The Banking Regulation Review

Fourth Edition

Editor
Jan Putnis

Law Business Research

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EDITOR'S PREFACE

2012 may be remembered as the year when practical reality caught up with those who thought that the financial crisis that emerged in Western economies in 2007 would result in more effective cooperation between financial regulators across the world. By one measure – the number of new initiatives and proposals for reform – the amount of cross-border financial regulatory activism has never been higher. But by more useful measures – moves towards solutions to the 'too big to fail' problem through the development of effective cross-border resolution mechanisms for banking groups and international cooperation on reform of OTC derivatives regulation – the optimism of the past has faded a little.

Questions are increasingly asked about whether the obstacles to truly productive cross-border regulatory cooperation – political imperatives, different incentives and straightforward differences of view – will ever be surmounted in ways that make international banking groups fundamentally safer. Media speculation in January 2013 that US regulators might not allow banks to assume cross-border regulatory cooperation in the resolution plans that they prepare in 2013 would, if substantiated, highlight this trend.

These apparently negative developments have not made the period since the publication of the last edition of this book in April 2012 any less interesting. It is also worth noting that most of the challenges that we have seen – new law and regulation that creates difficult questions of cross-border consistency and extraterritoriality, differing regulatory philosophies between major financial jurisdictions and the sheer slowness and unpredictability of developments – have rational, if depressing, explanations. For example, fundamental differences between the insolvency law of major jurisdictions, coupled with cross-border recognition issues and disagreements over how to pay for resolution, are nothing if not formidable barriers to the development of workable group-wide resolution plans for banking groups.

However, the past 12 months have not been a period of complete failure of regulatory reform either. Progress has been made, for example, in the enactment of legislation regarding OTC derivatives, most notably the European Market Infrastructure

Regulation (EMIR) in the European Union. But, as noted above, cross-border cooperation in this area remains an issue: it seems that hardly a month goes by without the discovery of a previously unremarked-upon anomaly between the rules in this area in different countries.

Bank liquidity regulation has continued to be the subject of intense debate in 2012, culminating in the Basel Committee's announcement in January 2013 of its decision to relax and to recommend the gradual phasing in of the liquidity coverage ratio ('LCR') for banks. Taking into account the fundamental influence that the LCR will have on many banks' business models, this was a welcome sign of pragmatism and also a sign of the Basel Committee's willingness to move the debate on liquidity forward.

Despite the challenges that have arisen in bank resolution initiatives, legislation and rules are developing in this area in multiple jurisdictions, with, for example, the publication of the draft European Union Recovery and Resolution Directive ('the RRD') in June 2012.

The European Union is, at the time of writing, enjoying a period of respite from the problems that it faced from the eurozone crisis in 2012, but it would be very optimistic to say that those problems have been brought under control. The European Commission is placing much emphasis on finalising the legislation implementing Basel III (CRD IV) and the RRD as soon as possible in 2013, notwithstanding that each of these initiatives may ultimately be affected profoundly by the parallel 'banking union' proposals for the eurozone.

In the United States, the main rules implementing Basel III are also expected to be substantially finalised in 2013. The significance of the restructuring of the financial regulatory regime in the United States, principally under the rules that are emerging from the framework established by the Dodd-Frank Act, continues to unfold and looks set to dominate the careers of a generation of regulators, bankers and their advisers.

The realisation dawned on many banks in 2012 that regulatory reform will be a longer and more drawn-out process than had been anticipated. For this reason, 2012 may also be remembered as the year when the banking sector in Europe, the United States and some other parts of the world began to think seriously about structural change in the long term, accepting that restructuring will have to take place against a backdrop of continuing regulatory reform. We have begun to see more group reorganisations, disposals, and the severe downsizing or closure of some businesses in banking groups, as well as opportunistic acquisitions. Four principal factors have contributed to these developments:

a A little more certainty, or at least the perception of a little more certainty, about rule-making (or, at least, the direction of rule-making) when compared to the past.

b The continuing urgent need that many banking groups have for capital and liquidity, and the related need to ensure that capital is deployed in the most efficient and profitable ways.

c Some specific legal and regulatory initiatives driving structural change, such as the US Volcker Rule (although this rule has not yet been fully defined at the time of writing) and some emerging (though not yet in force) 'ring-fencing' proposals in parts of Europe (so far principally in the United Kingdom and France).

d Continuing regulatory attacks on complexity and actual or perceived barriers to resolution of banking groups.

Accordingly, many banks are refocusing their businesses (or are currently planning how to do so) on what they consider to be the areas that will yield the highest returns relative to cost in regulatory capital and liquidity terms. Consistent with that objective, we are seeing intense competition for capital allocation between different businesses within banking groups and a more widespread appreciation of the relative capital cost (or capital efficiency) of different activities.

2012 was of course also marked by further recrimination about past practices in parts of the banking sector. Allegations that LIBOR and other benchmarks have been manipulated (or subject to attempted manipulation), continuing losses from mis-selling and other past misconduct continue to affect the sector. Attention has turned more recently to the ways in which banking groups quantify and present these problems in their financial statements.

An increasingly orthodox view among senior management of banking groups in Europe and the United States is to conclude that the only way through these difficulties is to adopt a 'whiter than white' approach to compliance. This involves banks taking the initiative to present a new way forward on compliance matters and breaking away from the more reactive stance that some of them held in the past. Some commentators have asked where this will lead. Will it result in banking groups that are so hobbled and diminished by internal policies and rules that innovation, efficiency and, ultimately, service to the 'real' economy, is put at risk? Observation would suggest that this is a concern unless banks keep in mind four critical objectives when developing their compliance strategy and relationships with financial regulators:

Compliance

The first and most obvious objective is to ensure that banking groups are and remain compliant with their legal and regulatory obligations. In many countries this involves developing a good understanding of the purpose and spirit of those obligations in addition to (or, in some cases, instead of) their literal meaning.

Predictability

It is desirable to maximise the predictability of relationships with financial regulators. Good and constructive relationships with regulators generally make it more likely that banks will see what is coming around the corner sooner and will be better able to find positive ways to plan ahead.

Influence

Constructive influence of regulatory policy development in areas affecting banks is also desirable, even if a bank achieves no more than a small proportion of the change that it would like to see. For this purpose I would include within the meaning of 'influence' the conveying of cogent arguments even where regulators do not act in response to them. This is simply because the route to influence for a bank includes convincing regulators that it has thoughtful and coherent ideas, even where political or other imperatives have the result that the regulator does not address the bank's concerns.

Flexibility and pragmatism

Flexibility and pragmatism in the relationships between banks and their regulators is critical. Inflexibility can lead to inappropriate or overly formulaic regulatory approaches to unexpected developments. Flexibility is often difficult to achieve but is worth pursuing in the interests of both banks and regulators, through regular informal contacts and exchanges of views with senior staff at regulators in addition to formal interactions.

Obvious-looking these objectives may be, but serious problems in relationships between banks and their regulators can usually be traced back to a failure to achieve at least one of them.

This updated edition contains submissions by authors provided for the most part between mid-January and mid-February 2013, covering 56 countries (in addition to the chapters on International Initiatives and the European Union). As ever, comments on this book from banks, regulators and governments are welcome.

My thanks go to the contributors to this book, who have once again taken time out from advising on important matters affecting the banking sector to update their chapters – 'update' meaning a fundamental revision in many cases.

Thanks are also due to Adam Myers, Lydia Gerges and Gideon Roberton at Law Business Research Ltd, for their continuing support in the preparation of this book.

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Jan Putnis
Slaughter and May
London
March 2013

Chapter 34

LUXEMBOURG

Franz Fayot[1]

I INTRODUCTION

i The banking industry in Luxembourg

In a continuously difficult economic environment, the performance of the Luxembourg financial sector further stabilised in 2011 without, however, achieving pre-crisis results. The importance of the financial sector for the Luxembourg economy remains crucial. Among the different industries making up the financial sector, the banking sector's direct impact on the economy in 2011 was estimated at €9.4 billion (which was down 2 per cent compared with 2010) and the net profit of the sector after provisions and taxes was €2.8 billion (down 26 per cent compared with 2010).[2] The main trends driving the performance of the banking sector in 2010 were as follows:

a balance sheets increased slightly in 2011, leading to higher interest margin;

b commission margins that relate to wealth management activities for both individual and institutional clients still show a positive trend; and

c an increase of €1 billion in net provision has been the main reason for the decrease in the net profit compared with last year.[3]

In terms of total assets, the five largest banks in 2011 were, in decreasing order: Deutsche Bank Luxembourg (€95.945 billion); Société Générale Bank & Trust (€49.410 billion); Banque et Caisse d'Epargne de l'Etat, Luxembourg (€39.763 billion); CACEIS Bank Luxembourg (€39.762 billion); and BGL BNP Paribas (€33.776 billion).[4] The total

1 Franz Fayot is a partner at Elvinger, Hoss & Prussen. The author would like to thank Susanne Goldacker of Elvinger, Hoss & Prussen for her help in researching and writing this chapter.

2 Luxembourg Bank Insights 2012, Financial Services, KPMG, p. 5.

3 Luxembourg Bank Insights 2012, Financial Services, KPMG, p. 16.

4 Luxembourg Bank Insights 2012, Financial Services, KPMG, p. 25.

assets of Luxembourg banks rose to €794 billion in 2011, an increase of 4 per cent compared with 2010.[5]

The model prevailing in Luxembourg is that of the universal bank: banks are licensed to provide the full scope of banking services set out in Annex I of Directive 2006/48, but must set out in their business plan the activities they primarily intend to pursue.

Luxembourg has a limited number of banks offering retail and commercial banking services to the general public and to the Luxembourg business community. These banks have large branch networks in Luxembourg and hence their financing model relies heavily on the collection of deposits from the public. They offer a universal array of bank services including deposit taking, personal and professional lending, payment services as well as wealth and treasury management. Most universal banks, in addition, have a more or less developed corporate finance activity, which is in most cases combined with money markets and capital markets activities. Also, at least medium-sized to large banks tend to have trading floors that cater to the trading, hedging and treasury optimisation needs of clients and of the banks themselves.

Another traditionally important activity in the banking sector is private banking, which comprises portfolio management in all its different forms, ranging from discretionary management to custody combined with investment advice.

Luxembourg is one of the main jurisdictions for the establishment and distribution of investment funds. As a result, the servicing of investment funds, including custodial services, central administration and also securities trading and the distribution of fund units has developed into a thriving activity for the Luxembourg banking sector.

ii Recent headline events and topics

Given the importance of the Luxembourg banking sector for the national economy and budget, which was under heightened scrutiny during the past year given the ongoing crisis in the eurozone, the performance of the banking sector is a constant subject of discussion. As indicated above, the ongoing international financial crisis continues to negatively affect the results of banks.

The EU-wide stress tests that were conducted in 2010 and 2011, and in which Banque et Caisse d'Epargne de l'Etat ('BCEE') participated in 2010 and 2011 were also discussed topics in the Luxembourg banking sector. The Luxembourg-based BCEE performed well in both tests.

Another much-discussed subject is the implications of FATCA for the Luxembourg banking sector. The US FATCA, given its extraterritorial scope and its considerable implications for the risk management and compliance functions of banks, is viewed as having potentially significant effects on business activities related to US customers. As a result of FATCA, an increasing number of banks no longer accept new US customers and are considering terminating their relationship with existing US customers. Luxembourg Finance Minister Luc Frieden announced on 11 December 2012 that the government

5 Luxembourg Bank Insights 2012, Financial Services, KPMG, p. 24.

has decided to start negotiations for a bilateral agreement between Luxembourg and the United States regarding the implementation of FATCA.

Also, in the field of taxation, it is noteworthy that on 1 July 2011 the withholding tax applicable under the EU Savings Directive increased to 35 per cent. However, if an individual taxpayer resident in an European Member State provides a Luxembourg bank (1) either with an exemption certificate, which shall be issued on the taxpayer's request and drawn up by the tax authorities of the taxpayer's country pursuant to Article 13(2) of the Savings Directive (Article 13(1)(b)); or (2) with a mandate to automatically report, according to Article 9 of the Savings Directive, nominative information through their competent authorities to the tax administration of their country of residence on all interest payments covered (Article 13(1)(a)), no withholding tax will be withheld by the Luxembourg paying agent, as the tax administration of the country of residence is already aware of the fact that its resident holds a cash or securities account in Luxembourg. In order to make it easier for clients of Luxembourg banks to obtain the exemption certificate from their country of residence, the Luxembourg Bankers' Association ('ABBL') has written to all EU Member States requesting information on their certificates and asking them to send the association model forms if available. The certificates/model forms for individuals as well as for so-called residual entities (opting for the UCITS treatment), may be downloaded from the website of the ABBL.[6] The discussions in the context of the G20 resolutions on increased contributions by banks to the national budgets in the aftermath of the financial crisis have also been much-debated in Luxembourg. This is particularly the case with the transaction tax, which was announced by the European Commission and was met with great resistance by the Luxembourg banking community. The position of the Luxembourg government in respect of this type of tax is not to oppose it as a matter of principle as a way to make the financial services sector contribute to the costs of the financial crisis, but to argue that it should be adopted at an international level rather than on a European level only. The concern is similar to that of the United Kingdom, where a locally introduced transaction tax could lead to a distortion in competition between international financial centres. Luxembourg will therefore not form part of the European countries[7] introducing the financial transaction tax, as approved by the Finance Ministers of the EU Member States on 22 January 2013.

Finally, the consolidation movement in the Luxembourg banking sector is continuing, with in particular the completion of the sale agreed in 2011 of two important banking groups to Qatari investors (see also Sections I.iii and VII, *infra*).

iii Deals

Qatari investors Precision Capital acquired 90 per cent of Dexia Banque Internationale à Luxembourg ('BIL') in a deal valuing the bank at €730 million. This acquisition came

6 www.abbl.lu

7 Pursuant to the information available at the time of the drafting of this chapter, 11 EU Member States will introduce the financial transaction tax: Germany, France, Austria, Belgium, Spain, Estonia, Greece, Italy, Portugal, Slovakia and Slovenia.

after the break-up of the Dexia Group in October 2011. The Luxembourg state agreed to take 10 per cent of the capital BIL for an amount of €73 million. The acquisition was finalised in October 2012. Precision Capital also agreed to acquire KBL European Private Bankers SA ('KBL') from KBC after the failed deal with Indian Group Hinduja. The transaction comprised KBC's entire interest in KBL and included all the private banking subsidiaries as well as the custody and life insurance businesses of KBL. The closing of that transaction took place in July 2012. In November 2012, KBL announced a reduction in staff (up to 150 staff members) for economic reasons. In October 2012, Banque de Luxembourg agreed to acquire the private banking business of Lloyds TSB Bank plc, Luxembourg branch. Completion is scheduled to take place on 31 January 2013. In January 2013, Hauck & Aufhäuser Banquiers Luxembourg SA announced that DZ Privatbank SA agreed to acquire its private banking business. Completion is expected to occur in the first quarter of 2013.

iv Statistics

As of 17 January 2013, 154 (against 143 as of 10 January 2012) banks were registered on the official list of authorised banks of the Luxembourg regulator, the CSSF.[8] As of 17 January 2013, out of a total of 154 banks there were 119 Luxembourg-established banks and 35 branches.[9] On 3 December 2011, the total balance sheet of the banks established in Luxembourg was €794.0 billion (against €762.3 billion on 31 December 2010).[10] The financial sector employed 26,695 people as of 31 December 2011, up from 26,254 on 31 December 2010.[11]

For a complete and up-to-date statistical overview of the evolution of the banking sector, please refer to the latest annual report and newsletters of the CSSF available on the CSSF's website.[12]

II THE REGULATORY REGIME APPLICABLE TO BANKS

The regulation of banks in Luxembourg is based almost exclusively on the European legislative framework. The Law on the Financial Sector of 5 April 1993, as amended ('LFS') is the main source of regulation for banks and it is also the law into which the different European directives are implemented. The LFS was first adopted with the implementation of the second banking directive, and thereafter all subsequent directives governing access to banking activity: Directive 2006/48, its supervision (Directive 92/130 on consolidated supervision of credit institutions), the Capital Adequacy Rules (Directive 2006/49), the Markets in Financial Instruments Directive ('MiFID'), and Directive 2010/78/EC in respect of the powers of the European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions

8 CSSF annual report 2001, p. 8.

9 List of authorised credit institutions published on the website of the CSSF (www.cssf.lu).

10 CSSF annual report 2011, p. 54.

11 CSSF annual report 2011, p. 52.

12 www.cssf.lu.

Authority and the European Securities and Markets Authority)[13] were implemented in this law.[14] The Payment Services Directive (2007/64) was enacted by a specific law, the Law of 10 November 2009 relating to payment services, which was amended on 20 May 2011 to introduce into Luxembourg law Directive 2009/110/EC regarding e-money establishments.[15]

The general legislative approach of the Luxembourg legislature is, to the fullest extent possible, to perform a one-to-one implementation of European rules.

i Securities activities

The securities activities of banks are primarily governed by the rules of conduct and organisational rules of the MiFID, which have been implemented by a law and grand-ducal regulation of 13 July 2007.[16] The Capital Adequacy Rules relating to the trading books of banks are set out in Circular CSSF 06/273, which implements the Capital Requirements Directive (Directive 2006/49 – 'CRD'). Rules relating to the organisation and internal control of the market activity of banks are set out in Circular IML 93/101.

The securities activities of banks are also subject to applicable market abuse rules, the transparency law and possibly the takeover law, all of which are implementations of the relevant EU directives.[17]

ii Deposit taking and lending

Deposit taking and lending, which is the core activity of banks, is regulated in Luxembourg as part of the general prudential supervision of banks. The CSSF does, however, have the power to instruct the banks to ask their auditors to perform special reports and risk assessments on their loan books, if it appears that a special risk (e.g., counterparty risk and concentration of risks) is attached thereto. This has occurred in the course of 2008 in relation to the subsidiaries of the three failed Icelandic banks.

Also, in relation to deposit taking, the CSSF has issued in its report for 2008 a statement that it will have 'an attitude which is in principle negative for projects

13 Directive 2010/78/EC was implemented by the Law of 21 December 2012.

14 The LFS has further recently been amended by the Law of 21 December 2012 relating to family office activities. This Law regulates the activity consisting in the provision of advice or services regarding wealth management to natural persons, families or corporate vehicles that belong to, are founded by, or benefit to natural persons or families. Credit institutions are authorised to exercise this activity under their banking licence.

15 The Payment Services Law has also been amended by the Law of 21 December 2012 implementing Directive 2010/78/EC.

16 The Law of 13 July 2007 has also been amended by the Law of 21 December 2012 implementing Directive 2010/78/EC.

17 The Transparency Law has been amended by the Law of 3 July 2012 regarding amendments to Prospectus Law and Transparency Law and the implementation of Directive 2010/73/EU. The modifications include an increase of the threshold from €50,000 to €100,000 to make a distinction between retail and professional investors. The Transparency Law has further been amended by the Law of 21 December 2012 implementing Directive 2010/78/EC.

which imply the receipt of deposits from the public at large abroad, either by way of branches or through the internet, by reason of the risks that such models imply for the system of deposit guarantee'. A common circular issued jointly by the CSSF and the Luxembourg Central Bank ('BCL') on 29 June 2012 addressed to all Luxembourg credit institutions and applying both on an individual and on a consolidated level aims to specify the application of Article 5(1)-bis of the LFS requiring credit institutions to adopt effective processes to detect, manage, control and declare risks to which they are or may be exposed in relation to US dollar denominated funding. The circular in particular implements in Luxembourg the recommendation of the European Systemic Risk Board (ESRB/2011/2) dated 22 December 2011.[18]

The circular requires credit institutions to apply the recommendation in a proportionate manner, and to adapt their internal governance by putting into place strategies and policies defining their US dollar liquidity and financing risk tolerance. Such tolerance levels have to remain within the capacity of the credit institutions to support and manage the underlying risk. Credit institutions will also have to develop emergency financing plans that provide measures to counter shocks affecting financing in US dollars. These plans must be based on feasibility studies for such measures and examine the emergency financing sources available in case of a reduction of several counterparty categories. The circular has entered into force with immediate effect.

A common circular of the CSSF and the BCL issued on 29 June 2012,[19] addressed to all Luxembourg credit institutions, investment firms and professionals carrying out lending transactions in order to grant loans to non-financial private borrowers in another currency than the currency of the country where the borrower is domiciled, clarifies the application of Articles 5(1)-bis and 17 of the LFS requiring these institutions to adopt effective processes to detect, manage, control and declare risks to which they are or may be exposed in relation to these loans. The circular applies to these institutions both on an individual and on a consolidated level. In particular, the circular implements the recommendation of the European Systemic Risk Board (ESRB/2011/1) dated 21 September 2011. The circular has entered into force with immediate effect.

iii Legal structures of banks

In accordance with the principles of Directive 2006/48, Luxembourg-established banks need to fulfil the approval procedures for access to the activity in Luxembourg and are also fully supervised by the CSSF in Luxembourg according to the home Member State principle. This principle also applies to branches of non-European Union banks.

In relation to branches of EU banks established in Luxembourg, the CSSF remains in charge of the supervision of the liquidity of such branches in its capacity as host Member State authority. Cross-border activities into Luxembourg without having a branch in Luxembourg are only possible for EU banks, which can exercise this possibility under the freedom of provision of services. This possibility is not given to non-EU banks.

18 CSSF Circular 12/537 – BCL Circular 2012/229 – Financing by Credit Institutions in US dollars.

19 CSSF Circular 12/538 – BCL Circular 2012/230 – Loans in Foreign Currencies.

iv Basic structure, priorities, agenda and resources of the regulators

The relevant regulators in the case of banks are the CSSF and, to a lesser degree, the BCL. The CSSF was created by the Law of 21 December 1998, which set it up as a public establishment in charge of assuming the prudential supervision of banks and professionals of the financial sector (including investment firms) and also as supervisor of the financial markets in Luxembourg.

The CSSF is governed by a board of directors and, on a day-to-day basis, by a management board comprising four directors. The director general of the CSSF was replaced in May 2009, along with most of the management board. The new management brought along a slight change in policy at the CSSF. Indeed, the CSSF has over the past year somewhat tightened its supervision of professionals in the financial sector and is intent on increasing its focus on quality-oriented supervision, by application of the new CRD framework and in particular the Pillar II principles, while at the same time maintaining the practical and principle-based approach in supervision which has always been the trademark of the Luxembourg regulator. The CSSF has also, starting in 2011, adopted a stricter approach with regard to enforcement of sanctions and is increasingly using the right conferred by the LFS to impose fines and to publish sanctions by press release. As of 8 November 2012, the CSSF employs 447 agents.[20]

Since the Law of 24 October 2008, the BCL has received the mission to carry out the micro-prudential supervision of the liquidity management and risks of banks. This supervision is exercised through off-site monitoring and on-site inspections, the latter being conducted jointly with the CSSF.[21] The BCL is also competent for periodically receiving the reporting of banks for statistical purposes.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The prudential regulation exercised by the CSSF is based in particular on the reporting by banks. The new harmonised European reporting developed by the European Committee of Banking Supervisors ('ECBS') consists of FINREP (financial reporting) and COREP (consolidated reporting). Both are based on IFRS rules, as opposed to Lux GAAP, which was the previous accounting referential.

The prudential supervision also relies to a large extent on the review of the long-form reports of independent auditors reviewing the accounts of the banks, on possible visits on the premises and on heightened scrutiny and caution in case a bank is in a difficult liquidity or solvency position or has exposures that do not comply with applicable prudential rules.

However, the CSSF is also increasingly controlling compliance with laws and regulations through on-site controls.

With the new European regulatory framework (CRD II) having entered into force, and because Luxembourg banks are predominantly branches or subsidiaries of

20 CSSF newsletter, November 2012.

21 BCL annual report 2010, p. 107.

European groups, the CSSF is a member of the European System of Financial Supervision (ESFS) and participates in each of the four activities composing the ESFS, the European Banking Authority ('EBA'), the European Securities and Markets Authority ('ESMA'), the European Insurance and Occupational Pensions Authority ('EIOPA') and the European Systemic Risk Board ('ESRB').

Disclosure obligations to the regulator

In addition to their regular reporting obligations (in particular COREP and FINREP, communication of annual accounts and management report, communication of reports of their internal audit and compliance officers and communication of analytical long-form reports of auditors), the CSSF must be informed promptly on all matters regarding the solvency, the liquidity position of banks (Circular 07/301, as amended) and on large exposures.

Also, the CSSF must generally be informed of all changes to the conditions for the approval of a bank, including changes to the top management, changes to the business plan and any change in the shareholder structure.

ii Management of banks

Typical management structures

Article 7.1 of the LFS requires any member of the management or administration body of a bank to justify sufficient professional honour, which requires a clean criminal record and elements demonstrating the good character of a person.

In addition to a board of directors, a bank would typically have two or more persons in charge of the daily management of the bank. The 'four eyes principle' is set out in Article 7(2) of the LFS and requires at least two persons to be in charge of the management, with the power to effectively determine the direction of the activity, and having appropriate professional experience (i.e., having exercised similar functions at a high level of responsibility and independence, and again with the required professional honour).

Other management structures are common, in particular in more sizeable banks, involving an 'executive committee' or a 'direction committee' composed of three or more persons fulfilling the same conditions and taking decisions as a collegiate body, with the possibility to delegate daily signature powers.

Legal and regulatory duties of managers of banks

The management of a bank is not only responsible for implementing the business plan of the bank, but also has responsibility for setting up and ensuring the proper operation of the main functions of a bank. In the context of Luxembourg banks, this includes the central administration in Luxembourg, sound administrative and accounting organisation, the internal control function and the compliance function. The requirements and conditions applying in this context are set out in the new CSSF Circular 12/552[22] abrogating

22 Generally applicable from 1 July 2013 (certain sections will be applicable from 1 January 2014).

Circulars IML 95/120, IML 96/126, IML 98/143 and CSSF 04/155 as regards credit institutions and investment firms[23] and Circulars IML 93/94 and CSSF 10/466. The new Circular 12/552 consolidates the provisions of the different above-mentioned circulars and transposes the guidelines of the EBA on internal governance,[24] the management of concentration risk[25] and liquidity cost benefit allocation[26] as well as the guidelines of the Basel Committee on Banking Supervision on internal audit.[27] It introduces changes relating, *inter alia*, to corporate governance (strengthening of the control by the board of directors and the internal control functions, introduction of new functions such as IT Officer and IT Security Officer) and risk controlling (risk management and credit risk). The management further assumes supervision on a consolidated basis (if applicable) (Circular IML 96/125) MiFID and rules of conduct (Circular CSSF 07/307), the organisation and internal control of market activity (Circular IML 93/101), client complaints (Circular IML 95/118) and of course compliance with all capital adequacy requirements, ICAAP (Circular CSSF 07/301), solvency ratios, liquidity ratios and maintaining all appropriate reporting procedures. Pursuant to Circular CSSF 09/424, a bank is at all times required to indicate in table B4.6 the members of authorised management that are responsible for all the aforementioned functions.

Approval by a holding company board before implementing decisions

The Luxembourg regulator has always followed the principle that a Luxembourg bank or a Luxembourg branch of a non-EU bank must have a certain independence in decision-making in all areas, including in the allocation of credits. This translates into the concept of 'central administration' as set out in the Circular 12/552, which in relation to management committees composed of representatives who do not exclusively belong to the authorised executive committee provides that, regardless of the composition of such committees, the authorised representatives of the local bank or branch always must at least have a veto right in relation to decisions taken by the relevant committee.[28]

Latest restrictions on bonus payments to management and employees

The CSSF published Circular CSSF 10/437 on 1 February 2010, comprising guidelines relating to the remuneration policies in the financial sector, completed and strengthened by Circulars CSSF 10/497 and 10/496 on 22 December 2010 transposing Directive 2010/76 on capital requirements for the trading book and for resecuritisations, and the supervisory review of remuneration policies. After referring to a number of international principles and recommendations, such as the ECBS 'High level principles

23 Some of the pre-mentioned circulars, however, remain in force as regards other professionals of the financial sector that are not investment firms and for payment institutions and e-money institutions.

24 of 27 September 2011.

25 of 2 September 2012.

26 of 27 October 2012.

27 of 28 June 2012.

28 CSSF Circular 12/552, point 53.

for remuneration policies' of 20 April 2009 and Recommendation 2009/384 of the European Commission of 30 April 2009 on remuneration policies in the sector of financial services, the Circular CSSF 10/437 defines the scope and type of remuneration policies to be put in place in the financial sector.

The CSSF requires all 'financial undertakings', which includes banks, to establish and implement a remuneration policy that is compatible with an efficient and adequate management of risks and that does not lead to excessive risk-taking. The circular contains guidelines as to the structure of the remuneration policy, including a distinction between fixed and variable components of a remuneration, the definition of a threshold for the variable part, the possibility to postpone the payment of the variable part, and the requirement of a relation between the premium paid and a long-term assessment of the performance of the financial undertaking. Circular 10/437 also includes certain principles as to the governance of the remuneration policy and the control of the policies. This circular adds that the credit institutions shall have a robust internal governance system, which includes remuneration policies and principles promoting a sound and efficient management of the risks, and it lists the principles that shall be respected by the remuneration policies such as the conduct of yearly internal audits, the conformity of the remuneration policy to the long-term strategy of the bank, the level of tolerated risk of the institution, etc.[29]

Finally, Circular 10/437 specifies that the remuneration policy will be supervised by the CSSF as part of the prudential supervision and that it is also a part of the review to be conducted by the independent auditors of a bank.

The management of 'financial undertakings' had to draw up the principles of its remuneration policy by 30 June 2010 and apply them as from the financial year 2011.

Circular 11/505, published on 11 March 2011, provided credit institutions and investment firms with essential precisions on the definition of the 'proportionality principle', making it possible for smaller banks to meet the CRD III's objectives in an easier or less burdensome way, thereby waiving or neutralising a certain number of requirements. Based on certain criteria, the proportionality principle can either be applied at the level of the institution as a whole or to some only of the identified staff within the institution.

In case the bank is allowed to resort to the proportionality principle, certain requirements can then be neutralised:

a the requirement to pay out a part of the variable remuneration in instruments and, *de facto*, the related instrument retention obligations;

b the requirement to pay out a part of the variable remuneration through a deferral scheme and, *de facto*, the related *ex post* risk adjustment obligations (*malus*); and

c the requirement to set up a remuneration committee.[30]

29 Circular 10/496 p. 40.

30 Luxembourg Bank Insights 2011, KPMG, pp. 57–58.

iii Regulatory capital

The only practical instances where regulatory capital concerns have arisen in corporate transactions involving banks and in the ordinary course of business (to our knowledge) were in the cases of the banks that had to be rescued in the context of the financial crisis (i.e., Fortis, Dexia-BIL and Kaupthing Bank Luxembourg (Fortis and Dexia-BIL were recapitalised and supported respectively through the aforementioned state intervention)).

Regulatory capital concerns could theoretically also arise in the case of a merger or demerger, but the CSSF would only agree to such a transaction if it had the assurance that the regulatory capital requirements would be met to cover the entire risks related to the new entity.

In the ordinary course of events, banks are subject to monthly prudential reporting. If capital concerns were to arise the CSSF would require the bank to take adequate measures in the form of recapitalisation or reduction of the risks related to the activity. In the case of bank groups operating cross-border, it is important to note that in the absence of an agreement at the level of the college of regulators, the principles introduced by CRD II allow for the host state regulator to take the final decision as to capital adequacy and, if necessary, to require additional capital at the host level (add-on).[31] The CSSF, however, notes that this may change with CRD IV, where this decision could fall to the EBA.

Principal elements of calculation of regulatory capital requirements

The new Basel II solvency ratio came into effect on 1 January 2008. It is defined in Circular CSSF 06/273 (as amended for the last time by Circular CSSF 11/501 defining capital ratio pursuant to Article 56 of the LFS), which implements the CRD. The own fund requirements are described in Part IV of Circular CSSF 06/273. The constitutive elements of own funds under Basel II are substantially the same as under the former solvency ratio, save that certain prudential filters apply for the calculation of the own funds. These prudential filters aim to ensure that prudential own funds comply with qualitative criteria, which are particular to their status, whereas they are based on elements of accounting own funds on the balance sheet, which follow other qualitative and formal criteria.

The prudential own funds must therefore comply with:

a a certain prudent approach involving stability or absence of volatility of own funds;

b a quality of permanence;

c availability to absorb losses; and

d credible evaluation.

The new Basel II ratio has three essential novelties:

a the possibility to use, in lieu of the standard approach, internal models for determination of own fund requirements for the credit risk;

b the consideration of operational risk; and

31 CSSF annual report 2010, p. 58.

c risk absorption techniques that are much more elaborate under Basel II: these techniques rely on a much broader base of instruments and elements, but eligibility and consideration criteria are much more restrictive (qualitative and legal criteria must be complied with) and a calculation method and review that are more nuanced, and therefore more complex, than under the former ratio.

While the calculation methods of exposures and requirements were unique under the former ratio, the new ratio provides for different methods that can be applied following the needs and abilities of each bank. The choice of methods and, if applicable, of internal models used are agreed upon and followed by experts of the CSSF. It is to be noted that the chosen method must always be applied.

Tier I own funds are composed essentially of paid-up capital, silent participations, share premiums, reserves, carried-forward profits and losses, funds for general banking risks and minority interests. To be deducted therefrom are own shares, intangible assets and certain deductions that for 2009 comprised, *inter alia*, deductions that were due to the first application of the IFRS accounting referential.

Tier II in Luxembourg banks essentially comprises cumulative preferential shares without fixed maturity and subordinated securities (upper Tier II) and subordinated securities and cumulative preference shares with fixed maturity (lower Tier II). As to Tier III, its share is nearly irrelevant in the context of Luxembourg banks. Generally, for the definition of prudential own funds, please refer to Part IV of Circular 06/273 of the CSSF, available on the CSSF website.

As to the capital requirements, the requirements for the coverage of credit risks continued to be by far the most important position in 2011 (83 per cent of the global capital requirements as of 31 December 2009)[32] but down by 4.7 per cent in comparison to 2008. The other risk elements (interest rate, foreign exchange, ownership risk, risk related to base products, risk requirements following internal model and settlement risk) are quite low in impact.

The part of CRD II concerning the establishment of supervisory colleges was implemented into the LFS by the Law of 28 April 2011. The technical provisions of CRD II (calculation of own funds requirements for credit risk related to securitisations, calculation of limitation for large exposures, definition of own funds) were implemented for banks by Circular CSSF 10/475.

Significant areas of divergence

There are no elements of divergence from the CRD and so from Basel II. The CSSF has performed a straight implementation of these rules and does not consider that any divergence is allowed. The CSSF has included reference tables and tables describing the options and national discretions taken in the section 'Supervisory disclosure' on its website. These tables are available in English.

32 CSSF annual report 2011 p. 61.

Consolidated supervision

By 31 December 2011, 26 Luxembourg law banks (as in 2010), two financial holding companies under Luxembourg law and one financial holding company under foreign law (as in 2010) were supervised by the CSSF on a consolidated basis.[33] Circular IML 96/125 sets out the practical rules for the supervision on a consolidated basis. The CSSF is paying particular attention to the function of 'head of group' put in place at the level of the Luxembourg establishment falling under its consolidated supervision. Thus, the CSSF particularly reviews the manner in which a Luxembourg mother company communicates its policies and strategies to its subsidiaries as well as the controls existing at the level of the mother company in Luxembourg in order to follow the organisation and the activities of its subsidiaries, as well as the risk taken by the subsidiaries.

There are multiple means by which the CSSF may exercise its supervision on a consolidated basis:

a the CSSF requires periodical reporting reflecting the financial situation and consolidated risk of the group;

b the ICAAP report must provide an assessment as to the adequacy of consolidated own funds with regard to the risks taken at the level of the group or the sub-group;

c reports from external auditors are another source of information (Circular CSSF 01/27, as amended, requires the establishment of an annual analytical report on a consolidated basis for any group subject to the consolidated supervision of the CSSF);

d CSSF requires in respect of each important subsidiary the establishment of an analytical individual report;

e the synthetic report on the activity of the internal audit department must also encompass the activity of subsidiaries in Luxembourg and abroad;

f the CSSF draws information from contacts with supervisory authorities from the host Member States of subsidiaries of any Luxembourg group;

g for those groups having an important network of subsidiaries, the CSSF is keen to follow the evolution of the financial situation and the risks of the subsidiaries included in the consolidated supervision on the basis of regular meetings with the management of the banks or the financial holding companies which are under consolidated supervision; and

h the CSSF can perform controls in the premises.

How much capital local regulators are currently requiring banks to hold and how much of that capital is required to be held in the form of ordinary share capital

The LFS requires banks to have a share capital of at least €8.7 million, of which at least €6.2 million must be paid up. In accordance with Article 8(2) of the LFS, the own funds of a bank may not fall below such amount of share capital.

Under the current CSSF regulation banks are entitled to hold up to 100 per cent of Tier II capital in addition to Tier I and own funds. This means that in theory a bank

33 CSSF annual report 2011 p. 73.

could hold up to 4 per cent of own funds represented by Tier II instruments. After the decision by the EBA of 8 December 2011 to require 71 European banking groups to comply with a ratio core Tier I of 9 per cent from July 2012, the CSSF has decided to require a core Tier I capital at a level of 9 per cent in all banks under its supervision in order to ensure equal competition conditions in the banking sector.[34] With an average core Tier I ratio of 15.1 per cent, such requirement was already fulfilled by a majority of banks in Luxembourg as of 31 December 2011.[35]

Description of the regime for the regulation of the liquidity of banks

The liquidity ratio is calculated as a percentage of liquid assets to current liabilities. Its minimum is 30 per cent in Luxembourg and in 2011 it improved by 4 per cent (compared with 2010) to 69 per cent.[36]

In relation to liquidity risks the CSSF applies the principles of prudential supervision, which were redefined at the end of 2008. These principles in particular provide for the acceptance by the CSSF of intra-group risks inherent to the reallocation of liquidities surplus intra-group, provided that such transactions do not negatively affect the sound risk profile of banks in Luxembourg.

In the field of liquidity supervision the CSSF cooperates with the BCL through a coordination of on-site control and regulatory developments.

The regulatory framework for the supervision of liquidity by the CSSF is defined by Circular CSSF 07/301, as amended, which defines the main principles in the fields of sound risk management; Circular CSSF 09/403, which refers to the qualitative requirements in the field of the proper management of liquidity risks; and Circular IML 93/104, which limits the structural liquidity risks and imposes a liquidity ratio (table B1.5). Circular CSSF 10/475 published in July 2010 formally completes the Basel II referential by qualitative requirements in the field of liquidity risk management provided in Directive 2009/111/EC. Previously these requirements existed substantially in the Luxembourg regulations through Circular CSSF 09/403, which implemented the guidelines detailed by the EBA in relation to liquidity risks management.

In the future, after completion of discussions that are ongoing with regard to CRD IV, the quantitative regime relating to liquidity as provided for in Circular IML 93/104 will be repealed and replaced by two prudential ratios called liquidity coverage ratio ('LCR') and net stable funding ratio ('NSFR'). These ratios are based on the proposal of the Basel Committee as published in December 2010 ('International framework for liquidity risk management, standards and monitoring').[37] While the entry into force of the new prudential regime involving LCR and NSFR is provided as 1 January 2015 and 1 January 2018 respectively, these measures are intended to be progressively complied with by Luxembourg banks. From 1 January 2013, banks have to report to the CSSF all

34 CSSF annual report 2011, p. 47.

35 CSSF annual report 2011, p. 47.

36 Luxembourg Bank Insights, KPMG, 2012, p. 17.

37 CSSF annual report 2011, p. 68.

LCR calculation elements. The CSSF has conducted local studies in order to monitor the evolution and the impact of the two new liquidity ratios.[38]

iv Recovery and resolution

The reorganisation and resolution regimes for failed banks is currently provided for in Part IV of the LFS relating to the 'reorganisation and winding-up of certain professionals of the financial sector'.

The two regimes provided by the LFS are the suspension of payments and judicial liquidation. While the suspension of payments, which is a type of controlled management involving the appointment of a judicial administrator, allows for the recovery or restructuring of a failed bank the judicial liquidation only serves the purpose of winding up a failed bank – it is possible that a restructuring or a spin-off could be made out of insolvent liquidation, although this question is debated. Both regimes are of a judicial nature. Instruments such as living wills or urgent intervention of the regulator in a resolution are not formally recognised by Luxembourg law. In spite of the weaknesses of the legal regimes in the context of the four bank failures during the 2008 financial crisis (Lehman Brothers, Kaupthing Banks Luxembourg, Landsbanki Luxembourg, Glitnir), two of these four bankruptcies were restructured (Kaupthing Bank after suspension of payments and Glitnir in the context of a voluntary liquidation). Systemic banks in trouble (Dexia-Bil and Fortis) were rescued during the 2008 crisis (and, in the case of Dexia-Bil, again in October 2012) by state intervention.

There are currently no plans in Luxembourg to legislate in relation to bank resolutions, the intent being to wait for the European legislator to propose regulation. The proposal for a Recovery and Resolutions Directive was published on 6 June 2012[39] and is currently under discussion between the EU Member States. It should be noted that the Law of 28 April 2011 has also introduced provisions for the quick transmission of information of a prudential nature to central banks and the competent departments of the Ministries of Finance to permit for an accurate intervention by an injection of liquidity or state intervention for the purpose of saving banks in financial difficulty.

IV CONDUCT OF BUSINESS

i Outline of local rules governing banks' conduct of business

The rules of conduct of banks are mainly set out in Part II, Chapters 4 and 5 of the LFS. In particular, they consist of the rules implemented from the MiFID, which are contained in Chapter 4 of Part II of the LFS. The MiFID rules include the organisational requirements, conflicts of interest rules, best execution, client order treatment, transactions with eligible counterparties and related agents' rules. These rules are further detailed in Circular CSSF 07/307 of 31 July 2007.

Furthermore, Chapter 5 of Part II of the LFS sets out other professional rules, including, in particular, anti-money laundering rules, which are the subject from time

38 CSSF annual report 2011, p. 68.; results of those studies can be found on www.cssf.lu.

39 COM (2012) 280 final.

to time of specific circulars relating to preventing money laundering and the financing of terrorism. The Law of 27 October 2010 enacted in response to the FATF's report on Luxembourg enhanced the obligations of professionals of the financial sector and strengthened the powers of the legal authorities and of the regulator in the field of anti-money laundering and terrorism financing. Chapters also contain the obligation to cooperate with authorities and the obligation to professional secrecy, which will be further discussed below.

Banks will also be held to those rules of conduct arising under the Payment Services Law of 10 November 2009, as amended, having implemented Directive 2007/64 on payment services, including all applicable information requirements. The Payment Services Law is also the object of Circulars CSSF 09/420 and 12/533.

On 4 October 2012, the ABBL's Private Banking Group, Luxembourg ratified the International Capital Market Association's Private Wealth Management Charter of Quality, which brings together in a single document the guiding principles of best practice adopted by the cross-border private banking industry. As of 23 January 2013, 61 banks have signed the Charter.[40]

ii Potential sources of civil, criminal and regulatory liability

Regarding regulatory liability of banks, Article 58 of the LFS provides for the possibility of clients complaining to the CSSF against banks that are subject to its supervision. These complaints often relate to the banks' alleged professional negligence, which are either dismissed by the CSSF if it considers that they are without merit, or followed up and discussed with the relevant bank. In relation to banks that do not comply with applicable regulations, the CSSF has a power of injunction, imposing disciplinary fines and even suspending the licence of a professional. The CSSF can also issue public statements disclosing the failure by banks or supervised entities to comply with applicable laws and regulations and publicly discussing the measures decided by the CSSF.

In particular, in the field of private banking, Luxembourg courts have over the years rendered numerous rulings in civil liability suits initiated by clients for claims in contractual and tortious liability cases against banks, especially in the context of portfolio management or wrong execution of client orders. Consistent with applicable principles of contractual civil liability, courts consistently rule that banks are only held to an obligation of means and that the client must establish a fault of the bank in the management of its portfolio as well as a causal link to the damage that the client has suffered, in order for the bank to be held liable.

iii Banking confidentiality rules

Luxembourg has a strict bank confidentiality rule that is enshrined in Article 41(1) of the LFS, which provides that the disclosure of any information that is subject to bank confidentiality is punished by sanctions provided for in Article 458 of the Criminal Code, which is imprisonment for up to six months or a fine of between €500 and €5,000, or

40 www.abbl.lu.

both. Bank confidentiality covers all information entrusted to bankers in the course of their professional activities.

Banking confidentiality is therefore primarily a criminal law rule that must comprise a material (tangible) element and an intangible element in order to be characterised. However, the breach of bank confidentiality also has civil law implications that can give rise to damages both on a contractual and on a tortious liability basis. Disciplinary sanctions against banks having breached bank secrecy are also possible.

Article 41 of the LFS, however, provides that the obligation to bank confidentiality ceases when the disclosure of information is authorised or imposed by, or under the terms of, a legal provision. The law provides certain exemptions to bank confidentiality if certain conditions are met, in particular in certain judicial matters, in relation to information on shareholders, supervisory authorities, in the context of market abuse, money laundering, outsourcing and upon instruction of clients. The Law of 27 October 2010 enhancing the anti-money laundering and counter-terrorist financing legal framework added a sentence to paragraph 39 of the LFS, pursuant to which any professional shall respond exhaustively and without delay to the requests from the competent authorities for the combat against money laundering and terrorism about the information on funds transfers and all relevant related information, despite any professional secrecy rule.

The Law of 28 April 2011 has introduced a clarification to Article 41 relating to the bank confidentiality obligations by specifying that the persons that are subject to such obligations continue to be so bound after the termination of the contract or the relationship having given rise thereto. In addition, the obligation to secrecy is extended to persons having received confidential information after withdrawal of the licence and to persons named after withdrawal of the licence, such as liquidators.

The Law of 21 December 2012 implementing Directive 2010/78/EC introduced a further clarification as regards the disclosure of confidential information between entities belonging to financial conglomerates and to supervisory authorities in accordance with EU Regulations 1093/2010, 1094/2010 and 1095/2010.

Given the recent entering by Luxembourg into OECD-compliant exchange of information protocols in the context of double taxation treaties, confidential information may also be requested in relation to clients of Luxembourg banks if the conditions of these protocols are met.

V FUNDING

Luxembourg banks tend to fund their activities in different ways, depending on their structure and their activity.

The large retail banks essentially rely on their Luxembourg commercial branches network to gather deposits from the public, which they use to fund their lending activities. Other banks, which are mainly active in private banking, tend to call on refinancing in the form of repos or other market instruments.

Subsidiaries and branches of international bank groups have also traditionally relied on credit lines with their parent company as a source of liquidity in their daily operations.

The CSSF report for 2011 has pointed out that the bank liabilities towards central banks have increased by 58.7 per cent over the year to reach a level of 1.8 per cent of the aggregate liabilities.[41] Interbank liabilities towards other bank creditors, including in particular intra-group loans, represent 45 per cent of the liabilities[42] in the balance sheets of Luxembourg banks at the end of 2011 and remain their first refinancing source.

Customer deposits represent 33.2 per cent and debt securities 8.3 per cent of the aggregate liabilities at the end of 2011.[43] Luxembourg banks that are eligible for refinancing in the Eurosystem as a counterparty for monetary policy operations with the BCL can participate in the auctions organised by the BCL. These operations are subject to the terms of the Eurosystem and of the internal rules of the BCL.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

Shareholders in Luxembourg banks are regulated in two ways. Article 6 of the LFS regarding shareholdings in banks provides that the approval of a bank is subordinated to the communication to the CSSF of the identity of shareholders – direct or indirect, individuals or legal entities – that hold a qualified participation in the bank to be agreed and the amount of such participation. The agreement is refused if, considering the need to guarantee sound and prudent management of the bank, the quality of the shareholders is unsatisfactory. Furthermore, the structure of the direct or indirect shareholding must be transparent and be organised in such a way that the prudential supervision of the bank and possibly of the group to which it belongs are clearly determined, that such supervision can be exercised without impediments and that supervision on a consolidated basis is possible. Generally, all the criteria set out in the Acquisitions Directive 2007/44 are implemented into Article 5 and apply to shareholders in Luxembourg banks.

The second control exercised over shareholders is the control of their good character, which includes the concept of good reputation and the absence of any criminal record.

As regards any proposed change of control in a bank, which is defined by the law as the increase of a 'qualified participation' (which is set by the LFS at 10 per cent of the share capital) in terms of the proportion of voting rights or shares in the capital to a level of, or in excess of, the thresholds of 20 per cent, 33.3 per cent or 50 per cent, such decision to acquire must be notified ahead of the proposed acquisition to the CSSF. Such proposed acquisition is then evaluated by the CSSF in accordance with the criteria set out in the Acquisition Directive, with a view to ensuring sound and prudent management of

41 CSSF annual report 2011, p. 55.

42 CSSF annual report 2011, p. 55.

43 CSSF annual report 2011, pp. 55–56.

the bank and taking into consideration the likely influence of the acquisition candidate on the bank, the quality of the candidate and the financial solidity of the envisaged acquisition applying a number of criteria set out in the law.

The Acquisition Directive 2007/44 was implemented in Luxembourg by the Law of 17 July 2008 and by Circular CSSF 09/392 of 4 February 2009 relating to the publication of common guidelines by the ECBS, CESR and CEIOPS for the potential evaluation of acquisitions and increases of participation in entities within the financial sector.

In relation to bank acquisitions, the CSSF opposes any arrangements consisting in a target bank giving security over part or all of its assets to secure the acquisition finance.

ii Transfers of banking business

The only way in which such a transfer may be realised is through a transfer of the whole of the business, either by a demerger, a merger, or a transfer of branch of activity, preferably recognised by applicable European company law directives. A transfer of banking business was recently carried out, again in the case of Kaupthing Bank Luxembourg, which was demerged into two new entities – Pillar Securitisation Sàrl and Banque Havilland SA, a new bank – without client consent. Transfers of activity branches are also commonly used in bank restructurings in Luxembourg.

VII THE YEAR IN REVIEW

i Important developments in banking

According to the CSSF, the profit (before provisions) of the Luxembourg banking sector increased by 17.8 per cent compared with the previous year.[44] The deleveraging phenomenon observed in 2010 and 2011 continued in 2012. Luxembourg is also currently living through a time of concentration in the financial sector with several mergers, restructurings and acquisitions over the past 12 months (see Section I.iii, *supra*).

The outlook for 2013 continues to be uncertain, as is the case in most parts of Europe. The Luxembourg bank community is investigating new niche areas such as Islamic finance, renewable energies, socially responsible finance and philanthropy.

The Luxembourg financial centre is also expecting a beneficial return from the general worldwide 'offshore to onshore' movement, Luxembourg having made important efforts to be a high-quality fully compliant financial centre. Hopes are also invested in new activities such as e-money, with the introduction of the new Law of 20 May 2011 implementing the E-money Directive 2009/110/EC, which has already attracted considerable interest from market participants in 2011 and 2012.

44 *Luxemburger Wort*, 23 January 2013, published on www.wort.lu.

ii Banking regulation

2012 saw the implementation in Luxembourg banks of the enhanced anti-money laundering and counter-terrorist financing legal framework introduced by the Law of 27 October 2010. The important on-site controls in 2011 and 2012 and letters of recommendation issued by the CSSF show that the CSSF intends to strictly implement these measures, which also corresponds to the political will.

On 9 January 2013, the CSSF Regulation No. 12-02 of 14 December 2012 regarding the fight against money laundering and against the financing of terrorism came into force. The Regulation confers a legally binding character to existing professional obligations that were, until now, set forth in the form of CSSF circulars. Additionally, CSSF Circular 13/556 repeals CSSF Circulars 08/387 and 10/476.

Other important developments in banking regulation included the completion of the implementation of CRD II and in particular the implementation of the colleges of regulators at EBA level.

The remuneration policies of banks has also been a major topic in banking regulation.

VIII OUTLOOK AND CONCLUSIONS

The general view of the Luxembourg banking community is that, in particular as regards private banking, the trend is towards catering for high-net-worth individuals in wealth management, rather than the traditional clientele of Luxembourg banks, which is small to medium-sized portfolios of residents from neighbouring countries (e.g., Germany, Belgium and France). It is generally considered that these clients will progressively disappear as a customer base for Luxembourg banks, in particular under the influence of measures taken by European countries to incentivise the repatriation of assets, for instance, through tax amnesties, and also under the influence of repeated attacks against the bank confidentiality rules prevailing in Luxembourg. The current trend is therefore to concentrate on new niches and to consolidate the existing customer base, while at the same time investigating new prospects in other geographical regions, such as the Middle East, Russia, Asia and South America. Finally, the Luxembourg bank community is also keeping a close eye on certain international developments such as FATCA, the possible introduction of a tax on financial transactions on developments in the field of exchange of information. The implications of AIFMD and its implementing measures for the activities of banks, such as for instance custodian services, are also watched with great interest.

Appendix 1

ABOUT THE AUTHORS

FRANZ FAYOT
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Franz Fayot is a partner with Elvinger, Hoss & Prussen, which he joined in 1997 when he became a member of the Luxembourg Bar. His principal fields of activity are mergers and acquisitions, banking, financial and securities law and corporate restructuring and insolvency law.

In the field of banking law, he advises local and international banks and institutional clients on all aspects of banking and securities legislation and is a regular adviser to clients seeking to establish banks or other financial activities in Luxembourg. He was a member of the firm's team advising Luxembourg banking clients in relation to the implementation of the MiFID requirements in their organisations. Mr Fayot is an associate lecturer at the Université du Luxembourg, and an author of a number of articles in the field of banking law and companies law. He is also a member of the publishing committee of the yearly legal publication *Annales du droit luxembourgeois*.

He holds a master's degree in law and a Diplôme d'Etudes Approfondies in business law from the Université Paris I Panthéon-Sorbonne in Paris. He is fluent in English, French, German and Luxembourgish.

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