COUNTRY UPDATE-Luxembourg: Securities & Banking

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Luxembourg has acquired a leading position in the world's financial arena. One of the main factors for such achievement is the presence of a rigorous regulatory environment for financial activities.

Regulated entities

The Law of April 5, 1993 on the financial sector, as amended (the Law on the Financial Sector), sets out the rules regarding the access to professional activities in the financial sector, the prudential supervision of the financial sector and the reorganisation and winding-up of certain financial sector professionals. In addition thereto, various other laws regulate certain specific entities.

Credit institutions/banks

Article one of the Law on the Financial Sector defines a credit institution as any legal person whose activities consist in taking deposits from the public and granting loans for its own account. The credit institutions (also called banks) can be divided into three groups on the basis of their legal status and place of incorporation:

- Credit institutions incorporated under Luxembourg law, i.e., having their central administration and their registered office in Luxembourg.
- Credit institutions incorporated and authorised in another European Economic Area (EEA) member state which may exercise their activities in Luxembourg through a Luxembourg branch or via the freedom to provide services under the European passporting regime, i.e., without applying for an authorisation from the Luxembourg authorities.
- Branches of credit institutions incorporated in non-member states of the EEA which need the same authorisations as Luxembourg credit institutions.

A special type of credit institution are the mortgage bond banks (banques d'émission de lettres de gage) which have as principal activity the issuance of securities covered by commercial and residential mortgage loans or public sector loans.

The Law of July 12, 2013 on alternative investment fund managers (the AIFM Law) implementing Directive 2011/61/EU of June 8, 2011 on alternative investment fund managers (the AIFM Directive) and amending certain Luxembourg laws including the Law on the Financial Sector introduced, in addition to banks, a new licensing regime for depositaries servicing alternative investment funds (AIFs) which, pursuant to their main investment policy, generally do not invest in assets which shall be held in custody pursuant to the AIFM Law or which generally invest in issuers or non-listed companies in order to eventually acquire control thereof in accordance with the AIFM Law, so long as those AIFs do not allow their investors to request the redemption of their shares/units for at least five years following investment.

These depositaries, which need not be authorised as credit institutions or investment firms, will need to be approved and subject to the prudential supervision of the Commission de Surveillance du Secteur Financier (CSSF).

The professionals of the financial sector

Other professionals of the financial sector (PFS) mean any person, other than a credit institution, who pursues, as its business, an activity in the financial sector or one of the related or ancillary activities. PFS are divided into three categories, namely:

- investments firms, which include investment advisers, brokers in financial instruments, commission agents, private portfolio managers, professional acting for their own account, market makers, underwriter of financial instruments, distributors of units/shares in UCIs, financial intermediation firms and investment firms operating an MTF in Luxembourg;
- specialised PFS, which include registrar agents, professional depositaries of financial instruments, professional depositaries of assets other than financial instruments, operators of a regulated market authorised in Luxembourg, currency exchange dealers, debt recovery, professionals performing leading operations, professionals performing securities lending, family offices, mutual savings fund administrators, corporate domiciliation agent and professionals providing company incorporation and management services and central account keepers; and
- support PFS, which include client communication agents, administrative agents of the financial sector, primary IT systems operators of the financial sector and secondary IT system and communication networks operators of the financial sector.

Licence requirement for non EU/non EEA financial service providers

The law of April 28, 2011 on the banking supervisory authorities and the exchange of information requires that non-European Union and non-EEA financial professionals who do not have a permanent base in Luxembourg, get a licence to enable them to provide financial services to Luxembourg-domiciled clients. Circular 11/515 clarifies the application of the aforementioned law.

The licence concerns only those financial actors which are not established in Luxembourg but who occasionally and temporarily come to Luxembourg in order, among other matters, to collect deposits and other repayable funds from the public and provide any other service under the Law on the Financial Sector. The licence is however not required, if the financial professional simply promotes or provides general information of financial services to the public on the Luxembourg territory (i.e. solicitation of clients, courtesy visits to clients and/or organisation of road shows) without entering into contract with the potential client.

Payment institutions and Electronic money institutions

The law of November 10, 2009 relating to payment services (the Payment Services Law) contains a limitative list of types of entities, among which are credit institutions and electronic money institutions (EMIs) that can file an application with the CSSF to be authorised as payment institutions. When granted, such licence gives the right to provide payment services as defined in the annex to the aforementioned law (e.g. enabling cash to be placed on a payment account, enabling cash withdrawals from a payment account, execution of payment transactions, including transfers of funds on a payment account, execution of payment transactions through a payment card or a similar device, and execution of credit transfers).

The Payment Services Law provides for another specific type of institution: the EMIs. These are legal persons whose main activity is to issue means of payment in the form of electronic money. The EMIs are not allowed to receive any deposits or other payable funds as defined by the Law on the Financial Sector.

Insurance and reinsurance companies

Article 32 (1) 5) of the Law of 7 December 2015 on the insurance sector, as amended, (the Law on the Insurance Sector) defines an insurance undertaking as an insurance undertaking from the EAA or as an insurance undertaking from a third country. An insurance undertaking from the EEA is itself defined by article 32 (1) 6) of the Insurance Sector Law as a direct life or non-life insurance undertaking which has received authorisation in accordance with article 14 of the Directive 2009/138/EC (the Insolvency II Directive). Non-life insurance activities are the activities listed in Annex I, Part A of the Law on the Insurance Sector and life insurance activities are those referred to in Annex 2 of the Law on the Insurance sector. Third-country insurance undertakings are defined by article 32 (1) 7) of the Law on the Insurance Sector as undertakings which would require authorisation as an insurance undertaking in accordance with article 14 of the Insolvency II Directive if its head office were situated in the EEA.

Article 32 (1) 9) of the Law on the Insurance Sector defines a reinsurance undertaking as a reinsurance undertaking from the EAA or as a reinsurance undertaking from a third country. A reinsurance undertaking from the EEA is itself defined by article 32 (1) 10) of the Law on the Insurance Sector as an undertaking which has received authorisation in accordance with article 14 of the Insolvency II Directive to pursue reinsurance activities, while a third-country insurance undertaking is defined by article 32 (1) 7) of the Law on the Insurance Sector as an undertaking which would require authorisation as a reinsurance undertaking in accordance with article 14 of the Insolvency II Directive if its head office were situated in the EEA.

Article 43 (28) of the Law on the Insurance Sector defines reinsurance as, inter alia, the activity consisting in accepting risks transferred by an insurance undertaking or by another reinsurance undertaking.

Investment companies in risk capital (sociétés d'investissement en capital à risque, SICARs)

The Law of June 15, 2004 on the investment companies in risk capital, as amended, (the SICAR Law) aims to develop Luxembourg vehicles investing in venture capital and private equity to be considered as risk capital by providing a flexible and competitive framework. A SICAR has as its object the investment of its assets in securities representing risk capital to provide to the investors the benefit of the result of the management of its assets in return of the risk they bear, and which reserves its securities to well-informed investors.

The investment may take various forms, such as buy-offs, leveraged buy-outs, management buy-outs, management buy-ins or start-ups and early stage investments. The articles of incorporation of a SICAR should expressly state that the company is submitted to the SICAR Law.

The AIFM Law separated the SICAR Law into two parts:

- Part I of the SICAR Law sets out common rules applicable to all SICARs, which replicate to a large extent the current regime applicable to SICARs; and
- Part II of the SICAR Law sets out additional rules for those SICARs that are within the scope of the AIFMD by cross-referring to the AIFM Law.

UCIs

The Law of December 17, 2010 on undertakings for collective investments (UCI Law) distinguishes two categories of UCIs: the undertakings for collective investment in transferable securities (UCITS) governed by part I of the UCI Law, which are eligible under the European passporting system; and the UCIs, which are governed by part II of the UCI Law which are non-UCITS retail funds (Part II UCI).

A Part II UCI will in principle always be an AIF within the meaning of the AIFM Law. A Part II UCI can, under certain limited circumstances, opt to be outside of the scope of the AIFMD but will need to comply with provisions relating to the appointment of the depositary and the valuation of assets in the same way as a Part II UCI falling within the scope of the AIFMD.

The Law of February 13, 2007 on specialised investment funds (the SIF Law) was enacted to permit the setting-up of UCIs whose shares are restricted to well-informed investors only. Well-informed investors are institutional investors, professional investors as well as any other experienced investor who fulfils the conditions set out in the SIF Law. SIFs are able to target private individuals (including high-net-worth individuals). These vehicles benefit from enhanced flexibility in their investment activity. The constitutional documents of a SIF should expressly state that the fund is submitted to the SIF Law.

The same approach as for the SICAR Law has been adopted for the SIF Law, which has been split into Part I, setting out general rules applicable to all SIFs, including those which are outside of the scope of the AIFM Law, and Part II, providing additional rules for those SIFs falling within the scope of the AIFM Law.

The AIFM Law also introduced the possibility for SIFs and SICARs to be incorporated under the legal form of a special limited partnership (société en commandite speciale), which is similar to an English limited partnership in that it is established using a limited partnership agreement and does not have a separate legal personality.

From a tax perspective, the concept of carried interest will be clarified, by distinguishing between:

- carried interest as an incentive right not attached to a share or unit, and which will be considered as miscellaneous income to be taxed in principle at the marginal income tax rate; and
- carried interest attached to a share or unit, which qualifies as capital gain for tax purposes (and which is exempted from income tax if it is realised after a minimum holding period of six months and if the participation does not exceed 10 percent of the issuer's capital).

Over the years, Luxembourg has grown to become the second largest fund centre in the world after the United States, with more than 3.4 trillion euros of assets under management. Luxembourg is the leading world hub for the cross-border distribution of UCIs.

Pension funds

Luxembourg pension funds are organised in the form of SEPCAV (société d'épargne-pension à capital variable) or ASSEP (association d'épargne-pension) under the Luxembourg Law of July 13, 2005 relating to pension funds, as amended, and are further regulated by Grand Ducal Regulations dated September 20, 2005.

The Law of July 13, 2005 defines a pension fund as an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or affiliated group for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed:

- individually or collectively between the employer(s) and the employee(s) or their respective representatives, or,
- with self-employed persons, in compliance with the legislation of the home and host Member States, and which carries out activities directly arising therefrom.

Securitisation vehicles

The securitisation is the transaction by which a securitisation undertaking acquires or assumes, directly or through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues financial instruments or enters into, partially or totally, any form of borrowing, whose value or yield depends on such risks. Securitisation vehicles are undertakings which carry out the securitisation in full, and undertakings which participate in such a transaction by assuming all or part of the securitised risks, i.e. the acquisition vehicles, or by issuing financial instruments or entering into, partially or totally, any form of borrowing to ensure the financing thereof, i.e. the issuing vehicles, and whose articles of incorporation, management regulations or issuing documents provide that they are subject to the provisions of the law of March 22, 2004 on securitisation, as last amended by the law of February 25, 2022.

The CSSF will not supervise such securitisation vehicles as long as the financial instruments issued by them are not offered on a continuous basis to the public (in Luxembourg and abroad). It is considered that a securitisation vehicle "issues financial instruments on a continuous basis" when it offers financial instruments to the public more than three times during the course of one financial year, taking into consideration the total number of issuances by all compartments of the securitisation vehicle. In addition, an issuance of financial instruments is considered as "offered to the public" when (i) it is not reserved to professional clients, (ii) the nominal value of the financial instruments is lower than EUR 100,000 and (iii) it is not distributed by means of a private placement. If the financial instruments are offered to the public on a continuous basis, the securitisation vehicle will have to obtain a licence from the CSSF and will have to fulfil additional requirements.

Since the law of February 25, 2022 amending the Luxembourg securitisation regime, securitisation vehicles are allowed to actively manage – directly or through a third-party manager – a portfolio of assets consisting of debt financial instruments or claims, provided that their acquisition is not financed by the issuance of financial instruments offered to the public.

Approved auditors

It should be noted that all auditors have to be members of the Institut des Réviseurs d'Entreprises, which is the professional body of all Luxembourg auditors. In addition thereto, the Law of July 23, 2016 concerning the audit profession, which has implemented into Luxembourg national law Directive 2014/56/UE on statutory audits of annual accounts and consolidated accounts, provides that any person who wishes to carry out statutory audits (contrôle légal des comptes) must obtain a prior authorisation from the CSSF. This requirement applies both to natural persons and to legal persons, which, once such authorisation has been granted, will be conferred the title of "approved auditor" (réviseur d'entreprises agréé) or "approved audit firm" (cabinet de révision agréé), respectively.

REGULATORS

The CSSF

The CSSF is the Luxembourg regulator in charge of the prudential supervision of credit institutions, other professionals of the financial sector, UCIs, certain types of pension funds, SICARs, securitisation vehicles that issue securities to the public on a continuous basis, stock exchanges, payment and securities settlement systems, operators of payment or securities settlement systems, approved auditors and approved audit firms. The CSSF also supervises the securities markets.

The law of April 28, 2011 empowered the CSSF in order to simplify administrative procedures, to deliver authorisations for credit institutions and PSFs which consider changing their corporate object, their denomination or their legal form without obtaining prior approval from the Minister of Finance. In the same line, the CSSF will be entitled to deliver authorisations for the setting-up or the acquisition of subsidiaries in Luxembourg or aboard. Henceforth, the CSSF will also be in charge to authorise investment firms considering to extend their agreement to other services or activities which are currently not covered by their authorisation.

The CAA

The Commissariat aux Assurances (CAA) is the Luxembourg regulator in charge of the prudential supervision of undertakings in the insurance and reinsurance sectors, the insurance intermediaries as well as of certain types of pension funds expressly made subject to the prudential supervision of the CAA.

The Banque Centrale du Luxembourg

The Banque Centrale du Luxembourg (BCL) was founded by the Laws of April 22, 1998 and December 23, 1998 (the Organic Law), as amended. The Luxembourg State is the sole shareholder of the BCL. Its independence, however, is provided for by its founding laws and by the Maastricht Treaty. The BCL's role is important in respect of the Euro area and for the country. The Maastricht Treaty and the advent of the Euro made the establishment of a central bank necessary. The BCL is in charge of essential missions regarding monetary policy, liquidity issues, the issuing of banknotes, financial stability, payment systems as well as economic analysis. Although the law has in principle entrusted the prudential supervision of the financial sector to the CSSF, the BCL also participates in such supervision when it comes to the general liquidity of the markets as well as the impact thereof on the market participants.

MISCELLANEOUS

Investor protection

The rights of customers of credit institutions and investment firms in Luxembourg are secured by a system of protection under the Deposit Guarantee Fund Luxembourg (Fonds de Garantie des Dépôts Luxembourg – "FGDL"), which is instituted by the Law on the Financial Sector. The FGDL has been set up in line with European directives relating to guarantee and investment compensation schemes. The aim of the FGDL is to establish a mutual guarantee system covering deposits in cash and claims from investment transactions in favour of customers and investors. Members of the FGDL are credit institutions and investment firms. In the case of insolvency of one of its members, the FGDL secures all cash depositors by guaranteeing the repayment of their deposits up to 100,000 euros. The same guarantee scheme applies to investors with claims arising out of investment transactions, but only up 20,000 euros.

Financial markets

The Luxembourg Stock Exchange was founded in 1927. It currently operates two markets. The first opened in May 1929 and is included in the list of European regulated markets. The second one, which opened in July 2005, is named "Euro MTF" and is a

multilateral trading facility. The same rules and regulations and trading mechanisms apply to both markets. Although the Euro MTF does not offer some of the advantages of the regulated market of the LSE (e.g. European passport), its attractiveness comes from the lighter financial reports regime and lesser costs for companies whose securities are admitted to trading on the Euro MTF.

One of the reasons for this is that the Luxembourg laws that implemented the Prospectus Directive (i.e. Regulation 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market) and the Transparency Directive (i.e. Directive 2004/109/EC of the European Parliament and of the Council of December 15, 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market) do not apply to securities admitted to trading on the Euro MTF.

Clearing systems

Luxembourg is the home of one of the major players of the clearing industry. Clearstream Banking S.A. is the clearing system based in Luxembourg and is a wholly owned subsidiary of Deutsche Börse AG. All major asset classes are covered including domestic and internationally traded bonds, equities and investment funds and structured products. The CSSF has approved the clearing system that Clearstream operates as a recognised payment system and securities settlement system. In compliance with the applicable legal framework, the BCL has notified such approval to the European Commission. As a leading financial centre, Luxembourg offers an efficient regulatory framework, the main features of which are stability, responsiveness, innovation and expertise.

Law on bearer shares and units

The Luxembourg legal regime applicable to bearer shares and units was amended by the law of July 28, 2014 on the "immobilization" of bearer shares and units (Bearer Shares Law), which entered into force on August 18, 2014. According to the Bearer Shares Law, units and shares issued or to be issued in bearer form by a Luxembourg entity – including investment funds – must be deposited with a professional depositary appointed by the issuer's board of directors or other representative body.

Bearer shares and units had to be cancelled if they were not deposited with a professional depositary by February 17, 2016.

This country profile was kindly provided by Marc Seimetz, Jean-Louis Frognet and Aurélien Martinot at Dechert (Luxembourg) LLP

Complaints Procedure