

Luxembourg: A new regulatory and prudential framework applicable to investment firms

In brief

The law of 21 July 2021, effective as of 31 July 2021 ("**Law**"), has implemented the European prudential regime applicable to investment firms authorized under the Markets in Financial Instruments Directive II (MiFID II) set out under the **Investment Firms Directive** (IFD) and the **Investment Firms Regulation** (IFR) into Luxembourg law.

The Law has the purpose of (i) embracing the MiFID II's classification based on the services and activities carried out by the investment firm and (ii) modernizing the statuses of certain other financial sector professionals.

Therefore, the Luxembourg classes of investment firms are being recast.

Overview of the key changes

Implementation of the IFR/IFD framework into the Luxembourg law dated 5 April 1993 on the financial sector, as amended (LFS)

The IFR/IFD framework is designed to better suit the nature, size, and complexity of investment firms' activities compared to the **Capital Requirements Regulation** (CRR) and the **Capital Requirements Directive** (CRD) framework applicable to traditional credit institutions and to which most investment firms were also subject until 25 June 2021.

The Law has amended the LFS to introduce four major classes of investment firms, as follows:

- The LFS distinguishes between (i) credit institutions or banks, (ii) CRR investment firms (iii) IFR investment firms and (iv) "IFR non-PNI investment firm" (where PNI stands for small and non-interconnected investment firm). Credit institutions or banks and CRR investment firms are collectively referred to as CRR institutions while a subcategory of IFR investment firms has further been introduced.
- A credit institution is now defined as a credit institution within the meaning of Article 4 (1) (1) of the CRR, i.e. an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.
- An investment firm under the LFS is now defined as a legal person as defined in Article 4(1)(1) of the MiFID II. Credit institutions have been removed from the definition of investment firms.
- The "bank-like" investment firms that are the largest investment companies engaged in the proprietary trading or underwriting of financial instruments and/or the placing of financial instruments with a firm commitment, and that exceed EUR 30 billion of total asset value, are treated in all respects as credit institutions and qualify as credit institutions under the LFS. They correspond to Class 1 investment firms under the IFR/IFD framework. As such, they remain subject to the more stringent CRR/CRD regime.

In this issue

Overview of the key changes

Implementation of the IFR/IFD framework into the Luxembourg law dated 5 April 1993 on the financial sector, as amended (LFS)

Practical implications

Reporting obligations

Reporting reference periods under the IFR/IFD framework

Transmission channels

Recasting of the Luxembourg investment firm types

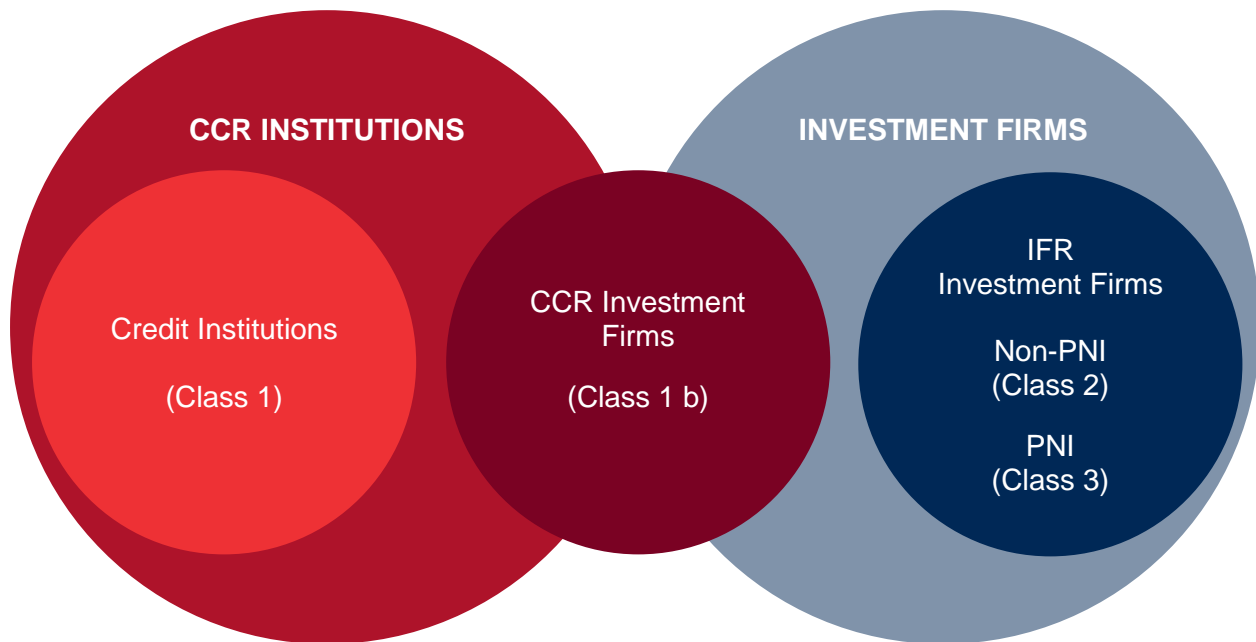
Practical implications

Other changes introduced by the Law in the Luxembourg regulatory landscape

[In more detail](#)



- CRR investment firms are investment firms that are no longer considered credit institutions but, due to their size and complexity, remain subject to a certain number of obligations applicable under the CRD/CRR regime. They correspond to Class 1b investment firms under the IFR/IFD framework.
- IFR investment firms are smaller, non-interconnected investment firms that benefit from lighter provisions under the IFD/IFR framework to ensure proportionality to their nature, scale and complexity. They correspond to Class 3 investment firms under the IFR/IFD framework.
- IFR non-PNI investment firms are all other investment firms that do not qualify as CRR institutions or IFR investment firms, i.e., the classic type of investment firms. They correspond to Class 2 investment firms under the IFR/IFD framework. These IFR non-PNI investment firms are fully subject to the IFR/IFD regime.



The Law has amended the LFS to implement the new applicable prudential treatment deemed calibrated to the size, activities and risks of the investment firms.

A new Section 1 under Part II of Chapter 4 bis of the LFS deals with the prudential framework applicable to CRR institutions. A new Section 2 under Part II Chapter 4 bis of the LFS is dedicated to the provisions applicable to IFR investment firms, itself divided into subsection 1 on the general provisions and subsection 2 on the additional provisions applicable to IFR non-PNI investment firms. The requirements in terms of own funds (as determined by the "K factors" under the IFR, i.e., risks that an investment firm poses to clients, markets and to itself), liquidity, concentration risks, internal governance, remuneration policies and reporting vary depending on the category and subcategory to which the investment firm belongs.

Practical implications

Investment firms must determine which category they fall into to determine the applicable prudential treatment to which they are subject. The largest CRR investment firms will have to apply for a new authorization.

Reporting obligations

Investment firms under the IFR/IFD framework must report information relating to the level, composition, requirements and calculation of capital requirements, level of activity, concentration risk and liquidity requirements according to the European reporting framework.

These investment firms remain subject to the national reporting requirements in Circular [CSSF 05/187](#).



On 1 October 2021, the Commission de Surveillance du Secteur Financier (CSSF) published the [Circular CSSF 21/784](#) on the periodic prudential reporting of investment firms introducing the [Reporting Handbook for Investment Firms](#). The reporting handbook is aimed at detailing, in one single document, the content and technical specifications of the period prudential reporting applicable to all Class 2 and Class 3 investment firms, i.e., Class 2 and Class 3 investment firms established under Luxembourg law with or without branches, branches of investment firms whose head office is not in the EU and that are qualified as Class 2 or Class 3 investment firms in Luxembourg, and branches of investment firms whose head office is in the EU (EU-based Class 2 or Class 3 investment firms) under the IFR/IFD and national reporting frameworks.

The Circular CSSF 21/784 further specifies that it does not apply to Class 1 investment firms that must comply with [Circular CSSF 14/593](#) regarding supervisory reporting requirements applicable to credit institutions and that the reporting handbook does not yet comprise detailed instructions for Class 1b investment firms, as the CSSF has not identified any Class 1b investment firms to date.

Reporting reference periods under the IFR/IFD framework

	First reporting reference date	Frequency	First remittance date
Class 2 investment firms	30 September 2021	Quarterly basis	11 November 2021
Class 3 investment firms	31 December 2021	Annual basis	11 February 2022

Transmission channels

- The IFR/IFD reporting will be communicated to the CSSF through the “investment firms reporting” module in the [eDesk portal](#).
- National reporting tables will continue to be communicated to the CSSF through the system introduced by [Circular CSSF 08/334](#) and will use the related signature/encryption mechanisms.

Recasting of the Luxembourg investment firm types

The Law has proceeded with reclassifying the Luxembourg investment firm types to adopt the same classification as under Annex I (List of services and activities and financial instruments) Section A (Investment services and activities) of the MiFID II, as follows:

- Reception and transmission of orders in relation to one or more financial instruments (new Article 24-1 of the LFS);
- Execution of orders on behalf of clients (new Article 24-2 of the LFS);
- Dealing on own account (new Article 24-3 of the LFS);
- Portfolio management (new Article 24-4 of the LFS);
- Investment advice (new Article 24-5 of the LFS);
- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis (new Article 24-6 of the LFS);
- Placing of financial instruments without a firm commitment basis (new Article 24-7 of the LFS);
- Operation of an MTF (new Article 24-8 of the LFS); and
- Operation of an OTF (new Article 24-9 of the LFS).

Accordingly, the required level of initial capital of an investment firm is determined based on the services and activities that the investment firm provides or performs. It varies from EUR 75,000 (for example for portfolio management and investment advice) to EUR 750,000 (for example for dealing on own account and the underwriting of financial instruments and/or the placing of financial instruments on a firm commitment basis) to EUR 150,000 (for example for operating an MTF).

The authorization for these investment services and activities can only be granted to legal persons.



Former classification	New classification (for references purposes only and subject to the appropriate review of the entity's services and activities to ensure that they fall within the scope)
Investment advisers (Article 24)	The Law has repealed the former Article 24 of the LFS. This classification is now generally included in the classification "investment advice" under the new Article 24-5 of the LFS.
Brokers in financial instruments (Article 24-1)	Reception and transmission of orders in relation to one or more financial instruments (new Article 24-1 of the LFS)
Commission agents (Article 24-2)	Execution of orders on behalf of clients (new Article 24-2 of the LFS)
Private portfolio managers (Article 24-3)	Dealing on own account (new Article 24-3 of the LFS)
Professionals acting for their own account (Article 24-4)	Portfolio management (new Article 24-4 of the LFS)
Market makers (Article 24-5)	Investment advice (new Article 24-5 of the LFS)
Underwriters of financial instruments (Article 24-6)	Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis (new Article 24-6 of the LFS)
Distributors of units/shares in undertakings for collective investment (Article 24-7)	Placing of financial instruments without a firm commitment basis (new Article 24-7 of the LFS)
Financial intermediation firms (Article 24-8)	This classification is now generally included in the classification "Placing of financial instruments without a firm commitment basis" under new Article 24-7 of the LFS
Investment firms operating an MTF in Luxembourg (Article 24-9)	Operation of an MTF (new Article 24-8 of the LFS)
Investment firms operating an OTF in Luxembourg (Article 24-10)	Operation of an OTF (new Article 24-9 of the LFS)

Practical implications

While existing authorizations to perform investment services or activities (as authorized under the former articles 24 to 24-10 before 31 July 2021) remain valid, each entity must ensure compliance with the new requirements under the Law.

In particular, as emphasized by the CSSF in its *communiqué* issued on 2 September 2021, investment firms may need to amend their articles of incorporation to reflect their new corporate objects in line with the new provisions of the LFS and file them with the Luxembourg Trade and Companies Register.

Other changes introduced by the Law in the Luxembourg regulatory landscape

- Specialized professionals of the financial sector (PSF)
 - The status of "currency exchange dealers" has been deleted from the list of specialized PSF, as only credit institutions can now carry out operations involving the purchase or sale of foreign currencies in cash.
- Support PSF
 - The statuses of primary IT systems operators and of secondary IT systems and communication networks operators have been merged into one single status - "operators of IT systems and communication networks" -, for which a single license from the CSSF is required.

Primary IT systems operators of the financial sector and secondary IT systems and communication networks operators of the financial sector authorized under the former Articles 29-3 and 29-4 as applicable before 31 July 2021 automatically acquire the status of IT systems and communication networks operator of the financial sector. These IT systems and communication networks operators must comply by 31 July 2022 at the latest with the authorization conditions of this Law as applicable as of 31 July 2021.



In more detail

- On 2 June 2020, the European Banking Authority (EBA) published **a roadmap** setting out its intentions concerning the mandates given to it under the IFD and the IFR.
- On 1 July 2021, the EBA published **a statement** to ease the implementation of the IFR/IFD. The opinion provides guidance on the actions to be taken in case of uncertainty on whether these investment firms should apply for an authorization as a credit institution in the absence of a delegated act establishing the methodology for the calculation of the highest threshold (i.e., EUR 30 billion threshold).
- To ensure the uniform application of the IFR/IFD framework, the EBA is currently developing draft regulatory technical standards (RTS) on prudential requirements, including a draft RTS on reclassifying certain investment firms to credit institutions, five draft RTS on capital requirements for investment firms at a solo level, and one draft RTS on the scope and methods of prudential consolidation for investment firms at a group level.

For further information and to discuss what these developments might mean for you, please get in touch with your usual Baker McKenzie contact.



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