PANORAMIC

BANKING REGULATION

Luxembourg

Banking Regulation

Contributing Editors

Gregory J Lyons, Alison M Hashmall and Chen Xu

Debevoise & Plimpton

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Contributors

Luxembourg

Loyens & Loeff

LOYENS LOEFF Law & Tax

Adrien Pierre adrien.pierre@loyensloeff.com
Vanesa Gómez Pena vanesa.gomez.pena@loyensloeff.com

REGULATORY FRAMEWORK

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

Luxembourg is a major financial centre and the development of the financial sector is, therefore, an important policy consideration. The Ministry of Finance works together with Luxembourg for Finance (the Luxembourg agency for the development of the financial centre) to promote, develop and diversify the Luxembourg financial centre, and identify new opportunities. Current priorities include digitalisation and digital resilience, anti-money laundering and countering the financing of terrorism (AML/CFT), sustainable finance and financial education.

Law stated - 1 January 2025

Regulated institutions
What are the defining characteristics of a bank to be caught by the banking laws and regulations? Is non-bank fintech regulated differently?

Credit institutions or banks are defined in the Law of 5 April 1993 on the financial sector, as amended (LFS), as legal persons whose activity consists of receiving deposits or other repayable funds from the public and granting credits for their own account. Any person who performs these two activities qualifies as a bank, falls within the scope of banking laws and regulations, and must obtain an authorisation.

There is no dedicated legal framework for non-bank fintech activities in Luxembourg, except a registration requirement for virtual asset service providers (VASPs) (which includes certain virtual asset exchanges, virtual asset transfer services, virtual asset safekeeping or administration services and custodian wallet services) under AML legislation, Regulation (EU) 2023/1114 on markets in crypto-assets (MiCAR) (which will replace the VASP regime), and the European framework for crowdfunding service providers under Regulation (EU) 2020/1503 (Crowdfunding Regulation).

Whether banking laws and regulations apply (or other laws and regulations, for instance in relation to payment services) depends on the nature of the activities performed by a given entity, regardless of its status as a fintech. This should be analysed on a case-by-case basis.

Law stated - 1 January 2025

Regulated institutions
Do the rules vary depending on the size or complexity of the banking institution?

To a certain extent, yes. Although there is a standard set of rules set out in laws and regulations, the legal framework applicable to banks is completed by regulations and circulars adopted by the Luxembourg Financial Supervisory Authority (CSSF) as well as

guidelines issued by the European Supervisory Authorities – in particular, the European Banking Authority (EBA). Certain of these rules include a proportionality principle whereby certain requirements can be applied in a manner that is appropriate to the bank's size and internal organisation and the nature, scope and complexity of its activity. This may impact, for instance, the bank's governance or the organisation of its internal control functions.

Law stated - 1 January 2025

Primary and secondary legislation
Summarise the primary statutes and regulations that govern the banking industry.

The main law governing banks in Luxembourg is the LFS, which covers:

- the authorisation of banks;
- professional obligations, prudential rules and rules of conduct;
- prudential supervision;
- prudential rules and obligations in relation to recovery planning, intra-group financial support and early intervention; and
- sanctions.

As Luxembourg is an EU member state, European banking regulations are also applicable to Luxembourg banks. These include, in particular, Regulation (EU) No. 575/2013 (Capital Requirements Regulation (CRR)) on prudential requirements for banks and investment firms, as amended.

Many specific laws and regulations also apply depending on the activities pursued by Luxembourg banks (eg, investment services, payment services, crypto-asset services, securitisation, derivative transactions and securities financing transactions).

Luxembourg banks are also subject to the following:

- the Law of 18 December 2015 on the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes, as amended;
- the Law of 17 June 1992 relating to the annual and consolidated accounts of banks governed by the laws of Luxembourg, as amended; and
- the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended.

The legal framework is completed by grand-ducal regulations, CSSF regulations and CSSF circulars on a variety of specific topics. One of the most important circulars is CSSF Circular 12/552 on the central administration, internal governance and risk management of banks and professionals performing lending operations, as amended.

Law stated - 1 January 2025

Regulatory authorities
Which regulatory authorities are primarily responsible for overseeing banks?

The regulatory authorities responsible for overseeing banks are the CSSF, the European Central Bank (ECB) and the Central Bank of Luxembourg (BCL).

The CSSF falls under the authority of the Luxembourg Ministry of Finance and is responsible for the authorisation and prudential supervision of banks in Luxembourg. The CSSF also acts as the competent authority under a number of specific regulations. In particular, the CSSF is the competent authority with respect to AML/CFT measures, and acts as the Luxembourg resolution authority.

The ECB plays a central role in the supervision of banks within the framework of the Single Supervisory Mechanism (SSM). The ECB is in particular responsible for:

- granting and withdrawing bank licences;
- assessing acquisitions and disposals of qualifying holdings;
- ensuring compliance with EU prudential and governance requirements; and
- conducting supervisory reviews, on-site inspections and investigations.

The ECB is also responsible for the effective and consistent functioning of the SSM. It directly supervises a number of significant banks (whereas less significant banks are supervised by their national supervisory authorities) and may impose sanctions.

The BCL forms part of the European System of Central Banks. The BCL implements the decisions made by the ECB in Luxembourg and is competent for monetary policy operations in favour of Luxembourg banks.

The BCL is also responsible for:

- supervising the general liquidity situation of the markets and of market operators;
- ensuring the efficiency and safety of payment and securities settlement systems, as well as the safety of payment instruments;
- contributing to ensuring financial stability by cooperating with prudential supervision authorities; and
- collecting statistical information from the competent national authorities or directly from economic agents, including banks.

The BCL has regulatory power, and may issue regulations and circulars on subject matters relating to its tasks. It also enforces ECB decisions and implements the sanctions imposed by the ECB.

The EBA, which is part of the European System of Financial Supervision, also plays a role in the overall supervisory framework – in particular, by publishing guidelines addressed to national competent authorities that are aimed at harmonising regulatory practices.

Finally, the AML/CFT package published by the European Commission on 20 July 2021 seeks to establish a new authority, the EU Anti-Money Laundering Authority (AMLA), with a view to enhancing supervision of AML/CFT measures in the European Union. AMLA will have direct

and indirect supervisory powers over high-risk obliged entities in the financial sector that provide services on a cross-basis. AMLA will also have a supporting role with respect to non-financial sectors, will coordinate financial intelligence units in member states and will be able to impose pecuniary sanctions in cases of serious, systematic or repeated breaches of directly applicable requirements.

Law stated - 1 January 2025

Government deposit insurance

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

Deposits are protected by the Luxembourg Deposit Guarantee Fund (FGDL). The FGDL ensures repayment to depositors – in the case of the unavailability of their deposits – up to €100,000 per person and institution. The standard €100,000 protection may be increased to €2.5 million in certain specific cases and subject to specific conditions. Certain deposits are excluded from protection.

All Luxembourg banks, as well as Luxembourg branches of third-country banks, must be members of the FGDL. The FGDL collects contributions from member institutions on an annual basis. The amount of each institution's contribution is calculated based on the amount of the covered deposits and the degree of risk incurred by the institution.

There is also the Investor Compensation Scheme Luxembourg, which, subject to certain conditions, protects customers holding financial instruments.

In addition to its shareholding in a number of international financial institutions, the Luxembourg government holds 100 per cent of the shares in the Banque et Caisse d'Épargne de l'État (BCEE) as well as stakes in BGL BNP Paribas SA and the Banque Internationale à Luxembourg SA (BIL). The BCEE was established in 1856 and is the oldest financial institution in Luxembourg. The shareholdings of the Luxembourg government in BGL BNP Paribas SA and the BIL stem from the 2008 financial crisis. There does not appear to be an intention by the government to increase its ownership in the banking sector.

Law stated - 1 January 2025

Transactions between affiliates

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

There is no regulation specific to transactions between a bank and its affiliates. As a general principle, banks should ensure that transactions with their affiliates are entered into on arm's-length terms. Certain regulations include specific rules or exemptions in the

case of intra-group transactions. For instance, Regulation (EU) No. 648/2012 (European Market Infrastructure Regulation) includes exemptions from certain requirements – such as the clearing obligation for over-the-counter derivatives or requirements with respect to the exchange of collateral – for intra-group transactions that comply with certain conditions. Luxembourg also regulates outsourcing to group companies, which is a common operating model in Luxembourg.

Intra-group financial support arrangements are subject to specific conditions.

The CSSF also exercises supplementary supervision of Luxembourg banks that belong to a financial conglomerate for which the CSSF assumes the role of coordinator with respect to intra-group transactions. The CSSF monitors, in particular, the possible risk of contagion in the conglomerate, the existence of conflicts of interest, the circumvention of sectoral rules, and the level and volume of intra-group transactions.

Banks are authorised to:

- perform the following banking activities:
    - acceptance of deposits and other repayable funds;
    - lending;
    - financial leasing;
    - provision of payment services;
    - provision of guarantees and commitments;
    - trading for own account or account of customers;
    - participation in securities issues and provision of services related to such issues;
    - advising undertakings on capital structure, industrial strategy and related questions and advice, as well as services relating to mergers and acquisitions;
    - money broking;
    - portfolio management and advice;
    - safekeeping and administration of securities;
    - credit reference services;
    - safe-custody services; and
    - issuance of electronic money; and
- provide the following investment services:
    - receipt and transmission of orders in relation to financial instruments;
    - execution of orders on behalf of clients;
    - dealing on own account;
    - portfolio management;
    - investment advice;
    - underwriting of financial instruments or placing of financial instruments on a firm commitment basis, or both;

  - placing of financial instruments without a firm commitment basis;
  - operation of multilateral trading facilities; and
  - operation of organised trading facilities; and
- provide ancillary services such as:
  - safekeeping and administration of financial instruments;
  - the granting of credits or loans to investors;
  - advising undertakings on capital structure, industrial strategy and related matters;
  - foreign exchange services, where they are connected to the provision of investment services;
  - investment research and financial analysis or other forms of recommendation relating to transactions in financial instruments; and
  - services related to underwriting; and
- perform any other activity that falls under the scope of the LFS (eg, registrar agent, operator of a regulated market, currency exchange dealer, debt recovery, securities lending and domiciliation agent).

Banks may also provide other services subject to specific authorisation from the CSSF, including crypto-asset services, fund administration services or depositary bank services for investment funds.

Law stated - 1 January 2025

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

The banking industry faces a continued influx of new regulations, which began with the 2008 financial crisis and has not yet come to a halt. After a banking package published in 2019, the European Commission published a new banking package on 27 October 2021 (to implement, among others, the Basel III framework), which led to the adoption of Regulation (EU) 2024/1623 (CRR III) and Directive (EU) 2024/1619 (CRD VI); these texts amend the existing EU banking regulatory framework and introduce a number of changes relating to (for instance):

- credit risk;
- credit valuation adjustment risk;
- operational risk;
- market risk;
- output floor;
- exposure to ESG risk;
- exposure to crypto-assets;

- new restrictions on third-country banking operations in the EU;
- new rules relating to M&A transactions; and
- a harmonised framework for the fitness and propriety of board members and key function holders.

Certain banks are impacted by Regulation (EU) 2019/2088 (Sustainable Finance Disclosure Regulation) and Directive (EU) 2022/2464 (Corporate Sustainability Reporting Directive) on ESG disclosures, which impose transparency with respect to the integration of sustainability risks and the provision of sustainability-related information with respect to financial products as well as a number of sustainability disclosures.

Banks should prepare for the extensive requirements set out in Regulation (EU) 2022/2554 (Digital Operation Resilience Act) on digital operational resilience for the financial sector, which will apply from 17 January 2025 and monitor the upcoming regulation of cryptoassets under Regulation (EU) 2023/1114 (Markets in Crypto-Assets Regulation), which applies since 30 December 2024, as well as the impact of the new AML/CFT package published on 20 July 2021.

Law stated - 1 January 2025

Consumer protection
Are banks subject to consumer protection rules?

The Luxembourg Consumer Code (LCC) includes a number of requirements that must be complied with by professionals when dealing with consumers. These include information to be provided to consumers, prohibition of unfair business practices and requirements for contracts entered into with consumers, including mortgages and loans. There are rules on:

- advertising;
- comparability of offers;
- assessment of the solvency of consumers;
- content of credit agreements;
- interest rates disclosures; and
- requirements with respect to overdrafts, loan pre-payments, late payments and staff training.

Clauses in consumer credit and mortgage loan agreements that breach the LCC are void. The LCC also includes administrative and criminal sanctions.

Law stated - 1 January 2025

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

The evolution of the regulatory environment for banks in Luxembourg is largely driven by developments at the level of the European Union. These developments include, in particular:

- the recent update to existing banking regulation under the 2021 Package (CRR III will apply from 1 January 2025, and the measures set out in CRD VI should be applicable as from January 2026);
- the focus on sustainable finance in the context of the European Green Deal; and
- the new rules on crypto-asset services and digital operational resilience.

AML/CFT measures as well as measures against proliferation financing will also remain a priority, as evidenced by the recent publication of a new AML/CFT package. This package includes proposals for a new AML/CFT regulation, an update to Regulation (EU) 2015/847 (Wire Transfer Regulation) on transfers of funds and a sixth AML/CFT directive, as well as a proposal for the establishment of a new EU AML/CFT authority which is tasked with developing guidance on several AML/CFT topics.

Technological developments, including artificial intelligence, will also remain high on the regulatory agendas.

Law stated - 1 January 2025

SUPERVISION

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

The regulatory authorities supervise banks mainly through reporting requirements, requests for information, surveys and on-site inspections.

Banks are subject to extensive reporting requirements. This includes reporting on own funds, financial information, large exposures, leverage, liquidity, losses that stem from lending collateralised by immovable property and asset encumbrance. Banks must also provide information on:

- participating interests and subordinated loans;
- staff expenses and taxes;
- their head office, agencies, branches and representative offices;
- their shareholding; and
- a list of persons responsible for certain functions and activities.

Depending on their activities, banks may also be subject to additional specific reporting requirements and ad hoc reporting.

Branches of banks that have their head office in a third country must also provide specific annual reporting to the Luxembourg Financial Supervisory Authority (CSSF). Such reporting includes information on total assets, liquid assets, own funds, deposit protection arrangements available to depositors of the branch, risk management arrangements,

governance arrangements, recovery plans and any other information considered necessary by the CSSF to ensure the appropriate monitoring of the branch.

Banks must publish their approved annual accounts, management reports and reports from the auditors. Periodic statistical reporting to the Central Bank of Luxembourg is also required.

The frequency of reporting is set by the laws, regulations and circulars applicable to banks. The frequency of other supervisory activities depends on a given bank's size, activities, complexity and history with the authorities.

Law stated - 1 January 2025

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

The CSSF may issue circulars and regulations on specific topics relating to its supervisory powers. Its powers include:

- accessing documents and information, including telephone and other data records;
- conducting on-site inspections or investigations;
- ordering the cessation of any practice;
- freezing or sequestration of assets, or both;
- temporary prohibition of professional activity;
- referring information for criminal prosecution;
- requiring approved statutory auditors or experts to carry out on-site verifications or investigations;
- issuing communications to the public;
- suspending the marketing or sale of financial instruments;
- removing directors from the board of a bank; and
- requiring network providers to hand over records of electronic communications.

The CSSF has powers of injunction and suspension, and may:

- suspend the members of the management body or any other persons;
- suspend the exercise of voting rights attached to shares held in the bank; or
- suspend the bank's business or a particular area of such business.

The CSSF may impose administrative penalties on banks and the members of their management body, the effective managers or other responsible persons if they:

- fail to comply with applicable laws, regulations, etc;
- refuse to provide accounting or other requested information;
- have provided incomplete, incorrect or false documentation;
- preclude the performance of the powers of the CSSF;
- contravene rules governing the publication of balance sheets and accounts;

- fail to comply with injunctions from the CSSF; or
- jeopardise the sound and prudent management of the bank.

In such cases, the CSSF may impose and publish the following penalties:

- a warning or reprimand;
- a fine of between €250 and €250,000;
- a temporary or permanent prohibition on the execution of any number of operations or activities; or
- a temporary or permanent prohibition on participation in the profession by the directors or senior managers, or all of the above.

The CSSF may impose a coercive fine of up to €1,250 per day (with a total upper limit of €25,000) to compel persons to comply with injunctions that it has issued.

There are specific sanctions for certain breaches, which include administrative pecuniary penalties of up to 10 per cent of the total annual net turnover, of up to €5 million or of up to twice the amount of the benefit derived from the breach.

Where a bank infringes or is likely to infringe legal requirements due to a rapidly deteriorating financial situation, the CSSF may take early intervention measures, including:

- requiring the management body of the bank to take certain measures;
- requiring the bank to remove or replace one or more members of the management body or authorised management, change its business strategy, or change its legal or operational structures; and
- acquiring, including through on-site inspections, all information necessary to update the resolution plan and prepare for the possible resolution of the bank.

The CSSF may also require the removal of the authorised management or management body, or appoint a temporary administrator to temporarily replace the management body or work with the management body.

The CSSF can also take supervisory measures with respect to financial holding companies and mixed financial holding companies where the conditions for their approval are not met or have ceased to be met. These measures include:

- suspending the exercise of the voting rights attached to the shares of the subsidiary institutions (including banks) held by the holding company;
- issuing injunctions or penalties against the holding company or the persons responsible for its administration or management;
- giving instructions to the holding company;
- temporarily designating another entity within the group as responsible for ensuring compliance with legal and regulatory requirements on a consolidated basis;
- restricting or prohibiting distributions or interest payments to shareholders;
- requiring the holding company to divest from or reduce holdings in institutions regulated by Regulation (EU) No. 575/2013 (Capital Requirements Regulation) on

prudential requirements for banks and investment firms, as amended (including banks), or other financial sector entities; and

- requiring the holding company to submit a plan on the return to compliance.

Finally, the Resolution Board (the CSSF acting as resolution authority) shall take a resolution action where all the following conditions are met:

- the bank is failing or likely to fail;
- there is no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure of the institution within a reasonable time frame; and
- a resolution action is necessary in the public interest.

The Resolution Board has resolution tools and powers at its disposal, and may impose administrative penalties on banks, members of their management body and other natural persons responsible in cases of specific infringements with respect to resolution. The Resolution Board may also, under certain circumstances, suspend any payment or delivery obligations under any contract to which a bank is a party.

Law stated - 1 January 2025

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

The most common issues revealed by on-site inspections typically concern anti-money laundering and countering the financing of terrorism (AML/CFT), and corporate governance. In 2023, the CSSF conducted 13 on-site inspections of banks related to AML/CFT (focused on banks' AML/CFT framework) and seven on-site inspections related to corporate governance (focused on the functioning of the board, management and internal control functions). The CSSF also carried out five on-site inspections related to credit risk, four on-site inspections related to Directive 2014/65/EU (Markets in Financial Instruments Directive II) (investment services), three on-site inspections on IT risk, and three on-site inspections related to depositary functions.

Issues identified during on-site inspections are typically summarised in a draft report provided to the bank, to which the bank is entitled to respond. After the CSSF has issued its final report on the identified shortcomings, it typically sets out a timeline for the bank to take appropriate remediation measures, with a requirement to provide regular updates.

Law stated - 1 January 2025

RESOLUTION

Government takeovers

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

In accordance with the Law of 18 December 2015 on the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and deposit guarantee and investor compensation schemes, as amended (the BRR Law), where a bank meets the conditions for resolution, the Resolution Board (the Luxembourg Financial Supervisory Authority (CSSF) acting as resolution authority) may take control of the bank as well as exercise all rights and powers conferred upon the shareholders, other owners and the management body of the bank. The Resolution Board may also appoint a special manager to replace the management body of a bank. The Resolution Board may take action if the following conditions are met:

- the bank is failing or likely to fail;
- there is no reasonable prospect that alternative measures or supervisory actions would prevent the failure; and
- the resolution action is necessary in the public interest.

No Luxembourg bank has been subject to resolution and taken over as described above since the adoption of the BRR Law.

The resolution of banks is subject to several general principles that must be taken into consideration when exercising resolution powers. For example:

- shareholders bear first losses;
- creditors are treated in accordance with the order of priority of their claims;
- the management body is replaced;
- natural and legal persons are made liable for actions that led to the failure;
- covered deposits are protected; and
- other general principles of fairness.

Where an institution is a group entity, resolution authorities shall exercise resolution powers in a way that minimises the impact on other group entities and the whole group, as well as adverse effects on financial stability in the European Union.

Law stated - 1 January 2025

Bank failure

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

The legal duties of Luxembourg bank directors and executives are similar to those in other major financial centres and are derived both from company law and financial regulation. The Law of 10 August 1915 on commercial companies, as amended, requires that directors act in the best interest of the bank.

Directors must ensure that a recovery plan provides for measures to be taken by the bank to restore its financial position following a significant deterioration of its financial situation and must, in particular, assess and approve the recovery plan before submitting it to the CSSF. They must also ensure that the bank collaborates with the Resolution Board (the CSSF acting as resolution authority) to draft a resolution plan.

In a bank failure, directors have the obligation to notify the CSSF if they consider that the bank is failing or likely to fail. Directors must cooperate with authorities where required.

Law stated - 1 January 2025

Bank failure

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

Natural and legal persons may be made liable for their responsibility for the failure of a bank, which includes directors. The CSSF may impose administrative penalties and other administrative measures on the directors of a bank in the context of a bank failure. The CSSF is entitled to impose sanctions on directors where they fail, for instance, to draw up, maintain and update recovery plans and group recovery plans. Likewise, directors may be subject to penalties imposed by the Resolution Board (the CSSF acting as resolution authority) for failure to comply with legal requirements applicable to the resolution of banks, and any requirements, measures or orders imposed by the Resolution Board.

Bank directors are also subject to the standard corporate liability provisions, which include:

- liability to the bank for management errors;
- liability to the bank and third parties for violation of the law or the bank's articles of association, or both; and
- liability under the general principles of tort.

In addition, specific liability rules may be applicable in the case of bankruptcy. Criminal liability may be incurred in specific cases.

Law stated - 1 January 2025

Planning exercises

Describe any resolution planning or similar exercises that banks are required to conduct.

Banks must draw up and maintain a recovery plan that provides for measures to be taken by the bank to restore its financial position following a significant deterioration of its financial situation, which must be updated at least once per year and is subject to an assessment by the CSSF. The recovery plan must include a communication and disclosure plan, a range of capital and liquidity actions, revised corporate governance, restoration of own funds, access to contingency funding sources and liability restructuring. The failure to draw up, maintain and update recovery plans is subject to specific administrative penalties, including substantial fines.

In the context of the resolution of banks, the Resolution Board (the CSSF acting as resolution authority) must, prior to any resolution, prepare a resolution plan and perform a resolvability assessment for each bank. Specific provisions apply to groups. The resolution plan provides for the actions that the Resolution Board may take where the relevant bank meets the conditions for resolution. Banks must collaborate with the Resolution Board for the purpose of drafting the resolution plan.

Law stated - 1 January 2025

CAPITAL REQUIREMENTS

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

Banks must have a share capital of at least €8.7 million that is subscribed, fully paid up and compliant with the relevant provisions of Regulation (EU) No. 575/2013 (Capital Requirements Regulation (CRR)) on prudential requirements for banks and investment firms, as amended.

Under the CRR, banks must maintain a total capital ratio of 8 per cent, composed of 4.5 per cent of common equity Tier 1 capital, 1.5 per cent of additional Tier 1 capital and 2 per cent of Tier 2 capital (each as defined under the CRR), and a leverage ratio of 3 per cent.

Banks must also maintain a capital conservation buffer composed of common equity Tier 1 capital equal to 2.5 per cent of their total risk exposure amount calculated in accordance with the CRR, and an institution-specific countercyclical capital buffer composed of common equity Tier 1 capital that is equivalent to their total risk exposure amount calculated in accordance with the CRR multiplied by the weighted average of the countercyclical buffer rates. The countercyclical buffer rate for the first quarter of 2025 is 0.5 per cent. Banks may also, under certain conditions, be required to maintain a systemic risk buffer of common equity Tier 1 capital.

Globally systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) must maintain additional capital buffers. G-SIIs must maintain an additional capital buffer that consists of common equity Tier 1 capital and varies between 1 per cent and 3.5 per cent, depending on the degree of the systemic importance of the bank. O-SIIs may, subject to certain conditions, be required to maintain an additional capital buffer that consists of common equity Tier 1 capital. At present, there are no G-SIIs in Luxembourg. Five O-SIIs have been identified, which are subject to O-SII buffers between 0.5 per cent and 1 per cent as at 1 January 2025.

Law stated - 1 January 2025

Capital adequacy
How are the capital adequacy guidelines enforced?

The Luxembourg Financial Supervisory Authority (CSSF) and the European Central Bank are responsible for ensuring compliance with capital adequacy requirements. Banks are subject

to extensive reporting requirements that include, in particular, reports on own funds and their internal capital adequacy assessment process.

The CSSF has broad supervisory and investigative powers for the purpose of exercising prudential supervision, including with respect to capital adequacy requirements. These powers include, among others:

- obtaining access to information, documents and records;
- performing on-site inspections or investigations;
- requesting the cessation of practices or freezing of assets;
- imposing temporary prohibitions of professional activity with respect to banks, directors and employees;
- removing persons from the board of the bank; and
- suspending certain activities.

The CSSF also has specific powers to ensure compliance by banks with capital adequacy guidelines, including the power to:

- require the strengthening of the internal capital adequacy assessment process;
- require the bank to hold own funds of a certain amount or quality, or in excess of the legal requirements;
- require the reduction of risks inherent to the bank's activities, products and systems (including outsourced activities);
- require the bank to apply a specific provisioning policy to its exposures;
- restrict or limit the bank's business, operations or network, or request the divestment of activities that pose excessive risks;
- require the bank to limit variable remuneration;
- require the bank to use net profits to strengthen its capital base;
- restrict or prohibit distributions or interest payments to shareholders;
- impose additional reporting requirements;
- impose liquidity requirements; or
- require additional disclosures.

The CSSF may impose sanctions for non-compliance.

Law stated - 1 January 2025

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

Banks must maintain a combined capital buffer (which includes, as applicable, a capital conservation buffer, a countercyclical capital buffer, a G-SII or O-SII buffer and a systemic risk buffer) in addition to the capital required to meet their own funds requirements. A bank that no longer complies with the combined capital buffer requirements becomes subject

to capital conservation measures, including a prohibition from making certain distributions, creating obligations to pay variable remuneration or discretionary pension benefits, or making payments on certain instruments. The bank must also prepare a capital conservation plan and submit it to the CSSF. The plan must include:

- estimates of income and expenditures;
- a forecast balance sheet;
- the measures that the bank intends to take to increase the capital ratios;
- a plan and time frame for the increase of own funds; and
- any other relevant information.

If the CSSF does not approve the capital conservation plan, it can require the bank to increase its own funds to specific levels within a specific time period or impose more stringent restrictions on distributions, or both. Where the capital base of a bank falls below the prescribed minimum capital amount, the CSSF may grant the bank a limited period during which it can rectify the situation or cease its activities.

Law stated - 1 January 2025

Insolvency

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

In addition to resolution, the Law of 18 December 2015 on the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes, as amended (the BRR Law) covers the reorganisation and winding-up of banks. The BRR Law notably covers suspension of payments and judicial winding-up proceedings.

Suspension of payments proceedings may be initiated where:

- the bank has lost its creditworthiness or has reached an impasse regarding liquidity, whether it is in a state of cessation of payments or not;
- the execution of the bank's commitments is compromised; or
- the authorisation of the bank has been withdrawn and a decision in this respect is not yet final.

Only the CSSF or the bank concerned may apply for suspension of payments proceedings. The application is lodged with the appropriate court. A bank must inform the CSSF prior to initiating proceedings before the court. The application filing results in the suspension of all payments by the bank and a prohibition of all acts other than precautionary measures pending a final decision. The judgment defines (for up to six months) the conditions and arrangements for the suspension of payments, and appoints one or more administrators who shall be in charge of the management of the bank's assets. The suspension of payments has a universal effect and applies to branches and assets of the institution located abroad.

The dissolution and winding-up of a bank may take place where:

- it is apparent that the suspension of payments set out above cannot rectify the situation that caused it;
- the financial situation of the bank is affected to such an extent that the bank will no longer be able to comply with the commitments with respect to the rights of holders of claims or participation; and
- the authorisation of the bank has been withdrawn and the decision in this respect is final.

Only the CSSF or the state prosecutor may file for an order of dissolution and winding-up of a bank with the court. When ordering the winding-up, the district court of Luxembourg appoints an official receiver and one or more liquidators, determines the winding-up method and may make applicable the general rules governing bankruptcy. The liquidators inform the known creditors located abroad of the winding-up. Any creditor has the right and obligation to deposit its claim with the court.

Where the Resolution Board (the CSSF acting as resolution authority) considers that a bank is failing – or likely to fail – and no private-sector measure or supervisory action would prevent such a failure but that a resolution action would not be in the public interest, the Resolution Board may request the winding-up of the bank.

Law stated - 1 January 2025

Recent and future changes

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

The 2019 'banking package' published on 7 June 2019 (Regulation (EU) 2019/876 (Capital Requirements Regulation II) and Directive (EU) 2019/878 (Capital Requirements Directive V)) included amendments to the CRR and Directive 2013/36/EU (Capital Requirements Directive IV), which apply since 28 June 2021 (with certain exceptions) and 20 May 2021.

Two important capital adequacy changes were the introduction of a new binding leverage ratio (3 per cent of Tier 1 capital) as well as a net stable funding ratio (NSFR) of at least 100 per cent (where the NSFR is equal to the ratio of the bank's available stable funding and the bank's required stable funding). G-SIIs must, since 1 January 2023, maintain an additional leverage ratio buffer set at 50 per cent of the risk-based G-SII capital buffer.

Further updates will become applicable as a result of CRR III and CRD VI. The key reforms include the introduction of a minimum floor ('output floor') on bank capital requirements calculated based on internal models, revisions of the calculation methodology for credit, market and operational risk exposure, and minimum capital and liquidity requirements for third-country bank branches operating in the European Union.

Law stated - 1 January 2025

OWNERSHIP RESTRICTIONS AND IMPLICATIONS

Controlling interest

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

Authorisation as a bank is subject to communication to the Luxembourg Financial Supervisory Authority (CSSF) of the identities of the shareholders (direct or indirect) that have qualifying holdings in the bank to be authorised, as well as the amount of those holdings. Owners of a qualifying holding in a Luxembourg bank must produce evidence of their professional repute, which is assessed in particular on the basis of criminal records and any other presented evidence. The regulator also assesses their skills and knowledge as well as their financial soundness. A qualifying holding is any direct or indirect holding that represents 10 per cent or more of the capital or the voting rights in the relevant bank, or that makes it possible to exercise a significant influence over the management of the bank. Similar requirements apply to other regulated financial sector entities.

Law stated - 1 January 2025

Foreign ownership

Are there any restrictions on foreign ownership of banks (or non-banks)?

There are no restrictions on the foreign ownership of banks or non-banks. To the extent that a foreign entity acquires or disposes of a Luxembourg bank (or non-bank), the provisions on acquisitions and disposals of qualifying holdings apply.

Where a bank incorporated under Luxembourg law is part of a third-country group that has two or more institutions (as defined under Regulation (EU) No. 575/2013 (Capital Requirements Regulation (CRR)), as amended) in the European Union, it must ensure that the third-country group has a single intermediate EU parent undertaking. Where such intermediate EU parent undertaking is established in Luxembourg, it must be a credit institution authorised in accordance with the provisions of the Law of 5 April 1993 on the financial sector, as amended (LFS), or a financial holding company or mixed financial holding company approved under the LFS. The requirement to have an intermediate EU parent undertaking does not apply where the total value of the assets of the third-country group in the European Union is less than €40 billion.

A new law of 14 July 2023 introduces a screening mechanism for foreign direct investments (implementing, among others, Regulation (EU) 2019/452 (Screening Regulation)) although this impacts only a limited set of strategic activities in the financial sector and does not affect the foreign acquisition of banks in general.

Law stated - 1 January 2025

Implications and responsibilities

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

Entities that hold a qualifying holding in a Luxembourg bank are assessed by the CSSF. They must permanently comply with the reputation, knowledge, skills and financial soundness

requirements needed for the bank's continued authorisation, bearing in mind that the CSSF may withdraw the bank's authorisation if the conditions for its granting are no longer met. The bank's management has an obligation to notify the CSSF of any change to the substantial information – including with respect to the shareholder or shareholders – on which the CSSF based its decision.

Law stated - 1 January 2025

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

Owners of a qualifying holding in a bank are subject to notification requirements, for instance in the case of an appointment of a new member of the management body, or the acquisition or disposal of holdings in the bank that exceed certain thresholds.

Entities that control banks may also qualify as a parent financial holding company or parent mixed financial holding company, which may trigger prudential supervision on a consolidated basis under the CRR on prudential requirements for banks and investment firms, as amended, and governance requirements. This includes reporting requirements as well as the requirement to obtain prior approval from the CSSF, for instance in cases of:

- a change in management or legal representatives;
- a change in the object, name or legal form;
- a change in the shareholding structure; or
- a change of registered office.

Luxembourg-based parent financial holding companies and parent mixed financial holding companies (each as defined in the CRR) must seek approval from the CSSF.

This requires the provision of information on the entity and the group to the CSSF, and, where different, the consolidating supervisor. An exemption from the approval requirement is available where certain conditions are met. For 'significant' banks, the approval or exemption must be obtained from the European Central Bank.

Law stated - 1 January 2025

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

Where a bank faces financial difficulties, several measures impacting shareholders may be taken by the CSSF or the Resolution Board (the CSSF acting as resolution authority). Early intervention measures in the case of a rapidly deteriorating financial situation include the replacement of the management body, which means the shareholders lose the power to appoint management.

Where a bank meets the conditions for resolution, the Resolution Board may take control of the bank and exercise all rights and powers conferred upon the shareholders. The Resolution Board also has several tools and powers at its disposal that may impact shareholders, including:

- the sale of shares or other instruments of ownership issued by the bank to a purchaser or bridge institution;
- the sale of assets, rights and liabilities of the bank without shareholder approval; or
- the cancellation of existing shares or dilution of existing shareholders as a result of a conversion of capital instruments or eligible liabilities into shares or other instruments of ownership in the context of the bail-in tool.

One of the principles of resolution is that shareholders bear first losses. In certain cases, the Resolution Board may prohibit distributions. In the context of suspension of payments or winding-up proceedings, there is no implication for shareholders.

Law stated - 1 January 2025

M&A AND CHANGES IN CONTROL

Required approvals

Describe the regulatory approvals needed to acquire control of a bank (or non-bank). How is 'control' defined for this purpose? Do the requirements differ depending on the size or complexity of the institution?

Any natural or legal person, whether acting alone or in concert with other persons, that has taken a decision to acquire, directly or indirectly, a qualifying holding in a Luxembourg bank must first notify the Luxembourg Financial Supervisory Authority (CSSF) in writing of its intention to acquire such a qualifying holding. The approval requires an assessment of the shareholder's fitness. A qualifying holding is any direct or indirect holding that represents 10 per cent or more of the capital or the voting rights in the relevant bank, or that makes it possible to exercise a significant influence over the management of the bank. Similar requirements apply to other regulated financial sector entities. The requirements do not differ depending on the size or complexity of the institution.

Law stated - 1 January 2025

Foreign acquirers

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

The Luxembourg regulatory authorities are receptive to foreign acquirers. In fact, most of the 115 banks established in Luxembourg as at December 2024 are foreign-owned. There is no difference in the regulatory approval process between Luxembourg acquirers, EU acquirers or acquirers from third countries.

Law stated - 1 January 2025

Foreign acquirers

Under what circumstances can a foreign bank (or non-bank) establish an office and engage in business? For example, can it establish a branch or must it form or acquire a locally chartered bank?

For banks established in a foreign jurisdiction that wish to operate in Luxembourg, a distinction is made between banks established in an EU member state and banks established in a jurisdiction outside of the European Union (a third country).

Banks established and authorised in another EU member state may operate in Luxembourg through the cross-border provision of services, through the establishment of a branch in Luxembourg or through the use of a tied agent, to the extent that the activities to be exercised in Luxembourg are covered by their licence and are covered by applicable EU regulation. In this case, no authorisation from the Luxembourg authorities is required. The relevant procedure is handled by the bank's home regulator.

There is no obligation for third-country banks to form or acquire a local bank. Currently, third-country banks that wish to establish a branch in Luxembourg to exercise their banking activities are subject to the same licensing requirements as Luxembourg banks. Luxembourg branches of third-country banks are subject to specific reporting requirements. Banks from a third country that are not established in Luxembourg, but that occasionally and temporarily come to Luxembourg to (among other things) collect deposits and other repayable funds from the public and to provide any other service subject to the Law of 5 April 1993 on the financial sector, as amended, must obtain an authorisation. The current framework will be impacted by a new framework for third-country branches under Directive (EU) 2024/1619 (CRD VI).

Specific conditions apply where a third-country bank intends to provide investment services in Luxembourg. If the third-country bank intends to provide investment services to eligible counterparties and to per se professional clients, it may establish a branch in Luxembourg that is subject to the same licensing requirements as Luxembourg-law banks and investment firms. The third-country bank may also provide investment services in Luxembourg to such clients on a cross-border basis to the extent that Luxembourg benefits from an equivalence decision made by the European Commission or the CSSF. A third-country bank that wishes to provide investment services to retail clients, however, must establish a branch that is subject to the same authorisation rules as banks incorporated in Luxembourg.

Other entities regulated at the EU level, such as investment firms or payment institutions, benefit from EU passporting provisions. Such entities may provide cross-border services, establish a branch in Luxembourg or use an agent without the need for a local licence. Third-country firms intending to provide investment services in Luxembourg are subject to the requirements described above. EU or third-country entities intending to provide certain specific services that are regulated in Luxembourg may require an authorisation or need to establish a branch, depending on the way in which the services are performed.

Third-country groups incorporating a bank in Luxembourg may need to establish a single intermediate EU parent undertaking where they have two or more institutions (as defined under Regulation (EU) No. 575/2013 (Capital Requirements Regulation) on prudential requirements for banks and investment firms, as amended) in the European Union and where

the total value of the assets of the third-country group in the European Union is €40 billion or more.

CRD VI will, as from January 2027, introduce an obligation for certain third-country undertakings (including banks) to establish a branch in the EU (a TCB) in order to provide the following services:

- taking of deposits and other repayable funds;
- lending (including consumer credit, real estate credit, factoring, financing of commercial transactions, forfeiting...); and
- granting of guarantees and commitments.

Several activities are explicitly carved out from the branch requirement (such as investment services, intra-group or inter-bank activities, and services provided on a reverse solicitation basis). TCBs will be subject to an authorisation procedure and specific capital, liquidity, governance, booking, and reporting requirements. They will not benefit from the EU passport.

In addition, in certain specific cases, national supervisory authorities will have the power to require the conversion of a TCB into a subsidiary.

Law stated - 1 January 2025

Factors considered by authorities

What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank (or non-bank)?

The CSSF seeks to ensure the sound and prudent management of the bank (or non-bank) that will be acquired, and will assess the suitability of the proposed acquirer based on the following criteria:

- its professional standing;
- the professional standing and the professional qualifications of the persons who will direct the daily business of the bank (or non-bank);
- its financial soundness;
- the capacity of the bank (or non-bank) to keep complying with the applicable prudential requirements after the acquisition; and
- the absence of suspicion surrounding money laundering or terrorist financing.

Law stated - 1 January 2025

Filing requirements

Describe the required filings for an acquisition of control of a bank. Do the requirements differ depending on the size or complexity of the institution?

Any potential acquirer of a qualifying holding in a Luxembourg bank must first notify the CSSF in writing of its intention to acquire such a qualifying holding.

The notification to the CSSF must include written submissions that describe the intended acquisition and request its prior approval. Supporting documentation includes all the documents required to assess the suitability of the acquirer (reputation, skills, financial soundness, etc) and the suitability of the new management, if any.

The CSSF carries out its assessment in accordance with the principle of proportionality. It also reviews the proposed acquisition considering the 'Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector', published by the Joint Committee of the European Supervisory Authorities.

The CSSF's approval is also required for changes to the composition of the target's management body and its senior staff. Candidates must complete an application form and provide the CSSF with several supporting documents (eg, identity documents, curriculum vitae, recent criminal record extracts, a declaration of honour, highest diploma and corporate documentation appointing the candidate, etc).

The seller of a qualifying holding in a bank must also notify the CSSF prior to such a sale. Banks must inform the CSSF without delay of any acquisitions or disposals of holdings in their capital that exceed or fall below certain thresholds.

The requirements to be complied with, and the approvals to be obtained by entities intending to acquire control in a Luxembourg credit institution, are the same regardless of the size or complexity of the potential acquirer or credit institution. If the CSSF considers that the explanations provided by the acquirer in the change of control notifications are not clear or sufficiently detailed to assess the impact of the change of control in the credit institution, the CSSF will request the clarifications it deems necessary.

Law stated - 1 January 2025

Time frame for approval

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

The CSSF has up to 60 working days (which can be extended to up to 90 working days) as of the notification to assess a proposed acquisition and to declare whether it is opposed to the acquisition. Failing formal opposition, it is deemed to be approved.

Law stated - 1 January 2025

Regulatory trends

Are there any notable recent regulatory trends or developments affecting M&A and changes in control in the banking sector?

The CSSF carries out its assessment in accordance with the 'Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector', published by the Joint Committee of the European Supervisory Authorities in December 2016. Therefore, no major changes have taken place in recent years as to how the CSSF conducts the assessment of qualifying shareholders of credit institutions. The CSSF pays attention to the skills and reputation of proposed members of management (where

acquirers intend to change the management of a target institution) as well as their location and time commitments; CRD VI will further harmonise and strengthen the assessment of the fitness and propriety of directors and key function holders. The reputation of potential new shareholders is important, and the CSSF also looks closely at the financing of acquisitions to ensure there is no money laundering risk and questions the rationale behind acquisition structures to understand whether they are tax-driven.

Law stated - 1 January 2025

UPDATE AND TRENDS

Key developments of the past year

Are there any emerging trends or hot topics in banking regulation in your jurisdiction?

From a regulatory perspective, banks must adapt to the changes introduced by Regulation (EU) 2024/1623 (Capital Requirements Regulation III) and Directive (EU) 2024/1619 (Capital Requirements Directive VI).

Banks should also prepare for:

- the information and communication technology (ICT) related requirements introduced by Regulation (EU) 2022/2554 (Digital Operational Resilience Act (DORA)) on digital operational resilience for the financial sector;
- the regulation of crypto-asset services under Regulation (EU) 2023/1114 (Markets in Crypto-Assets Regulation);
- the new anti-money laundering and countering the financing of terrorism (AML/CFT) package, which notably includes:
    - Regulation (EU) 2024/1624 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing (AMLR); and
    - Directive (EU) 2024/1610 on the mechanisms to be put in place by member states for the prevention of the use of the financial system for the purposes of money laundering and terrorist financing (AMLD 6).

Banks are affected by EU regulations on sustainability-related disclosures in the financial services sector and sustainability-related disclosures for benchmarks. In addition, Luxembourg will be following the current EU proposal on the establishment of a framework to facilitate sustainable investment. Together, these initiatives will affect the manner in which banks lend funds, and require changes to internal approval processes and monitoring systems. Banks also need to take ESG risks into account. This will affect both the supervision of banks and the evaluation of assets against specific ESG criteria.

The Luxembourg Financial Supervisory Authority (CSSF) published a number of circulars in 2021, 2022 and 2023 relating notably to AML, ESG, telework, reporting, ICT risk management and outsourcing and implementing a number of European Securities and Markets Authority and European Banking Authority Guidelines. Of particular interest is Circular 22/806 on outsourcing arrangements, which sets out extensive requirements for outsourcing (including intra-group outsourcing) by financial sector entities (including banks). On 5 January 2024,

the CSSF published Circular 24/847 on ICT-related incident reporting, which applies to banks since 1 April 2024 (but will be replaced by DORA).

Finally, technology remains a priority, with banks also impacted by Directive (EU) 2022/2555 (Network and Information Security Directive (NIS 2)) and developments in artificial intelligence.

Law stated - 1 January 2025