luxembourg (BCEE). In December 2011, the European Banking Authority and the CSSF confirmed that the BCEE had passed the stress test, so that it required no recapitalisation measures. In addition to that, Circular CSSF 11/505 stipulates which expectations the CSSF has regarding the application of the proportionality principle by credit institutions and investment firms governed by Luxembourg law and all branches of non-EU credit institutions and investment firms in establishing their remuneration policy.

During 2011, the CSSF carried out, as described in its 2011 annual report, various ad hoc surveys within the context of the macroprudential supervision of UCIs. Within the context of the sovereign debt crisis in the euro area, the CSSF carried out a first internal analysis at the beginning of 2011, in order to determine the extent of the risks incurred by UCIs governed by Luxembourg law. This analysis was then supplemented by meetings with various participants and the evaluation of a detailed questionnaire sent to certain UCIs as well as a quantitative analysis of UCIs that are likely to fall within the scope of the AIFM Directive.

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

Most of the current and upcoming developments in the Luxembourg banking regime are directly induced or at least strongly influenced by EU legislation and international treaties.

Within the framework of the European harmonisation of the financial services market, the intention was to create as far as possible a unique approach to financial regulation and to supervision in the financial industry. The financial crisis has emphasised the need to reinforce the framework of supervision. By implementing the powers of the European Banking Authority and the European Supervisory Authorities into Luxembourg law with the Law of 21 December 2012 on the implementation of the Directive 2010/78/EC of the European Parliament and the Council of 24 November 2010 modifying the directives 98/26/EC, 2002/87/EC/, 2003/6/EC, 2003/41EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/9/EC and 2009/65/EC this had been achieved.

In the next few years, the existing regulations will be updated and enhanced (cf, CRD IV directive, Basel III, UCITS VI, AIFM, MIFID II/MIFIR, shadow banking, PRIPS, KIID, Single Supervisory Mechanisms).

Supervision

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

The supervision carried out by the CSSF is based on the examination of the periodical information submitted by the legal entities under its supervision, on-site inspections and the analysis of the reports and comments provided by the external and internal auditors of the entities.

The CSSF defines the contents of periodical reports. The establishments must report to the CSSF on a monthly, quarterly, half-yearly or annual basis depending on the object, financial information on their on- and off-balance sheet activities, their results and the risks they incur, such as credit risk, foreign-exchange risk and the various other market risks. The periodical reports further enable the CSSF to verify compliance with the structural ratios imposed on the establishments under its supervision.

On-site inspections are undertaken to conduct analyses and assessments of risk management policy and techniques, to examine information and facts that can only be verified on-site, to supplement the information from periodic reporting or other sources and to gather full and reliable basic data for the purpose of analysis.

Banks must submit their annual financial statements to a review carried out by one or more external auditors authorised beforehand by the CSSF. The establishments must submit to the CSSF all documents issued by the external auditor in the context of the audit of the annual financial statements and, in particular, the auditor's analytical report. The CSSF may also instruct an external auditor to carry out a specific audit on one or more particular aspects of the activity or operation of a supervised undertaking. The banks and other professionals in the financial sector are further required to submit to the CSSF a written management report on the state of their internal controls and a copy of the summary report on the controls effected by the internal audit during the course of the financial year. From 1 July 2013 the Circular CSSF 12/552 will be applicable. Credit institutions, investment firms and professionals carrying out lending operations have to comply with the reporting obligations defined in this circular (see question 14).

In addition, to carry out its supervision tasks, the CSSF performs interviews with the directors or other professionals in the financial sector.

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

To ensure that the persons subject to its supervision comply with the banking laws and regulations, the CSSF may, among other things, issue an injunction requesting the concerned credit institution to remedy the situation and may suspend persons or voting rights of certain shareholders or even the activities or a sector of activities of the bank concerned. In addition, the CSSF may impose or request the Minister for Treasury and Budget to impose disciplinary fines on the persons in charge of the administration or management of the banks concerned; under certain conditions, request the district court dealing with commercial matters to have payments suspended; and place a bank under controlled administration, or refuse or withdraw registration if a bank does not fulfil or no longer fulfils the conditions to be registered on the official list of credit institutions. In extreme cases and under precise conditions laid down by law, the CSSF may request the district court to order the winding up and liquidation of an undertaking (article 61 of the 1993 Law).

According to article 63 of the 1993 Law, the CSSF may, inter alia, also impose administrative fines of between €250 and €250,000 on the legal persons subject to the supervision of the CSSF as well as on physical persons responsible for the administration and management of the bank and all other physical persons subject to the same supervision by the CSSF for non-compliance with their obligations stipulated in the Luxembourg banking regulation.

Finally, article 64 of the 1993 Law specifies that the breach of certain obligations is punishable by criminal sanctions (eg, conducting banking activities without the Ministry's authorisation is punishable by a term of up to five years' imprisonment, a fine of between €5,000 and €125,000, or both).

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

In the past, enforcement issues have been rather rare in Luxembourg, as banks generally comply with the requirements the CSSF expresses during the control. In its annual report for 2011, the CSSF listed the situations in which it has intervened in that year. The CSSF:

- has intervened once in writing regarding non-compliance with the capital ratio (once in 2010 and not at all in 2009);
- had to take measures once regarding failure to meet the liquidity ratio (three times in 2010 and twice in 2009);
- intervened 16 times (12 times in 2010 and 14 times in 2009) in cases of large exposure to risk to inform that the maximum level of large exposures had been exceeded;
- sent out 220 deficiency letters to banks based on shortcomings in terms of organisation (119 in 2010 and 75 in 2009) and 27 on deficiencies in compliance with money laundering provisions (34 in 2009 and 17 in 2009);
- intervened in relation to two banks that had exceeded the maximum level of interest rates risk ratio established by Circular CSSF 08/338 (two in 2010);
- held 217 meetings to discuss business and problems between CSSF representatives and bank executives (264 in 2010);
- carried out 58 on-site inspections, as against 38 in 2009 and 35 in 2010, focusing on anti-money laundering and financing of terrorism obligations, functioning of the banks' institutions, the position of the bank within the group, as well as the efficiency of the control functions such as internal audit (as in 2009, five of these on-site inspections were conducted in collaboration with foreign supervisory authorities); and
- requested external auditors to conduct extraordinary audits five times (11 times in 2010).

In 2012, the CSSF imposed administrative fines on one bank for non-compliance with sound and prudent management obligations. Administrative fines have also been imposed on two directors and five members of the board of a bank for non-compliance with its money laundering obligations and on members of the board of another bank for non-compliance with the internal control obligations. The CSSF also reprimanded one credit institution. The annual report 2012 of the CSSF has not yet been published.

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

The CSSF must cooperate with the government, the Banque Centrale du Luxembourg, the other authorities responsible for prudential supervision at a national level, the European Securities and Markets Authority, the European Banking Authority, the European Union and international level, in order to contribute to ensuring financial stability, in particular within the committees set up for such purpose. It must take into account the international dimension of prudential supervision and financial stability. Furthermore, within the limit of its remit and role, by the Law of 24 October 2008 the CSSF is also empowered to enact regulations, which must then be published in the Luxembourg Official Journal (*Mémorial*).

In practice, due to the financial crisis, the CSSF has had to intervene in a more extensive way since late September 2008. Besides temporary suspensions of negotiation of the shares of various banks, it also had to declare the suspension of payments proceedings of three Icelandic banks. Other investigations and interventions concern the implication of Luxembourg-based banks and investment funds with respect to an international financial fraud case.

The CSSF's assessment of potential acquirers of shares in the capital of banking institutions has also intensified. For the time being, no legislative changes have taken place. However, given the recent crisis, the CSSF pays, more than ever, very close attention to all criteria on which it appraises the suitability of the proposed acquirer. For instance, the CSSF will only give approval to an acquisition if it comes to the conclusion that the business plan proposed by the bank is viable both in the current situation of the financial markets and in the long run, and if sufficient capital adequacy provisions are made available by the proposed acquirer to the bank to put such business plan into practice (see questions 22 and 30).

In addition, since the Law of 18 December 2009 concerning the audit profession entered into force and since the Law of 21 December 2012 on family office activity, the CSSF has also become the competent public oversight authority for the audit profession and for providers of family office activity as defined under article L8-6 of the 1993 Law, which considerably widens the spectrum of its mission and powers.

The CSSF's supervision of the banks' compliance with applicable rules on capital ratio, liquidity ratio, risk exposure and remuneration policies is also becoming more and more important.

At the EU level, the European System of Financial Supervision (ESFS) and the European Systemic Risk Board (ESRB) pursuant to the Regulation 2010/1092/EC as well as the EBA pursuant to the Regulation 2010/1093/EC have been established. The ESFS brings together all those involved in financial supervision at a national and EU level to act in a coordinated manner. The ESRC is part of the ESFS. It ensures the supervision of the European Union's financial system. For the broad competencies of the EBA, see question 3.

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?

In the light of the recent global financial crisis, the Luxembourg government has taken some crucial measures aimed at stabilising the financial sector such as governmental investments, governmental guarantees and the increase of the depositor protection scheme.

On 28 September 2008, the Belgian, Luxembourg and Dutch governments bailed out the Fortis Group. As part of this bailout the Luxembourg government invested €2.5 billion in Fortis Banque Luxembourg SA in the form of a convertible loan. The loan was converted on 15 December 2008 as a result of which the Luxembourg government became the holder of 49.9 per cent of the shares in Fortis Banque Luxembourg. Collectively, the Belgian, Dutch and Luxembourg governments have invested €11.2 billion in the Fortis Group.

On 30 September 2008, the Luxembourg government invested €376 million in Dexia Banque Internationale à Luxembourg via a convertible loan. The French, Belgian and Luxembourg governments together invested €6.4 billion in the Dexia group.

With respect to state guarantees, the Grand-Ducal Regulation of 10 October 2008 authorised the government to give a guarantee to the Dexia Group. Based on this Regulation, the Luxembourg government together with the Belgian and French governments issued a guarantee covering Dexia's liabilities towards credit establishments and institutional counterparties, as well as bonds and other debt securities issued to the same counterparties provided that these liabilities, bonds or securities fall due before 31 October 2011 and have been contracted, issued or renewed between 9 October 2008 and 31 October 2009.

Luxembourg's participation in the guarantee is limited to a maximum amount of €4.5 billion and is granted jointly but not severally with Belgium and France. The Dexia entities benefiting from this measure are Dexia SA, Dexia Banque Internationale à Luxembourg SA, Dexia Banque Belgique SA and Dexia Crédit Local de France SA, as well as their issuing vehicles. On 13 March 2009, the European Commission approved the guarantee as compliant with EU state aid regulations. On 18 September 2009, the guarantee was renewed for one year and its cap for Luxembourg has been reduced to €3 billion. The guarantee mechanism ended on 30 June 2010. However, in October 2011 with Dexia again in financial turmoil, the Belgian, French and Luxembourg governments decided to help Dexia regain lenders' trust on the markets by guaranteeing loans granted to and bonds and other securities issued by Dexia. A Grand-Ducal Regulation of 14 October 2011 enables the Grand Duchy of Luxembourg to guarantee up to a total amount of €2.7 billion of loans to be granted to and securities to be issued by Dexia SA and Dexia Crédit Local SA before the end of 2021 with a term of no longer then 10 years. On 24 January 2013, Luxembourg provided a final guarantee of an amount of €2.25 billion to Dexia Crédit Local SA together with France and Belgium.

On 24 October 2008, the Luxembourg parliament (Chambre des Députés) adopted a law regarding the improvement of the Luxembourg legal financial framework. Article VII of this law provides that the minister for treasury and budget is authorised to issue, on a needs basis, a short or medium-term loan in one of several tranches, for a global amount of up to €3 billion. The proceeds of this loan are aimed at reinforcing the capital base of financial institutions by participating in their capital, acquiring shares issued by these institutions, granting loans or borrowings in their favour and investments in these institutions. The same law also amends the 1998 Law by expanding the CSSF's supervisory missions and competencies (see question 11).

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?

For the moment, there is no Luxembourg legislation dealing with resolution regimes, such as the 'living will' under US law. Basel III aims to introduce such resolution regimes in the European Union but nothing has been implemented yet.

Concerning management guidelines, on 12 December 2012, the CSSF published a circular (Circular CSSF 12/552), which is the new reference in terms of central administration, internal governance and risk management. This circular applies to credit institutions, investment firms and professionals carrying out lending operations. The aim of this circular is to introduce new rules to prevent bank failure from happening and to re-establish trust in financial institutions and the banking system by creating effective internal governance and an efficient risk-management process. These measures create more responsibility for the bank's managers and directors in order to prevent bank failures. The board of managers has the overall responsibility for the establishment.

The transition period for credit institutions and investment companies on certain provisions as further defined in the circular to comply with the circular ends on 1 January 2014.

Parallel to that, the European Commission has, on 6 June 2012 (COM (2012) 280 final), introduced a proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms. The aim of this proposal is to construct an effective recovery and resolution framework in the European Union and to equip the relevant authorities of the member states with common and effective tools and powers to address banking crises pre-emptively, safeguarding financial stability and minimising taxpayers' exposure to losses.

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

No specific regulation applies. The Law of 10 August 1915 on commercial companies (the Law of 1915) provides for a liability of managers and directors towards the company for the execution of their mandate and any misconduct in the management of the affairs of the company. This liability under civil law towards the company applies notably to all companies in the form of a public company limited by shares (SA).

The liabilities under book III of the Commercial Code in relation to bankruptcy are not applicable to directors in case of a judicial liquidation of a credit institution governed by Luxembourg law.

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

Until now there has been no change in bank resolution.

Concerning specific insolvency rules applicable to credit institutions in Luxembourg, the Directive 2001/24/CE on the reorganisation and winding up of credit institutions has been implemented by the law of 19 March 2004 on the reorganisation and winding up of credit institutions. This law has been inserted in the 1993 Law on the financial sector as amended, introducing notably the proceedings for suspension of payments as well as voluntary winding-up procedures, each including special provisions for branches of establishments situated in another member state or non-EU countries.

Capital requirements

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

According to article 56 of the 1993 Law, the ratios to be observed by credit institutions and the PSF as further defined in the 1993 Law pursuant, in particular, to the provisions of Directives 2006/48/EC, 2006/49/EC, 2007/64/EC, 2009/111/EC and 2010/76/EC (based on Basel II), are laid down in CSSF Circular 06/273 as amended by several other CSSF circulars, most notably CSSF Circular 10/496.

The capital adequacy ratio compares eligible capital adequacy provisions to the overall capital requirement for the risks concerned. Banks must at all times possess sufficient capital adequacy provisions to meet their overall capital requirement on a stand-alone and, where applicable, on a consolidated basis. The general minimum requirement is to hold 8 per cent capital for risk-weighted assets. However, a European Summit held on 26 October 2011 in relation to the recapitalisation of European banks, decided to increase this minimum requirement to at least 9 per cent (core Tier I ratio) until June 2012. Although most of the European banks have reached the core Tier I ratio within the time period, some banks only reached it after June 2012 and specific backstop measures will be taken with regard to these banks (for instance, prudential scrutiny and remedial actions). However, the obligation to comply with the core Tier I ratio still applies and European banks may never fall below such 9 per cent.

Eligible capital adequacy provisions, constituting the numerator of the ratio, include original capital adequacy provisions and additional capital adequacy provisions. Besides advanced methods to calculate the capital adequacy provision requirements, there are also simplified methods: a standardised approach for credit risk and basic risk, and a basic indicator approach for operational risk. Banks may use them without prior request and without having to meet qualitative or quantitative minimum requirements. The circular also introduces a 'retail' category, which allows assigning a 75 per cent risk weight to most outstanding exposures to natural persons and small businesses. The coming into force of CSSF Circular 10/496 extended certain transitional provisions on the minimum capital requirement for credit risks arising from non-trading book activities.

The basic indicator approach for operational risk sets out a 15 per cent risk weight of a single indicator that is determined by the sum of net interest income and net non-interest income. The credit risk can be mitigated in several ways, notably through collateral, guarantees and credit derivatives. A substitution approach is applied with respect to the treatment of guarantees and credit derivatives.

In Luxembourg, banks must furthermore maintain a regulatory minimum liquidity ratio of 30 per cent. This ratio is calculated as the percentage of liquid assets to current liabilities.

Finally, there is a minimum capital entry requirement for credit institutions of €8.7 million of which €6.2 million must be paid up (article 8 of the 1993 Law). This capital entry requirement also applies to branches and subsidiaries of foreign banks.

18 How are the capital adequacy guidelines enforced?

According to article 53 of the 1993 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 specific capital adequacy requirements as stipulated under question 17.

The CSSF may also require the cessation of practice that it considers contrary to the capital adequacy provisions and it can request the freezing or sequestration of assets, or both, in court. 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-the-spot verifications or investigations on a financial institution (Law of 18 December 2009).

It may even request temporary prohibition of professional activity with respect to persons subject to its prudential supervision as well as to restrict or limit the business, operations or network of banks.

Furthermore, the administrative fines as mentioned above (see question 10) can be imposed by the CSSF on the administrators of the bank and all other persons subject to its supervision in cases of non-compliance with the capital adequacy requirements.

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

According to article 59 of the 1993 Law, the CSSF must enjoin the bank, by registered letter, to re-establish, within such period as it may prescribe, the required capitalisation. If by the end of this period the capitalisation is still insufficient, the CSSF may inter alia suspend the members of the bank's administration, suspend the exercise of voting rights of shareholders whose functions or influence may prejudice the reimplementation of the capital adequacy requirements, or both.

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

Article 60-2 of the 1993 Law stipulates that if a bank is in an insoluble liquidity crisis, if its creditworthiness becomes undermined, or if its entire ability to meet its commitments is compromised, the bank or the CSSF may apply to the Luxembourg District Court for a suspension of payments declaration. The court must quickly give its ruling on the application. If it grants leave for a suspension of payments, it must appoint one or more administrators to control the management of the bank's assets.

The judgment must be published in the *Mémorial* and in two national newspapers and one foreign newspaper having a sufficiently large circulation. Additional publications are required if the bank has a branch office in a foreign country. The CSSF must also provide information about the application for the suspension of payments to the competent authorities of the states in which the bank has a branch office.

The CSSF and the bank itself may appeal against the judgment, but no further appeal may be lodged against the appellate judgment.

If a bank is established in a foreign state and has a branch office in Luxembourg, the law of that state applies on the implementation of reorganisation measures. Such measures will be fully effective in Luxembourg. For Luxembourg branches of non-EEA banks only, the district court may declare, upon application by the CSSF, a suspension of payments.

Where the suspension of payments scheme is not able to rectify the situation, the district court may declare, upon application by the CSSF or the state prosecutor, the dissolution of the bank. Winding-up proceedings are also regulated in the 1993 Law (article 61 to 61-22). A bank may not place itself in voluntary liquidation without first having notified the CSSF. The notice must be published.

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

Capital adequacy guidelines for credit institutions governed by Luxembourg and for branches of non-EU credit institutions have been amended by Circular CSSF 10/496.

Further changes on capital adequacy guidelines are contained in the CSSF Circular 10/475 (calculation of own funds requirements for credit risks related to securitised products, calculation of risk tolerance limits, definition of own funds).

By the CSSF Circular 10/497, which applies to investment firms under Luxembourg law and branches of investment firms from non-EU countries, the Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies has been transposed.

The Law of 28 April 2011, which incorporated Directive 2009/111/EC into Luxembourg law, also partially revised capital adequacy rules, liquidity risk management principles and their supervision, cross-border banking groups and their supervision, limitation on inter-bank exposures and improvement of risk management of securitised products.

In addition, the implementation of the Basel III rules expected to take place in the next few years might lead to tougher capital standards through more restrictive capital definitions, higher risk-weighted assets, further capital buffers and increased minimum capital ratio requirements combined with stricter liquidity requirements. In its press release No. 11/39 of 27 October 2011, the CSSF announced the European Banking Authority's recommendation that the CSSF and other national supervisory authorities should require banks to strengthen their capital positions by building up an exceptional and temporary capital buffer against sovereign debt exposures to reflect market prices. In addition, banks had been required to establish an exceptional and temporary buffer such that the core Tier I capital ratio reaches a level of 9 per cent by the end of June 2012. These buffers are designed to reassure markets about the ability of banks to withstand shocks and still maintain adequate capital.

Through Circular CSSF 11/513 which among others applies to credit institutions governed by Luxembourg law, the CSSF has updated its prudential reporting scheme regarding capital adequacy (COREP) in order to implement the modifications made by CRD II and CRD III. In this respect, the circular introduced elements concerning, inter alia, hybrid capital instruments, capital requirements in the context of resecuritisations, capital requirements for non-trading settlement or delivery risks, capital requirements as regards securitisation in the trading book, capital requirements associated with the related trading book, and the amount of capital according to the ICAAP process. It also aimed to adapt the reporting methods to provide for a uniform reporting format within the European Union as of 31 December 2012.

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?

There are no rules in Luxembourg's banking law that prohibit certain types of entities or individuals from owning a controlling interest in a bank. The authorisation to carry on the business of a bank may not be granted to an entity if the suitability of one of its shareholders (representing 10 per cent or more of the capital or of the voting rights or otherwise enabled to exercise a significant influence on the conduct of the bank's business) is not satisfactory, taking into account the need to ensure the sound and prudent management of the bank (article 6, paragraph 1 of the 1993 Law).

Therefore, the identity of all shareholders or members (whether direct or indirect and whether natural or legal persons) must be communicated to the CSSF and the CSSF must not be prevented from effectively exercising its supervisory functions. The Law of 17 July 2008 incorporating Directive 2007/44/EC into national law adds a list of criteria against which the CSSF must appraise the suitability of the proposed acquirer and the financial soundness of the proposed acquisition (article 6, paragraph 9 of the 1993 Law). This list contains:

- the reputation of the proposed acquirer;
- the reputation and experience of any person who will direct the business of the credit institution as a result of the acquisition;
- the financial soundness of the proposed acquirer;
- whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing is being or has been committed;
- whether the credit institution will be able to comply and continue to comply with the prudential requirements; and
- whether the group of which it will become a part has a structure that makes it possible to:
  - exercise effective supervision;
  - effectively exchange information among competent authorities; and
  - determine the allocation of responsibilities among the competent authorities.

The guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC published by the CSSF in its Circular 09/392 dated 4 February 2009 contain detailed information on each of the criteria mentioned above.

23 Are there any restrictions on foreign ownership of banks?

There are no such restrictions in Luxembourg. The direct and indirect shareholding structure of the bank must, however, be transparent and organised in such a way that the CSSF is not prevented from exercising its supervisory functions effectively on all domestic and foreign shareholders. This could be the case where an entity controlling the bank is established in a third country whose laws either prevent the control by foreign regulatory authorities or do not make it possible to determine the allocation of responsibilities among the competent authorities or whose regulatory authorities do not effectively exchange information with foreign authorities. In such cases, the CSSF would be forced to refuse the business authorisation (article 6, paragraphs 4 and 9 of the 1993 Law).

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

Traditionally, the CSSF had only allowed banks to control other banks. However, this position had to be given up, as Luxembourg law does not distinguish between parent companies that are engaged in banking or financial services and parent companies exercising non-financial business activities.

Thus, in principle, every entity may be allowed to control banks. As already described above (see question 22), there may only be differences in the due diligence process undertaken by the CSSF regarding the capacity of the shareholders. For instance, with respect to natural persons, the CSSF examines the professional standing and trustworthiness of that person, similar to the conditions to be met for the authorisation of members of the bodies performing administrative, management and supervisory functions within a bank (article 7 of the 1993 Law).

As regards legal entities, the CSSF pays attention to the name of the entity and its business activity. If the company is completely unknown to the CSSF, it may request, among other things, the financial statements, annual reports, articles of association and a scheme of the company's structure.

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

As a general rule, the capital adequacy provisions of a credit institution may not be less than the amount of the authorised capital. However, article 8, paragraph 2 of the 1993 Law stipulates that if the capital adequacy provisions fall below the authorised capital, the CSSF may, where the circumstances so justify, allow the institution a limited period in which to rectify its situation or cease its activities.

With respect to shareholders' responsibility, it depends on the legal form of the bank, which can be a *société anonyme* (public limited company), a *société en commandite par actions* (limited partnership with a share capital) or a *société coopérative* (cooperative society). Normally, the liability of shareholders is limited to the amount of its shares in the share capital of the bank so that in the case of bankruptcy they may not lose more than the capital invested.

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

Insolvency of the bank does not result in insolvency of its shareholders. The insolvency procedure of the bank is not extended to the controlling entity or the individual, except in cases where:

- the bank has the corporate form of a *société en commandite par actions*; or
- the Luxembourg District Court sitting in its capacity as a commercial court has extended the insolvency procedure to these persons because they have mismanaged the bank (as de facto managers) provided that article 495 of the Commercial Code has been declared applicable to the procedure and that the requirements set forth by this provision are fulfilled by the judge in charge of the liquidation.

Shareholders have a subordinated rank in the bank's insolvency meaning that they are only entitled to any surplus from the winding up – if there is any – in proportion of their shareholding.

If a bank is in liquidation, its management is dismissed and nobody except the liquidator appointed by the court is entitled to manage the bank or act on its behalf. The shareholders are obliged to support the liquidator and the judge in charge of the liquidation, that is, to provide them with relevant information and documents in relation to the bank's business as well as its assets and liabilities.

In principle, the shareholders must refrain from interfering in the liquidation process. In practice, however, it may happen that a cooperation agreement is entered into between the liquidator and the shareholders. The winding-up procedure of Landsbanki Luxembourg SA is a good example in this respect: in the context of this procedure, a settlement agreement was concluded between Landsbanki Luxembourg SA, its parent company (which was also a creditor, as lender) and its major creditors providing a restructuring of the parent company's claim and granting seniority to the other creditors of Landsbanki Luxembourg SA.

Changes in control

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

According to article 6, paragraph 5 of the 1993 Law, any natural or legal person that proposes to acquire, directly or indirectly, a qualifying holding in a credit institution must first inform the CSSF in writing, telling it of the amount of the intended holding. Qualifying holding means a direct or indirect holding in the bank, which represents 10 per cent or more of the capital or of the voting rights (see also articles 9 and 10 of Directive 2004/109/EC). Likewise any natural or legal person must inform the CSSF if he proposes to increase his qualifying holding in such a way that the proportion of the voting rights or of the capital held by him will reach or exceed 20 per cent, 33.3 per cent or 50 per cent or so that the credit institution will become his subsidiary. Following its investigation, the CSSF may oppose such a plan if it is not satisfied as to the suitability of the person, in view of the need to ensure sound and prudent management of the bank. In this respect the criteria set out in question 22 apply. If a holding is acquired despite the opposition of the CSSF, it may suspend the exercise of the corresponding voting rights or demand the nullification or cancellation of votes cast (article 6, paragraph 17 of the 1993 Law).

In addition to the above special regulation of the banking sector by the 1993 Law, the general regulation on takeover bids and changes of control through the Law of 19 May 2006 implementing Directive 2004/25/EC may also be taken into consideration, which applies to takeover bids for the securities of companies of EU member states, where all or some of those securities are admitted to trading on a regulated market. If the shares of a credit institution are admitted to trading on such a market and it has its registered office in Luxembourg, several obligations concerning the procedure for takeover bids must be respected (for instance, protection of minority shareholders, information concerning the bids, disclosure, etc). The competent supervisory authority in Luxembourg in this regard is the CSSF. The non-respect of the obligations of this law may be punished by up to five years' imprisonment, a fine of between €251 and €125,000, or both.

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

Most of the credit institutions in Luxembourg (142 on 31 January 2013) are part of international banking groups or otherwise held by foreign entities. In addition, seven branches of credit institutions originating from a non-member state of the European Union and 29 branches of credit institutions originating from an EU member state are registered in Luxembourg as of 18 January 2012. No difference is made if a foreign acquirer is involved. However, the applicable criteria as described in question 22 may lead to the CSSF's refusal if the laws of the acquirer's country either prevent the control by the CSSF or do not make it possible to determine the allocation of responsibilities among the competent authorities or if the local regulatory authority does not effectively exchange information with the CSSF.

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

See the list of criteria in question 22. Further information on the application of each of the criterion can be found in the guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC published by the CSSF in its Circular 09/392 dated 4 February 2009. In practice, all depends on the particular circumstances of the case.

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

According to article 19a(4) of Directive 2006/48/EC as amended by article 5 of Directive 2007/44/EC, EU member states have to make publicly available a list specifying the information that must be provided to the competent authorities. In this respect, the CSSF applies the list contained in appendix II of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC, published by the Committee of European Banking Supervisors (CEBS) for its assessment.

According to this extensive and precise list, the following information has to be provided to the CSSF for an acquisition of control of a bank:

- where the proposed acquirer is a natural person:
  - 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 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;
  - description of his professional activities;

Update and trends

Luxembourg banks are being affected by consolidation which implies a reduction of manpower and a general trend towards cost-cutting. The application of the AIFM Directive (see question 6) also has a great impact on all Luxembourg banks whose activities include those of custodian banks.

  - ratings and public reports on the companies controlled or directed by the acquirer and if available, on the acquirer himself; and
  - a description of the financial and other interests or relationships of the acquirer with current shareholders of the bank, its board members, etc;
- where the proposed acquirer is a legal person:
  - evidence of business and the registered name and address of the head office;
  - registration of legal form;
  - up-to-date overview of entrepreneurial activities; and
  - 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 last three 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 shares in the bank's capital already owned by the proposed acquirer.

Furthermore, the CSSF has to 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 case of 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?

Within two working days following receipt of the notification, the CSSF has to acknowledge receipt. From the date of such written acknowledgement, the CSSF has 60 working days to carry out the assessment and to oppose the acquisition (article 6, paragraphs 6 and 7 of the 1993 Law).

During the first 50 working days of this assessment period, the CSSF may request any further information it deems necessary. Until such additional information has been received by the CSSF, the above assessment period can be interrupted for up to 20 working days. Further requests of information do not interrupt the assessment period. These rules apply independently of the acquirer's nationality. However, the CSSF may extend the interruption of the assessment period for its first additional information request up to 30 working days if the acquirer is situated or regulated outside the European Union (article 6, paragraph 8 of the 1993 Law). In practice, the time frame may be much shorter and mostly depends on the completeness of the request and the workload to be undertaken by the CSSF in relation to the acquirer's capacity.

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