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Legal Conditions for Banking and Investment Activities by Third-Country Firms in Luxembourg

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Credit institutions and investment firms from third countries are experiencing a time of profound regulatory changes. The Luxembourg third-country regime defined in the Financial Sector Law has been significantly amended by a law of 30 May 2018 implementing MiFID II and MiFIR rules in Luxembourg for all third-country firms. In addition, in order to anticipate the negative consequences of a potential "hard Brexit", the Luxembourg lawmaker adopted on 8 April 2019 another amending law establishing a temporary regime for the benefit of UK firms only. These two amending laws raise new questions of interpretation that third-country firms need to understand in order to carry out their activities in compliance with Luxembourg and EU law requirements.

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Introduction: A New Regulatory Era

The place of foreign credit institutions and investment firms in the Grand Duchy of Luxembourg (**Luxembourg**) has been historically important, if not predominant. Several large United States, Canadian and Swiss banks have been present in Luxembourg for many years and more recently important Chinese banks have established a branch in that country situated at the heart of the financial system of the European Union (**EU**).

Besides credit institutions and investment firms authorised in another member state of the EU or in the

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European Economic Area[2] (**EEA**), which can either provide cross-border services or establish a branch in Luxembourg in accordance with Article 30 of the Luxembourg financial sector law of 5 April 1993, as amended (the **Financial Sector Law**), third-country credit institutions and investment firms had the possibility, until 9 May 2011, to provide relatively freely cross-border financial services in Luxembourg (in the silence of the law until that date) or to establish a local branch regulated by Luxembourg law in accordance with the provisions of Article 32 of the Financial Sector Law applicable at that time.

This situation which appeared to be a "gap"[3] in the Luxembourg financial sector legislation has been corrected by a law of 28 April 2011[4] introducing a new paragraph 5 to Article 32 of the Financial Sector Law according to which credit institutions and other persons from a third country carrying on activities of the financial sector which are not established in Luxembourg but which occasionally and temporarily come to Luxembourg in order, among others, to collect deposits and other repayable funds from the public and to provide any other service under the Financial Sector Law shall hold an authorisation from the Minister responsible for the *Commission de surveillance du secteur financier* (the **CSSF**).

Seven years after this important improvement, the Luxembourg third-country regime has further been amended with the law of 30 May 2018[5], which introduces notably a new Article 32-1 into the Financial Sector Law in order to implement the relevant provisions of directive 2014/65/EU on markets in financial instruments[6] (**MiFID II**) and regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments[7] (**MiFIR**). Henceforth, the Financial Sector Law makes a distinction between "banking services and activities" which are still treated under a slightly amended version of Article 32 of the Financial Sector Law and "investment services and activities" which are governed by the new Article 32-1 of the Financial Sector Law.

Banking services and activities are described in Annex I of the Financial Sector Law[8] and can be exercised only by authorised credit institutions. Investment services and activities are covered by Annex II, Section A of the Financial Sector Law[9] and can be exercised by investment firms (*i.e.* professional of the financial sector of "category 1" under the Financial

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2 Which brings together the EU member states, Iceland, Liechtenstein and Norway.

3 See Bill of law No 6165 at pages 27-28 (extract hereafter) and the CSSF circular 11/515 of 14 June 2011 on the entry into force of the law of 28 April 2011, p. 4: « [Le nouveau paragraphe 5 de l'article 32 de la loi sur le secteur financier] *comble une lacune qui existe actuellement dans le texte de la loi de 1993 en ce qui concerne la libre prestation de services financiers qui est effectuée par des opérateurs d'États tiers à l'Union européenne. Il n'est pas exclu que ces prestataires de services peuvent actuellement opérer sans aucun agrément et par conséquent en dehors de tout contrôle public luxembourgeois sur le territoire national. Désormais et comme par le passé, ces opérateurs devront également disposer d'un agrément, identique aux prestataires de droit luxembourgeois, lorsqu'ils agissent sous un régime de libre prestation de services au Luxembourg.* »

4 The law of 28 April 2011 was published in Mémorial A-81 and came into force on 9 May 2011.

5 The law of 30 May 2018 on markets in financial instruments was published in Mémorial A under number 446 and came into force on 4 June 2018.

6 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending directive 2002/92/EC and directive 2011/61/EU, *OJEU* L 173, 12 June 2014, p. 349-496.

7 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending regulation (EU) No 648/2012, *OJEU* L 173, 12 June 2014, p. 84-148.

8 *i.e.* 1) acceptance of deposits and other repayable funds; 2) lending, including, inter alia, consumer credit, mortgage credit, factoring, with or without recourse, financing of commercial transactions (including forfeiting); 3) financial leasing; 4) payment services within the meaning of Article 1(38) of the law of 10 November 2009 on payment services, as amended; 5) issuing and administering other means of payment (e.g. travellers' cheques and bankers' drafts) insofar as this activity is not covered by point 4; 6) guarantees and commitments; 7) trading for own account or for account of customers in: (a) money-market instruments (cheques, bills, certificates of deposit, etc.); (b) foreign exchange; (c) financial futures and options; (d) exchange and interest-rate instruments; (e) transferable securities; 8) participation in securities issues and the provision of services related to such issues; 9) advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings; 10) money broking; 11) portfolio management and advice; 12) safekeeping and administration of securities; 13) credit reference services; 14) safe-custody services; 15) issuance of electronic money. The following services belong to the category of "payment services" within the meaning of Article 1(38) of the above-mentioned law on payment services: 1) services enabling cash to be placed on a payment account as well as all the operations required for operating a payment account; 2) services enabling cash withdrawals from a payment account as well as all the operations required for operating a payment account; 3) execution of payment transactions, including transfers of funds on a payment account with the user's payment service provider or with another payment service provider: (a) execution of direct debits, including one-off direct debits; (b) execution of payment transactions through a payment card or a similar device; (c) execution of credit transfers, including standing orders); 4) execution of payment transactions where the funds are covered by a credit line for a payment service user: (a) execution of direct debits, including one-off direct debits; (b) execution of payment transactions through a payment card or a similar device; (c) execution of credit transfers, including standing orders; 5) issuing and/or acquiring of payment instruments; 6) money remittance; 7) execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device and the payment is made to the telecommunication, IT system or network operator, acting only as an intermediary between the payment service user and the supplier of the goods and services.

9 *i.e.* 1) reception and transmission of orders in relation to one or more financial instruments; 2) execution of orders on behalf of clients; 3) dealing on own account; 4) portfolio management; 5) investment advice; 6) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; 7) placing of financial instruments without a firm commitment basis; 8) operation of multilateral trading facilities (MTF).

Sector Law[10]) and by credit institutions as complementary activities to their core banking activities.

In addition to these new rules, Luxembourg adopted on 8 April 2019 a law regarding measures to be taken in relation to the financial sector in the event of a withdrawal of the United Kingdom of Great Britain and Northern Ireland (**UK**) from the EU without a withdrawal agreement based on Article 50 of the treaty on European Union[11] (the **Brexit Law**). This law has been adopted in order to anticipate the consequences of the loss of UK firms' passporting rights and to ensure the continuity of existing contracts at the date of a "hard Brexit" and the possibility to enter into new contracts with "close links" to existing contracts post "hard Brexit" for a maximum duration of 21 months starting from the withdrawal date.

These two amending laws introduced new rules and raise new questions of interpretation. For instance, what is a new contract with "close link" to an existing contract under the meaning of the Brexit Law? Under which conditions a third-country credit institution having both banking and investment activities can provide its services in Luxembourg? To which extent a third-country investment firm can rely on the reverse solicitation exemption set out in Article 32-1(3) of the Financial Sector Law?

This article aims to analyse the features and innovations of the recently amended Luxembourg third-country regime, which will be fully applicable as long as no EU international agreement on intra-EU passporting rights for third-country banks will be adopted in accordance with the provisions currently in force of the Capital Requirements Directive[12] (**CRD IV**) and the European Commission will not take an equivalence decision at EU level on the basis of MiFIR with respect to third-country investment firms, as we will examine it below.

This article will therefore examine in a first part the current EU regulatory framework on the basis of which EU member states' national third-country regimes are built (**I**), and in a second part the new Luxembourg third-country regime (**II**). It will not, however, analyse the new rules introduced by the directive (EU) 2019/878 of 20 May 2019 amending the CRD IV[13] (**CRD V**), which will have to be implemented into national laws by 28 December 2020, and will notably oblige EU member states to require third-country credit institutions having a branch in their territory to provide them annually with various new sets of information[14] and include a new requirement for third-country groups with significant activities in the EU to have at least one EU intermediate parent undertaking by 30 December 2023[15]. This article will also not examine the proposals for a directive amending CRD IV and MiFID II[16] (the Investment Firm Directive or **IFD**) and an EU regulation on prudential requirements of investment firms[17] (the Investment Firm Regulation or **IFR**), which have not yet been adopted by the European Parliament and the EU Council, and should in particular strengthen the equivalence regime as set out in MiFIR.

I. The current EU Regulatory Framework

The current EU regulatory framework relevant in terms of EU market access for third-country firms is mainly formed by CRD IV, MiFID II and MiFIR. In accordance with the principle of primacy of EU law, the Luxembourg Financial Sector Law is built on the basis of these European texts. While CRD IV provisions leave a large place for national regimes of authorisation for banking activities in each EU member state (**A**), investment activities' authorisation regimes for retail clients and professional clients "on request" (or elective professional clients) are placed under national rules in accordance with MiFID II, and investment services to *per se* professional clients and eligible counterparties are temporarily placed under national rules of authorisation until the European Commission will adopt for each relevant

10 *i.e.* investment advisers, brokers in financial instruments, commission agents, private portfolio managers, professionals acting for their own account, market makers, underwriters of financial instruments, distributors of units/shares in UCIs, financial intermediation firms, investment firms operating an MTF in Luxembourg and CRR investment firms.

11 Law of 8 April 2019 on the measures to be taken in relation to the financial sector in the event of the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union published in Mémorial A 2019, No 237. This law will come into force only on the day on which the UK will withdraw from the EU without a withdrawal agreement based on article 50 of the treaty on European Union (if this is the case).

12 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending directive 2002/87/EC and repealing directives 2006/48/EC and 2006/49/EC, OJEU L 176, 27 June 2013, p. 338-436.

13 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, *OJEU* L 150, 7 June 2019, p. 253-295.

14 Article 1(11) of CRD V amending Article 47 of the Capital Requirements Directive.

15 Article 1(9) of CRD V introducing a new 21b in the Capital Requirements Directive.

16 Proposal for a directive of the European Parliament and of the Council on the prudential supervision of investment firms and amending directives 2013/36/EU and 2014/65/EU, COM (2017) 791 final, Brussels, 20 December 2017.

17 Proposal for a regulation of the European Parliament and of the Council on the prudential requirements of investment firms and amending regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010 ongoing, COM (2017) 790 final, Brussels, 20 December 2017.

third country an "equivalence decision" pursuant to MiFIR provisions (**B**).

A. Banking Activities of Third-Country Firms Under CRD IV

Under the provisions of CRD IV, the SSM Regulation[18] (**SSMR**), and the SSM Framework Regulation[19], national laws of the EU member states govern the ability of credit institutions from third countries to establish a branch or to provide cross-border services in their territory. Indeed, recital 28 of the SSM Regulation provides that supervisory tasks not conferred on the European Central Bank (**ECB**) remain with the national authorities, which is notably the case of the supervision of credit institutions from third countries establishing a branch or providing cross-border services in the EU[20].

Pursuant to Article 47(2) of CRD IV, the competent authorities are only required to notify the European Commission, the European Banking Authority (**EBA**) and the European Banking Committee of all authorisations for branches granted to credit institutions having their head office in a third country.

However, it is interesting to note that Article 47(2) of CRD IV provides that the EU may, through international agreements entered with one or more third countries, agree to apply provisions which accord to branches of third country's credit institutions identical treatment throughout the territory of the EU. However, to the best of our knowledge there is no such international agreement in force. If it would be the case, national regimes would cease to be fully applicable for the third country concerned, which should respect the provisions of such agreements.

B. Investment Activities of Third-Country Firms under MiFID II and MiFIR

Regarding investment activities, MiFID II and MiFIR introduced new regimes for third countries. The applicable regime depends on the type of clients to whom the third-country firm wishes to provide services.

The MiFID II regime applies to retail clients and professional clients on request (**1**), whereas the MiFIR regime applies to credit institutions and investment firms' investment activities that are only intended to eligible counterparties and *per se* professional clients (**2**).

Professional clients are clients who possess the experience, knowledge and expertise to make their own investment decisions and properly assess the risks that they incur (as defined in Annex II of MiFID II, and Article 1(5) and in Annex III of the Financial Sector Law).

Within the category of professional clients, *per se* professional clients are clients that are by nature professional clients (*e.g.* other authorised or regulated financial institutions or institutional investors, large undertakings) within the meaning of Annex II of MiFID II (or Section A of Annex III of the Financial Sector Law). Professional clients on request are clients (*e.g.* public sector bodies, local public authorities and private individual investors) who, on their own request, are treated as professional clients in accordance with Section II of MiFID II (or Section B of Annex III of the Financial Sector Law).

Eligible counterparties are the clients classified in accordance with Article 30(2) of MiFID II (and Article 37-7(2) of the Financial Sector Law), *i.e.* investment firms, credit institutions, insurance companies, undertakings for the collective investment in transferable securities and their management companies, pension funds and their management companies, other financial institutions authorised or regulated under EU law or under the national law of an EU member state, national governments and their corresponding offices including public bodies that deal with public debt at national level, central banks and supranational organisations. Clients categorised as eligible counterparties are treated like professional clients but they may request the protection provided for retail clients.

Finally, the category of retail clients includes by default all the persons that do not meet the criteria defining professional clients and eligible counterparties (as defined in Article 1(1)(11) of MiFID II and Article 1(4) of the Financial Sector Law). These clients benefit from an additional level of protection compared to professional clients, in particular owing to the fact that financial institutions must provide detailed information on the financial services and instruments offered and are obliged to assess the clients' knowledge, experience and expertise before providing investment services.

18 Council regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation), *OJEU* L 287, 29 October 2013, p. 63-89.

19 Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17), *OJEU* L 141, 14 May 2014, p. 1-50.

20 On the ECB Prudential Supervision Regulation and the Single Supervisory Mechanism, see *e.g.* C. Kesseler, "Recent Banking Authorisation Developments", in *Bulletin Droit & Banque*, n° 64, 2019, p. 27-33; F. Goergen, « Perspectives européennes et luxembourgeoises sur le Mécanisme de Surveillance Unique : un nouveau modèle pour la surveillance prudentielle des banques », in *Bulletin Droit & Banque*, n° 56, 2015, p. 23-49; and H. Wagner and N. Kayser, "A Glimpse at Amended Supervisory Authority Competency Rules under the Single Supervisory Mechanism", in *Bulletin Droit & Banque*, n° 56, 2015, p. 53-57.

1. MiFID II Optional Branch Regime for Services to Retail Clients and Elective Professional Clients

Article 39 of MiFID II provides that EU member states may require third-country firms that intend to provide investment services to retail clients or professional clients on request in their territory to establish a branch in that EU member state.

Article 39's regime is an option for EU member states which are not required to implement these provisions into national law. As we will examine in part II below, Luxembourg decided to implement this requirement to establish a branch in Luxembourg for investment activities of third-country firms to retail clients or professional clients on request.

Where an EU member state requires that a third-country firm intending to provide investment services in its territory establish a branch, the branch shall acquire a prior authorisation by the competent authorities of that EU member state in accordance with the conditions set out in Articles 39(2) to 41 of MiFID II (as implemented in the new Article 32-1 of the Financial Sector Law in Luxembourg, see below). Indeed, the EU lawmaker's intention was to introduce a minimum common regulatory framework regarding the requirements applicable to such third-country branches[21].

Once the branch is established, it will need to comply with a number of substantive provisions of MiFID II as implemented in each EU member state (in particular organisational requirements, conflict of interest rules, conduct of business rules and information requirements, best execution requirements and market transparency and integrity requirements).

The third-country firm's branch will not be granted any EU passporting rights, and will be limited to provide its services to the clients in that EU member state only. If the third-country firm wishes to use its branch in another EU member state, this would in principle require an additional authorisation in that EU member state.

It is important to note that Article 42 of MiFID II (also implemented in Article 32-1(3) of the Financial Sector Law) entails one derogation to the requirement for authorisation under Article 39 of MiFID II that has to be interpreted strictly (the so-called "reverse solicitation exemption"). Under the reverse solicitation exemption, where a retail client or professional client established or situated in the EU initiates on its own exclusive initiative the provision of an investment service by a third-country firm, the requirement for the establishment of an authorised branch in EU member states opting for such a rule does not apply to the provision of that service by the third-country firm to that person, including a relationship specifically relating to the provision of that service or activity. However, an initiative by such clients shall not entitle the third-country firm to market otherwise than through the branch, where one is required in accordance with national law, new categories of investment products or investment services to that client.

This regime for retail and professional clients on request differs from the third-country rules applicable to *per se* professional clients and eligible counterparties under MiFIR.

2. MiFIR Regime with or without a Branch for Services to per se Professional Clients and Eligible Counterparties

Article 46 of MiFIR introduces the possibility for third-country firms to provide investment services to eligible counterparties and to *per se* professional clients throughout the EU without the establishment of a branch in the EU once an "equivalence decision" regarding their country of origin is taken by the European Commission in accordance with Article 47 of MiFIR, and when these firms are registered in the register of third-country firms kept by the European Securities and Markets Authority (**ESMA**), pursuant to Article 48 of MiFIR.

Under Article 47(1) of MiFIR, the European Commission may only grant an equivalence decision if the legal and supervisory framework of a third country has been recognised to be equivalent to the ones of the EU and that this third country provides for an effective equivalent system for the recognition of investment firms authorised under other third-country legal regimes. In other words, an equivalence decision will be possible only where the third country itself has adopted a system of mutual recognition allowing EU investment firms to provide investment services into that third country[22].

The registration with ESMA creates a "passport" for the entire EU, and EU member states cannot impose any additional requirements on such third-country firms. However, the right to passport their services is only valid for services provided to *per se* professional clients and to eligible counterparties. Therefore, such third-country firms will still need to comply with the national regime in each EU member state in order to provide their services to retail or professional clients on request.

Before the provision of any investment services, third-country firms providing services in accordance

21 See recital 109 of MiFID II and A. de Backer, "MiFID II: Territorial Scope and Cross-Border Services", in I. de Meuleneere, V. Colaert, W. Kupers, A.-S. Pijcke (eds.), *MiFID II & MiFIR: capita selecta: Scope, Investor Protection, Market Regulation and Enforcement*, Anthemis, coll. Cahiers AEDBF/EVBFR-Belgium, 2018, p. 43.

22 A. de Backer, "MiFID II: Territorial Scope and Cross-Border Services", *art. cit. supra* at footnote 21, p.42.

with the MiFIR equivalence regime shall inform in writing clients established in the EU that they are not allowed to provide services to clients other than eligible counterparties and *per se* professional clients and that they are not subject to supervision in the EU. They shall also indicate the name and the address of the competent authority responsible for supervision in their third country of origin. They shall also before providing any service or performing any activity in relation to a client established in the EU, offer to submit any disputes relating to those services or activities to the jurisdiction of a court or arbitral tribunal in an EU member state.

Nevertheless, it is interesting to note that similarly to Article 42 of MiFID II and under similar limits, Article 46(5), last sub-paragraph, of MiFIR[23] provides for a reverse solicitation exemption applicable to eligible counterparties and *per se* professional clients of third-country firms allowing for limited cross-border services requested by such clients on their own exclusive initiative.

Finally, it is important to note that Article 47(3) of MiFIR provides that a third-country firm established in a foreign jurisdiction recognised as equivalent by the European Commission and which has an authorised branch in an EU member state (in accordance with Article 39 of MiFID II) shall be able to provide the services covered under the authorisation to eligible counterparties and *per se* professional clients in other EU member states without the establishment of new branches if the prior notification procedure for the cross-border provision of services of Article 34 of MiFID II is complied with[24]. However, as pointed out by Axel de Backer, it is not entirely clear whether this regime can also apply without registering with ESMA. Indeed, as the regime under Article 47(3) of MiFIR does not expressly require a registration with ESMA, this could mean that a firm which has established a branch in accordance with Article 39 of MiFID II and that is authorised in an "equivalent jurisdiction" may provide services to eligible counterparties and *per se* professional clients throughout the EU without registering with ESMA, subject to complying with the notification procedure under Article 34 of MiFID II[25].

Nevertheless, if the third-country firm wishes to expand its activities to retail clients or professional clients on request in another EU member state, it will need to comply with the applicable national regime in each jurisdiction (unless the reverse solicitation exemption of Article 42 of MiFID II would be applicable).

To date, the European Commission did not adopt any equivalence decision. Therefore, third-country firms still need to assess their situation under the national regime of each EU member state in which they intend to provide their investment services. If a third-country firm wishes to provide investment services in several EU member states, it will in principle need to be authorised to provide such services in each EU member state. The national regime will also be applicable where a European Commission equivalence decision is no longer in effect or where ESMA withdraws the registration of a particular third-country firm from its register (unless the rule of Article 47(3) of MiFIR would apply as discussed above). The Luxembourg third-country regime is further discussed below.

II. The New Luxembourg Third-Country Regime

Since the entry into force of the laws amending the Financial Sector Law and implementing MiFID II and MiFIR provisions into Luxembourg law, the Luxembourg third-country regime makes a clear distinction between banking activities (**A**) and investment activities (**B**) of third-country firms, which was not the case under the former wording of Article 32 of the Financial Sector Law. We will analyse the general rules applicable to third-country firms under the slightly amended Article 32 and the new Article 32-1, as well as the specific rules applicable to UK firms under the above-mentioned Brexit Law which will introduce, in case of a "hard Brexit", a new Article 67 to the Financial Sector Law (**C**). We will finally examine the sanctions that the CSSF may take when a third-country firm is in breach of its obligations under the Financial Sector Law (**D**).

A. Banking Activities under the Amended Article 32 of the Financial Sector Law

Article 32's regime on banking activities applies to credit institutions and professional of the financial sector (**PFS**) other than investment firms from third countries (*i.e.* specialised PFS, support PFS, and data communication service provider in the meaning of the Financial Sector Law). As explained above, this Luxembourg national third-country regime will

23 *"Member States shall ensure that where an eligible counterparty or professional client within the meaning of Section I of Annex II to* [MiFID II] *established or situated in the Union initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm,* [Article 46 of MiFIR] *does not apply to the provision of that service or activity by the third-country firm to that person including a relationship specifically related to the provision of that service or activity. An initiative by such clients shall not entitle the third-country firm to market new categories of investment product or investment service to that individual."*

24 In such a case, the branch of the third-country firm shall remain subject to the supervision of the EU member state where the branch is established.

25 A. de Backer, "MiFID II: Territorial Scope and Cross-Border Services", *art. cit. supra* at footnote 21, p.45.

apply as long as no EU international agreement on intra-EU passporting rights for third-country credit institutions under CRD IV provisions exists.

Article 32(1) provides an option to third-country firms to establish a branch in Luxembourg (**1**), and Article 32(5) specifies that firms which are not established in Luxembourg but which occasionally and temporarily come to Luxembourg in order to provide banking and financial services (other than the services covered by Article 32-1) must hold a specific authorisation from the Minister responsible for the CSSF on the latter's advice, unless the exception recognised by the CSSF in the circular 11/515[26] would apply (**2**). Finally, both paragraphs 1 and 2 of Article 32 specify that this Article is without prejudice of the new Article 32-1 on investment activities of third-country credit institutions and investment firms, which is important to keep in mind in case of "combined offers" involving banking and investment services (**3**).

1. Optional Establishment of a Branch in Luxembourg

According to Article 32(1) of the Financial Sector Law, third-country credit institutions and PFS other than investment firms wishing to establish a branch in Luxembourg are subject to the same authorisation requirements as any Luxembourg credit institutions and other PFS governed by the Financial Sector Law. In addition, the authorisation for an activity involving the management of funds of third parties will be granted to branches of companies governed by foreign law only if those companies are endowed with own funds which are separate and distinct from the assets of their shareholders. Moreover, the branch must have at its permanent disposal an endowment capital or capital base equivalent to that required of a person governed by Luxembourg law who carries on the same activity.

The compliance with the conditions for the authorisation will be assessed in relation to the foreign institution and the requirement concerning professional standing and experience will extend to those responsible for the management of the branch. Finally, instead of fulfilling the condition regarding central administration, the branch will be required to produce evidence of the existence of a satisfactory administrative infrastructure in Luxembourg.

The application must be done in writing but there is no standard form. The application file must be accompanied by all such information as may be needed for the assessment of the CSSF and by a programme of operations indicating the type and volume of business envisaged and the administrative and accounting structure of the institution in question[27].

2. Cross-Border Banking Services

In addition, Article 32(5) of the Financial Sector Law establishes a cross-border authorisation regime pursuant to which third-country credit institutions and PFS other than investment firms may provide banking and financial services (other than investment services) to Luxembourg clients without establishing a permanent presence in Luxembourg. These services notably include deposit taking, lending activities and payment services.

According to the CSSF circular 11/515 (which is still applicable so far regarding banking activities of third-country firms), the following cumulative criteria[28] must be met for this authorisation to be applicable:

i) the persons are originating from a third country;

ii) the persons do not have an establishment in Luxembourg;

iii) the persons perform an activity of bank or PFS in their home country; and

iv) one or more of their agents travel occasionally and temporarily to Luxembourg, notably to collect deposits or other repayable funds from the public and to provide any other service covered by the Financial Sector Law.

In such a situation, the authorisation from the Minister responsible for the CSSF is granted on the condition that such a third-country firm is subject to rules of approval and supervision deemed equivalent to those of the Financial Sector Law in their State of origin.

According to the CSSF circular 11/515, these rules notably include the requirement to have an authorisation granted by a public authority of the concerned third country, the reputation of the directors, the internal administrative organisation (organisational requirements, existence of human and technical resources, establishment of internal systems, resources and procedures), the existence of rules of conduct, as well as requirements relating to financial bases and the membership of a deposit-guarantee scheme[29].

Moreover, the CSSF considers that credit institutions whose home country is represented in the Basel Committee on Banking Supervision are presumed to be subject to authorisation and supervisory rules equivalent to the ones of the Financial Sector Law. The CSSF may request the other credit institutions and persons carrying out activities of the financial sector to have an independent legal opinion on the

26 CSSF circular 11/515 quoted at footnote 3 above.

27 The minimum content of the banking authorisation application file and a list of annexes to be provided is described on the CSSF website at https://www.cssf.lu/en/supervision/banks/authorisation/.

28 CSSF circular 11/515, quoted at footnote 3 above, p. 5.

29 CSSF circular 11/515, p. 6.

equivalence of the home country authorisation and supervisory rules with the Financial Sector Law[30].

As any persons providing financial services on the Luxembourg territory, the persons concerned will be required to comply with certain Luxembourg territorial rules, such as the legislation relating to the fight against money laundering and terrorist financing or consumer protection.

It is interesting to note that the fourth cumulative condition stated above means implicitly that if a third country often sends its agents to Luxembourg to provide regulated services or has permanent regulated activities on the territory of Luxembourg, an authorised branch in Luxembourg in accordance with the first paragraph of Article 32 will be necessary.

However, the CSSF specifies in the circular 11/515 that *"it is not sufficient that the persons concerned direct their activities to Luxembourg from their home country"*. Indeed, for the CSSF, *"*[h]*aving customers domiciled in Luxembourg does not mean that the aforementioned persons perform ipso facto their activities on the Luxembourg territory"*[31].

Indeed, in line with the European Commission views in its 1997 interpretative communication[32] regarding the identification of activities subject to prior notification in relation with the freedom to provide banking services in the EU, the CSSF considers that coming on the Luxembourg territory temporarily in order to carry out an activity upstream or downstream from the activities referred to in Article 32(5) is not subject to an authorisation. According to the CSSF circular 11/515, the same applies to introductory visits made by the persons concerned to their Luxembourg-based customers, on the condition that these visits are not accompanied by the exercise of activities falling within the scope of Article 32(5).

As Article 32(5) of the Financial Sector Law only covers the physical travel of agents to Luxembourg and, moreover, only to carry out activities covered by the Financial Sector Law, it does not prevent the persons concerned from informing the Luxembourg public of their banking activities and to make brand advertising on the Luxembourg territory. Activities such as the simple canvassing of customers or more generally the advertising and organisation of a "road show" are thus excluded from the scope of Article 32(5).

Finally, according to the CSSF if persons originating from third countries only provide general information on their activities and if the potential Luxembourg clients must approach these persons themselves in their home country in order to enter into a contract with them, an authorisation as referred to in Article 32(5) of the Financial Sector Law is not required.

An authorisation in Luxembourg will be necessary only if the third-country firm is deemed to provide its services on the Luxembourg territory. Indeed, in order to determine whether a person carries out a regulated activity in Luxembourg, it is necessary to "locate" the place of the supply of the regulated services or what may be termed the place of the "characteristic performance" of the service (*i.e.* the place where the essential performance of the service is provided and for which a payment is due[33]).

On the basis of the CSSF circular 11/515, it can therefore be considered that cross-border banking activities with relevant entities established in Luxembourg originating exclusively through distance communication means from a third country (*e.g.* via email or telephone but without any physical presence on the Luxembourg territory or the use of an Internet website ending with "*.lu"* or targeting specifically the Luxembourg market) would not be subject to a prior authorisation in Luxembourg. However, it is not entirely clear if repeated transactions with a significant number of Luxembourg clients would be accepted by the CSSF without a licence in Luxembourg, and an analysis *in concreto* on a case-by-case basis is in any event necessary.

Finally, it is interesting to note that the CSSF press release 19/17[34] indicates that the CSSF circular 11/515 is currently being reviewed and could therefore clarify the interpretation of Article 32(5) as amended. In addition, this press release and footnote 3 of the CSSF circular 19/716[35] (which we will examine more in detail below) specify that CSSF circular 11/515 is no longer up to date and no longer applies to third-country firms with regard to the provision of investment services as Article 32(5) of the Financial Sector Law does not apply anymore to investment services provided by third-country firms which are now covered by the new Article 32-1 of the Financial Sector Law.

This is interesting, as until the publication of those two documents by the CSSF of April 2019, questions of interpretation existed where a third-country credit

30 CSSF circular 11/515, p. 6.
31 CSSF circular 11/515, p. 5.
32 Commission Interpretative Communication, "Freedom to provide services and the interest of the general good in the Second Banking Directive", doc. 97/C 209/04, *OJEC* C 209, 10 July 1997, p. 6-22.
33 Doc. 97/C 209/04, quoted at footnote 32 above, p. 7.
34 CSSF Press Release 19/17 of 12 April 2019, "Publication of CSSF circular 19/716 on the "Third Country" National Regime Under MiFID II/MiFIR".
35 CSSF circular 19/716 of 10 April 2019, "Provision in Luxembourg of Investment Services or Performance of Investment Activities and Ancillary Services in accordance with Article 32-1 of the LFS".

institution wanted to provide both banking services and investment services on a pure cross-border basis.

3. Rules Applicable to "Combined Offers" involving Banking and Investment Services

Until April 2019, the possibility to carry on pure cross-border banking activities with parallel or concomitant investment services without triggering local licensing requirements was not entirely clear.

Footnote 3 of the CSSF circular 19/716 and the CSSF press release 19/17 indicate that this is not possible any more. Indeed, the more stringent rules under Article 32-1(1) second sub-paragraph for cross-border investment services, but also the stricter rules introduced by Article 32-1(3) of the Financial Sector Law regarding the provisions of services at the exclusive initiative of a client (the "reverse solicitation exemption") for investment activities (as further described below), should apply to parallel or concomitant banking and investment activities. Therefore, the interpretation given in CSSF circular 11/515 should no longer apply to "combined offers" involving banking and investment services. In particular, for such firms, it will no longer be possible to send their agents in Luxembourg for introductory visits related to banking and investment services without an authorisation under Luxembourg law, as they would at least need an authorisation under Article 32-1(1), second sub-paragraph, of the Financial Sector Law.

The revised CSSF circular 11/515 that is currently under preparation by the CSSF might clarify these questions. In any event, it will be necessary to verify if investment activities can be completely isolated from banking activities and if a specific authorisation for cross-border investment services of a third-country credit institution is necessary. Indeed, it is now essential for third-country firms wishing to carry out investment activities in Luxembourg to fully comply with the new rules introduced by Article 32-1 of the Financial Sector Law.

B. Investment Activities under the New Article 32-1 of the Financial Sector Law

Under the new Article 32-1 of the Financial Sector Law, which is fully applicable as long as the European Commission does not take an equivalence decision at EU level and a particular firm is registered on the ESMA register of third-country firms authorised to provide their services in the entire EU, credit institutions or investment firms from third countries wishing to provide investment services and ancillary services[36] in Luxembourg will have four options[37].

If they intend to provide investment services to retail clients or professional clients "on request", they will have to establish a branch in Luxembourg in accordance with Article 32-1(2) provisions (**1**). If they wish to provide investment services to eligible counterparties or *per se* professional clients, they will either have the possibility to establish a branch in Luxembourg in accordance with Article 32-1(1), first sub-paragraph (**2**), or to provide cross-border services under the specific requirements of Article 32-1(1), second sub-paragraph (**3**). Finally, it is possible to provide limited investment services for all categories of clients under the strict conditions of the reverse solicitation exemption provided for in Article 32-1(3) of the Financial Sector Law (**4**).

1. Compulsory Establishment of a Branch in Luxembourg for Services to Retail Clients and Elective Professional Clients

By requiring the establishment of a branch in Luxembourg by third-country firms that wish to provide in Luxembourg investment services to retail clients or to professional clients on request, Luxembourg opted for the branch option granted under Article 39 of MiFID II described above.

In accordance with MiFID II provisions, the third-country firm's branch will be subject to the same authorisation rules laid down in the Financial Sector Law as credit institutions and investment firms incorporated under Luxembourg law and must comply with provisions of Article 32(2) to (4) presented above.

In addition:

i) the provision of services for which the third-country firm requests authorisation to provide services in Luxembourg must be (i) subject to authorisation and supervision in the third country where the firm is established, and (ii) properly

36 Ancillary services are described in Annex II, Section C of the Financial Sector Law, *i.e.* 1) safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management; 2) granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction; 3) advice to undertakings on capital structure, industrial strategy and related matters; advice and services relating to mergers and the purchase of undertakings; 4) foreign exchange services where these are connected to the provision of investment services; 5) investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments; 6) services related to underwriting; and 7) investment services and activities as well as ancillary services of the type included under Section A or C of Annex II of the Financial Sector Law related to the underlying of the derivatives included under points 5, 6, 7 and 10 of Section B of Annex II of the Financial Sector Law, where these are connected to the provision of investment or ancillary services.

37 We will not present the intra-group exemption provided for in Article 1-1(2)(c) of the Financial Sector Law according to which the requirement of an authorisation will not apply to persons providing services covered by the Financial Sector Law exclusively to one or several undertakings belonging to the same group as the person providing these services. Indeed, this exemption does not apply to extra-group clients for such services and is of limited interest.

authorised by a third-country competent authority paying due regard to any Financial Action Task Force (**FATF**) recommendations in the context of anti-money laundering and countering the financing of terrorism (*i.e.* unregulated third-country firms in their home country will not be allowed to provide services in Luxembourg through a branch);

ii) cooperation arrangements, including notably provisions regulating the exchange of information for the purpose of preserving the integrity of the market and protecting investors, must be in place between the CSSF and competent supervisory authorities of the third country where the firm is established;

iii) the branch must comply with initial capital requirements provided for in the relevant Luxembourg authorisation rules;

iv) one or more persons must be appointed to be responsible for the management of the branch and they all must comply with the requirements laid down in Article 19(1 *bis)*, Article 38(4), and Articles 38-1, 38-2 and 38-8 of the Financial Sector Law;

v) the third country where the third-country firm is established must have signed an agreement with Luxembourg, which fully complies with the standards laid down in Article 26 of the *OECD Model Tax Convention on Income and on Capital* and ensures an effective exchange of information in tax matters, including, if any, multilateral tax agreements; and

vi) finally, the firm must belong to an investor-compensation scheme authorised in accordance with Article 156 of the Luxembourg law of 18 December 2015 on the failure of credit institutions and certain investment firms, as amended.

The application file must be submitted in writing and include at least a detailed description of the activities carried out in the home country and those contemplated or carried out in Luxembourg, as well as any relevant information and supporting documents allowing the CSSF to ensure that the activities are indeed covered by the scope of Article 32-1 of the Financial Sector Law, and that the prerequisites of this Article are fulfilled.

Moreover, in accordance with the provisions of Article 35(4) of the Financial Sector Law an authorised branch in Luxembourg of a third-country firm must comply notably with the relevant professional obligations, prudential rules and rules of conduct in the financial sector applicable to credit institutions and investment firms in Luxembourg and is subject to the supervision of the CSSF.

Once authorised, a third-country firm's branch in Luxembourg will not be in authorised to provide cross-border investment services in another EU member state, unless the strictly interpreted reverse solicitation exemption could apply.

2. Optional Establishment of a Branch in Luxembourg for Services to Eligible Counterparties and per se Professional Clients

According to the provisions of the new Article 32-1(1), first sub-paragraph of the Financial Sector Law, third-country credit institutions and investment firms intending to provide investment services and activities to eligible counterparties and professional *per se* clients in Luxembourg may choose to provide their services by establishing a branch in Luxembourg which will be subject to the same authorisation requirements as any Luxembourg credit institutions and investment firms and the provisions of Article 32(2) to (4) of the Financial Sector Law.

As for third-country branch providing services to retail clients, the application for the establishment of a branch targeting professional clients in Luxembourg must be submitted in writing to the CSSF with all supporting documents related to the intended activities of the branch and its background and such a branch will have to comply with provisions of Article 35(4) of the Financial Sector Law and other relevant professional obligations applicable to credit institutions and investment firms in Luxembourg. They will also be subject to the supervision of the CSSF which is empowered to examine the measures implemented by such branches and to require their amendment, where such amendments are necessary to ensure compliance with the requirements of the Financial Sector Law.

3. Specific Cross-Border Licence for Services to Eligible Counterparties and per se Professional Clients

Finally, if a third-country firm wishes to provide its investment services from its home state on a cross-border basis without establishing a branch in Luxembourg, Article 32-1(1), second sub-paragraph sets out that, in the absence of an equivalence decision of the European Commission and registration in the register of third-country firms kept by ESMA, the investment services may be carried out provided that:

i) the third-country firm is authorised to provide the relevant services in its jurisdiction of establishment;

ii) the CSSF considers that the third-country firm is subject to supervision and to authorisation rules deemed equivalent to the ones of the Financial Sector Law; and

iii) the cooperation between the CSSF and the supervisory authority of the relevant third-country firm is ensured.

As specified in the CSSF circular 19/716[38], the CSSF considers, in principle, that third countries that are not signatories of the International Organisation of Securities Commissions' Multilateral Memorandum of Understanding concerning Consultation and Co-operation and the Exchange of Information[39] are not equivalent. It also considers as non-equivalent third countries that do not have adequate legislation and supervision with respect to the fight against money laundering and terrorist financing. In that respect, the CSSF will assess the condition of equivalence notably in light of the list of high-risk and/or non-cooperative jurisdictions established by the FATF and its assessments. The CSSF may also, where appropriate, request the third-country firm to provide an independent legal opinion on the equivalence to the Financial Sector Law of the authorisation and supervisory rules of the third country in which the firm has its head office or its registered office for the provision of investment services.

The list of countries that the CSSF considers as equivalent for the purposes of the national regime will be published by the CSSF and updated based on the requests submitted by third-country firms. But, so far no list of equivalent third countries has been published by the CSSF yet.

The decision on the provision of investment services in Luxembourg is made by the CSSF upon written application. Third-country firms must include in their request the specific form enclosed in Annex II of the CSSF circular 19/716. The application file must at least include a detailed description of the activities carried out in the home country and those contemplated or carried out in Luxembourg, as well as any relevant information and supporting documents allowing the CSSF to ensure that the requirements of the Financial Sector Law are fulfilled.

It is worth noting that pursuant to Article 46(5) of MiFIR third-country firms are required before offering any investment service, to inform their clients that they are not allowed to provide services to clients other than eligible counterparties and *per se* professional clients and are not subject to supervision in the EU. Third-country firms must point out, in writing and in a prominent way, the name and address of the competent authority responsible for their supervision in the relevant third country[40].

Finally, in a situation where the CSSF takes an equivalence decision relating to a third country in which the third-country firm has its head office or its registered office and, at a later stage, the European Commission takes an equivalence decision for the same third country, Article 54(1) of MiFIR provides for a transitional regime allowing the third-country firm to continue to provide investment services in Luxembourg in accordance with the national regime up until three years after the adoption of the equivalence decision by the European Commission on the third country concerned. In other words, the third-country firm can remain subject to the national regime for a maximum transitional period of three years[41].

All the above-mentioned rules for investment services are, however, without prejudice of the reverse solicitation exemption which is strictly interpreted.

4. The Reverse Solicitation Exemption

In accordance with Article 32-1(3) of the Financial Sector Law, where a client established or situated in the European Union initiates on its own exclusive initiative the provision of an investment service by a third-country firm, the rules laid down in Article 32-1(1) and Article 32-1 (2) of the Financial Sector Law do not apply. In such a case, and irrespective of the client's classification (retail client, professional client on request, *per se* professional client, or eligible counterparty[42]), the third-country firm can provide the investment service without being required to have to establish a branch or to obtain a decision of the CSSF nor to notify it prior to the provision of the service. Nevertheless, the initiative by such client shall not entitle the third-country firm to market new categories of investment product or service to the client. This must remain a "one investment product category deal".

According to ESMA[43], whether a third-country firm markets a new category of an investment product needs to be assessed on a case-by-case basis, taking into account elements such as (i) the type of the financial instrument which is offered, (ii) the distinction between complex and non-complex products, and (iii) the riskiness of the product (for example, a subordinated bond does not belong to the same category as a plain-vanilla debt instrument).

In addition, categories of investment products should be "granular enough"[44] (*i.e.* clearly differentiated) to ensure that the reverse solicitation is not used as a way of circumventing a national regime of an EU member state governing the provision of investment services by a third-country firm. As an example, if a third-country firm has been providing investment

38 See CSSF circular 19/716, quoted at footnote 35 above, p. 6.
39 Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf
40 CSSF circular 19/716, p. 7.
41 CSSF circular 19/716, p. 7.
42 As confirmed by the CSSF in the CSSF circular 19/716, p. 8.
43 See ESMA's revised *Q&A on MiFID II and MiFIR Investor Protection and Intermediaries Topics*, document ESMA35-43-349, 3 October 2019, p. 111. These questions and answers are published on ESMA's website and are regularly updated.
44 *Idem.*

advice to a client prior to 3 January 2018 (deadline for the implementation of MiFID II into national laws) under the national regime of an EU member state governing the provision of investment services by third-country firms, the third-country firm will not be entitled to continue providing investment advice without an authorisation under that national regime in relation to an investment product other than those that belong to the same category on which the investment advice was provided prior to 3 January 2018.

Moreover, as set out in MiFIR and MiFID II (respectively recitals 43 and 111), if a third-country firm solicits clients or potential clients in the EU or promotes or advertises investment services or activities together with ancillary services in the EU, such services or activities shall not be deemed as provided at the own exclusive initiative of the clients. According to ESMA (and the CSSF which invites to take into account ESMA interpretations with respect to reverse solicitation[45]), such a solicitation, promotion or advertising should be considered regardless of the person through whom it is issued (*i.e.* the third country firm itself, an entity acting on its behalf or having close links with such third country firm or any other person acting on behalf of such entity).

Any communication means used, such as press releases, advertising on the Internet, brochures, phone calls, emails or face-to-face meetings should be considered to determine if the clients or potential clients have been subject to any solicitation, promotion or advertising in the EU. The test for the reverse solicitation exemption is therefore broader than the sole aspect of where the contract is entered into.

ESMA and CSSF consider that third-country firms should be able to provide records tracking the relationship with the client and in particular whether the client has taken the initiative to receive investment services (*e.g.* a letter/email from a Luxembourg client requesting a specific investment service from a third-country firm and specifying that it can be contacted by the third-country firm representatives from time to time to discuss the implementation of the requested service). Indeed, according to ESMA, contractual provisions or disclaimers purporting to state, for example, that the third-country firm will be deemed to respond to the exclusive initiative of the client will not be sufficient in that respect[46].

Although it is still to be confirmed how exactly Article 32-1(3) of the Financial Sector Law will be interpreted in practice by the CSSF, it could be argued that the reverse solicitation exemption could apply to a third-country firm's investment activities if a preliminary interaction with a Luxembourg client takes place outside the EU. However, an express decision to solicit a third-country firm shall always come from the Luxembourg client, without such initiative somehow being provoked by the third-country firm.

Therefore, the reverse solicitation exemption will only apply to limited circles of clients and will be construed and approached restrictively by the CSSF. Thus, a cautious approach is recommended when relying on Article 32-1(3) of the Financial Sector.

The above-described rules apply to all third-country firms, but Luxembourg decided to establish temporary specific rules for the UK in case of a "hard Brexit" which will be examined in the point below.

C. Toward a "Hard Brexit"? The New Article 67 of the Financial Sector Law

In preparation of a potential "hard Brexit", Luxembourg adopted the above-mentioned Brexit Law. That law which will come into force only on the day on which the UK will withdraw from the EU without a withdrawal agreement based on article 50 of the treaty on European Union (if it is the case) introduces notably a new Article 67 to be inserted in Part VI of the Financial Sector Law (dedicated among other things to transitional provisions) in order to allow the CSSF to continue to apply, by way of derogation from Articles 32 and 32-1 of the Financial Sector Law, the provisions under Article 30 applicable to EU and EEA credit institutions and investment firms to UK credit institutions and investment firms governed by English law (i) exercising the freedom to provide services, or (ii) having an established branch, or (iii) having a tied agent in Luxembourg at the withdrawal date, for a maximum duration of 21 months starting from the withdrawal date, notwithstanding the fact that such UK credit institutions or investment firms will no longer qualify as EU credit institutions or investment firms.

According to the Brexit Law and CSSF instructions[47], UK's firms were given until 15 September 2019 to notify the CSSF on its eDesk portal using dedicated Brexit notification forms in order to continue their existing activities in Luxembourg for a transitional period of 12 months (finally retained by the CSSF in July 2019[48]) following the date of a "hard Brexit". This transition mechanism applies only if there is a "hard Brexit" and only to existing contracts and to those concluded post-Brexit but with "close links" to existing contracts.

45 See CSSF circular 19/716, p. 8.

46 See ESMA's revised *Q&A on MiFID II and MiFIR Investor Protection and Intermediaries Topics*, quoted at footnote 43 above, p. 110.

47 See notably CSSF Press Release 19/33 of 15 July 2019, "Mandatory Notification for UK Firms in the Context of Brexit", and CSSF Press Release 19/41 of 2 August 2019, "Opening of the e-Desk Portal for the Purpose of the Mandatory Notification in the Context of Brexit".

48 CSSF Press Release 19/33 of 15 July 2019.

Entities that have not submitted a notification through the CSSF's eDesk portal by 15 September 2019 will not be entitled to benefit from the transitional regime and will have to cease all business as of the date of a no-deal Brexit. The CSSF will assess each notification received and inform UK firms individually as to whether they can benefit or not from the transitional regime.

Regarding new contracts and new banking and investment activities, and unless an exception to the obligation to hold an authorisation in Luxembourg applies (as in the cases analysed above for any other third-country firms), UK firms will have to apply (just like any other third-country firms) for an authorisation from the Ministry of Finance (either to set up an establishment in Luxembourg or to submit an application to provide investment services in Luxembourg on a cross-border basis under Article 32-1(1) of the Financial Sector Law) as soon as possible before or after a "hard Brexit" in order to continue their business and enter into new contracts in Luxembourg[49].

There is, however, no definition of what could constitute a new contract having a "close link" with existing contracts. The only indication provided in the comments to the Articles of the Bill of Law n° 7401 of 31 January 2019 proposing the Brexit Law is that this exception would notably allow to cover cases where operations in connection with existing contracts at the time of the withdrawal date (*life-cycle events*) give rise to the conclusion of a new contract.

Subject to further official guidance from the CSSF and to specific EU law rules that may be adopted in case of a "hard Brexit", it is interesting to note that the comments to the Articles of the Bill mention in particular *non-cleared derivatives contracts* among contracts that could enter in the scope of the proposed Article 67. It seems therefore reasonable to consider that trade conducted under an existing master agreement would constitute a "close link". However, no new type of derivatives products unforeseen in the master agreement and without close link with it may be created without triggering a licence requirement as they will constitute new investment activities after Brexit.

For banking activities, as the main obligations of the agreements will most often be fulfilled at the time of their execution, most pre-Brexit agreements should validly continue after a "hard Brexit". The increase of the amount of a loan or a change in the maturity post-Brexit could be considered as technical adjustments of existing contracts and would not require a prior authorisation. However, the addition of a new Luxembourg borrower could be interpreted as the provision of a new banking service if it occurs after Brexit, and could require an authorisation (except in cross-border situations covered by the CSSF circular 11/515 as explained above).

In case of a change at the initiative of a Luxembourg client, if related to the same investment product, the reverse solicitation exemption could also cover such a change.

As a consequence, the question of whether a licence is required in Luxembourg for existing agreements will need to be assessed on a case-by-case basis, agreement by agreement, in a no-deal Brexit scenario. Indeed, under the explanatory statement of the Bill, the purpose of the Brexit Law is to allow the grandfathering of an existing regulatory situation for a limited period of time. It will therefore be necessary to assess in each case whether activities conducted under existing terms of business would lead to exercise new regulated activities (*i.e.* regulated activities not covered under existing contracts) for which there is an authorisation requirement in Luxembourg.

Finally, it is apparent from a combined reading of Article 67 and Article 30 of the Financial Sector Law that the derogation foreseen in the Brexit Law covers only regulated credit institutions and investment firms duly authorised in the UK and exercising their activities in Luxembourg through (i) the freedom to provide services, or (ii) a Luxembourg branch, or (iii) a tied agent in Luxembourg, at the withdrawal date. UK branches of EU authorised firms who passported into the UK their services before the Brexit should therefore not benefit from the temporary derogatory regime of Article 67 of the Financial Sector Law, as they are not in-scope of the Brexit Law. In addition, it should be noted that according to the ECB, the purpose of branches of EU firms in third countries is to meet local needs. The ECB and national supervisors do not expect that branches in third countries perform critical functions for the EU credit institution itself or provide services back to customers based in the EU. Therefore, credit institutions should clarify the role of branches in the UK in their Brexit plans and discuss each situation with their relevant regulators[50].

D. Sanctions

Finally, it is important to note that the provision of regulated services in Luxembourg without a proper authorisation is illegal and thus subject to sanctions.

Depending on various factors that need to be assessed *in concreto* in each case, the CSSF (in cooperation with the ECB, as the case may be) may impose the

49 CSSF Press Release 19/18 of 12 April 2019, "Publication of the Laws Regarding Measures to be taken in Relation to the Financial Sector in the Event of a Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union".

50 See ECB, "Relocating to the Euro Area", article available at https://www.bankingsupervision.europa.eu/banking/relocating/html/index.en.html#eubranch.

following administrative penalties or measures in order of increasing severity:

i) a warning;

ii) a reprimand;

iii) a fine of between EUR 250 and EUR 250,000;

iv) one or more of the following measures:

(a) a temporary or definitive prohibition on the execution of any number of operations or activities, as well as any other restrictions on the activities of the person or entity;

(b) a temporary or definitive prohibition on participation in the profession by the *de jure* or *de facto*, directors or senior management personnel of persons or entities subject to the supervision of the CSSF.

The CSSF may also disclose to the public any penalties imposed, unless such disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved.

Finally, in accordance with Article 64(1) of the Financial Sector Law, any person who contravenes or attempts to contravene the provisions of Article 32(1) and (5) or of Article 32-1(1), first sub-paragraph, first sentence and Article 32-1(2), first sub-paragraph, shall be punishable by a term of imprisonment of between eight days and five years and/or a fine of between EUR 5000 and EUR 125,000. Criminal sanctions for lack of authorisation in the financial sector are not hypothetical in Luxembourg and should be taken seriously[51].

Conclusion

In conclusion, the amended third-country regime of the Financial Sector Law introduces several new rules. Depending on various factors that need to be assessed in each case, banking and investment activities may require an authorisation in Luxembourg or can be carried out on a cross-border basis or at the exclusive initiative of some clients without a licence in Luxembourg. Although the CSSF has not yet addressed all questions of interpretation related to the new rules in its official communications and circulars, it is currently working on revised versions of the relevant existing circulars and interpretative documents in that field.

Due to the complexity of modern financial services and the increased use of distance communication technology in the financial sector, third-country firms should always analyse their contemplated activities in Luxembourg and strive to determine before starting any operations if their activities would require or not an authorisation from the Luxembourg competent authorities. In case of doubt, they should submit to the CSSF a detailed description of the activities envisaged, allowing the CSSF to determine whether the activities carried out are subject to an authorisation or not.

Finally, as pointed out in the introduction of this article, new EU law texts and Luxembourg law rules implementing the most recent or forthcoming EU directives and regulations will be adopted and come into force in the following years (in particular in connection with CRD V, IFD and IFR). Third-country firms should ensure that sufficient attention is paid to these future rules. It is worth noting in this context that Article 1(10) of CRD V requires the EBA to submit by 28 June 2021 a report to the European Parliament, the EU Council and the European Commission on the treatment of third-country branches under national law of EU member states. That report shall notably consider to what extent supervisory practices under national law for third-country branches differ between EU member states and could result in regulatory arbitrage, and whether further harmonisation of national regimes for third-country branches would be necessary. The European Commission could then submit a legislative proposal based on the recommendations made by the EBA, opening the possibility of an additional set of new rules for third-country firms in the long term.

With the Brexit as a backdrop, the third-country regime is definitely on the EU and national lawmakers' agendas. These developments should therefore be followed carefully by third-country firms in order to continue their activities in the EU and in Luxembourg.

51 See *e.g.* a judgement of the Luxembourg district court (*Tribunal d'Arrondissement*) of 23 March 2016, No 1103/2016, in a case involving a Luxembourg company carrying out banking activities without an authorisation in accordance with the requirements of the Financial Sector Law.

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