

New measures to strengthen the Luxembourg regulatory framework for financial services.

The draft law n°6846 on the OTC derivatives, central counterparties and trade repositories adopted by the Luxembourg Parliament on 23 February 2016 has been published yesterday, 17 March 2016, in the Luxembourg Official Gazette, the *Mémorial A* (the “**Law**”). The Law implements a series of European legislative measures aiming at strengthening the Union’s regulatory framework for financial services into Luxembourg law.

The Law (i) designates the regulator of the financial sector, the *Commission de Surveillance du Secteur Financier* (CSSF), and the regulator of the insurance sector, the *Commissariat aux Assurances* (CAA), as the competent authorities to ensure proper application of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), (ii) updates the law of 10 November 2009 on payment services and (iii) amends existing laws so as to introduce a general principle against over-reliance on credit ratings.

I. EMIR – powers granted to the CSSF and the CAA

As concluded in the de Larosière report¹ the financial crisis has revealed that there is a need to take a look at the functioning of derivatives markets. EMIR lays down conditions for mitigating risks and improving transparency of derivatives contracts. Amongst others, certain OTC derivatives contracts shall be cleared through a central counterparty (CCP) and be reported to trade repositories. As a regulation, EMIR is directly applicable in EU Member States, however Member States shall designate competent authorities in charge of the duties under EMIR (Article 22 EMIR).

A. Powers granted to the CSSF

The Law grants various powers set out in EMIR to the CSSF, in particular in respect of the approval and oversight of central counterparties established in Luxembourg and the proper application of EMIR (amongst others Title II (*Clearing, reporting and risk mitigation of OTC derivatives*), Title VI (*Registration and Supervision of Trade Repositories*) under which the CSSF has to cooperate with ESMA where trade repositories are also entities supervised by the CSSF). The additional powers granted to the CSSF are

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¹ http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf

without prejudice to the competences of the *Banque centrale du Luxembourg* and the CAA.

Accordingly, the CSSF is given supervision, intervention, inspection and investigation powers required for the exercise of its tasks as defined by EMIR. In particular, these powers include:

- > a right to access all documents and to receive copies thereof;
- > a right to request information from financial counterparties (FCs) under its supervision, non-financial counterparties (NFCs), central counterparties (CCPs), trading venues, including persons (and their delegates) who are successively involved in the transmission of orders or the execution of the operations concerned, as constituents thereof and, if necessary to hear these persons;
- > inspection rights on FCs under its supervision, CCPs and trading venues;
- > a right to request recorded information (telephone communications and existing computer records) from FCs under its supervision, CCPs and trading venues; and
- > a right to request FCs under its supervision, NFCs, CCPs and trading venues to cease any practices which are in breach of EMIR.

The CSSF is empowered to sanction FCs under its supervision and NFCs in case of breaches of EMIR and in particular in respect of Article 4 - clearing obligations, Article 5 - clearing obligation procedure, Article 9 - reporting obligations, Article 10 - non-financial counterparties and Article 11 - risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty. Furthermore, the CSSF is empowered to sanction CCPs and trading venues under specific circumstances specified in the Law. More generally, it may sanction the entities referred above where these provide or publish incomplete, inaccurate or wrong information or documents and/or do not cooperate with the CSSF in its mission in relation to EMIR.

Depending on the seriousness of the breach, the CSSF may impose the following sanctions:

- > a warning;
- > a reprimand;
- > an administrative fine (which may not be less than EUR 125 and no more than EUR 1.5 million or in case the offence has procured a financial benefit, directly or indirectly, to certain persons, the fine cannot be less than the amount of profit made nor more than five times that amount); and
- > a temporary or final barring from performing one or more operations and/or activities linked to financial instruments or providing certain services.

For certain breaches, the CSSF must publish the sanctions that it imposes on FCs under its supervision, NFCs, CCPs or trading venues unless such a publication would seriously disrupt the financial markets or cause

disproportionate damage to the parties. The CSSF shall further publish information on status of recourse and final decision.

B. Powers granted to the CAA

Under the Law, the CAA is given similar powers to the ones given to the CSSF, i.e. supervision, intervention, inspection and investigation powers necessary for the exercise of its tasks as defined by EMIR in respect of insurance and re-insurance entities.

II. Changes to the law of 10 November 2009 on payment services

The Law also amends the law of 10 November 2009 on payment services (the “**2009 Law**”) in various respects. The principal changes are the following:

The CSSF is empowered to ensure compliance with the rules set up by Regulation (EU) No 260/2012 of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 (known as Single Euro Payment Area (SEPA) Regulation, establishing common Union-wide payment services).

The Law removes any ambiguity as to the location of the depository that payment institutions use to protect the funds they have received in exchange for payment transactions or against issuing electronic money. The reference in Article 14(1)(a) and in Article 24-10(1)(a) of the 2009 Law to “*Luxembourg depository*” is removed and replaced by “*depository*”.

The Law introduces amendments aiming at meeting the requirements under TARGET2 – Securities, a European securities settlement engine, setting up a single set of rules, standards and tariffs which applies to all transactions in Europe. Finality of settlements under TARGET2 – Securities is structured around three pillars:

- > introduction of a transfer order into the system (opposability of the transfer order in case of insolvency);
- > irrevocability of the transfer order; and
- > irrevocability and opposability of settlement (finality).

Equivalent rules regarding the moment of entry into the system and irrevocability of transfer orders and finality must apply to interoperable links of central securities depositories (CSDs) which has lead to Article 111 of the 2009 Law being amended accordingly.

In addition, Article 112(2) of the 2009 Law has been amended to reflect the provisions of Article 87 of EMIR, stating that in the context of interoperability arrangements, the rights of the providing system operator in relation to collateral granted by such providing system operator to a receiving system operator are not impacted by the insolvency of the latter having received such collateral.

III. New rules in respect of the over-reliance on credit ratings

A. Introduction of a general principle against over-reliance on credit ratings provided for in Directive 2013/14/EU

The Law introduces new provisions requiring management companies of UCITS and AIFMs to make their own credit risk assessment and not to rely solely or mechanistically on credit ratings for assessing the creditworthiness of the assets of the funds they manage or using them as the only parameter when assessing the risk involved in the investments made by UCITS and AIFs.

B. Reinforcement of the powers of the CSSF and the CAA

Taking into account the nature, scale and complexity of the activities of UCITS funds and AIFs, the CSSF as Luxembourg supervisory authority of funds must monitor the adequacy of their credit assessment processes, assess the use of references to credit ratings issued by credit rating agencies in their investment policies and, where appropriate, encourage mitigation of the impact of such references, with a view to reducing sole and mechanistic reliance on such credit ratings.

Similar provisions apply to the CAA regarding pension funds.

Further, when managers of UCITS and AIFs are part of financial conglomerates, they are subject to the supplementary supervision of CSSF as provided under the law of 5 April 1993 on the financial sector as amended.

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