

## Post-Brexit options in the Luxembourg financial sector

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# 1. BACKGROUND INFORMATION

- 1.1 The risk is increasing that the United Kingdom (UK) will leave the European Union (EU)<sup>1</sup> without a deal and that, in this context of hard Brexit, the UK will become a third country with no possibility to rely on EU passports available for certain financial institutions in the EU.
- 1.2 We therefore provide below a list of available options for UK firms currently passporting their activities to Luxembourg or willing to provide services to Luxembourg clients in a post-Brexit environment. This summary therefore focuses on options available to UK firms currently holding a CRD 4, PSD 2, EMI 2 and MiFID 2 licence.
- 1.3 An important distinction must be drawn between investment services and activities (within the meaning of MiFID 2<sup>2</sup>, see section 4 below) and other banking and financial services (see section 3 below), as the available options will not be exactly the same for these two types of services. A certain number of options would however be available to provide both investment services or other banking and financial services (see section 2 below). A flow chart displaying the available post-Brexit options in Luxembourg is attached to this summary (see Appendix 1).
- 1.4 Some of the points discussed in the summary below raise a number of issues, which have, to our knowledge, neither been considered by Luxembourg courts nor by Luxembourg legal literature. It is therefore necessary to form a view on the basis of general principles of Luxembourg law and it cannot be ruled out that a Luxembourg court or national competent authority (such as the Luxembourg financial sector regulator, the *Commission de surveillance du secteur financier* or **CSSF**) would have a different view.
- 1.5 This summary is provided for information purposes only and should not constitute or be relied upon as legal advice. If you are in any way impacted by Brexit in relation to your business in Luxembourg, we recommend that you contact the members of the A&O regulatory team in Luxembourg.

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<sup>1</sup> For the purposes of this summary, the term EU also includes the members of the European Economic Area (EEA) which do not form part of the EU.

<sup>2</sup> Directive 2014/65/EU on market in financial instruments.

## 2. AVAILABLE OPTIONS FOR ANY TYPE OF FINANCIAL SERVICES

### 2.1 Luxembourg Brexit Transitional Period Regime (TPR)

#### (a) *Objective*

A specific Luxembourg (Brexit related) act dated 8 April 2019, has been adopted in Luxembourg to anticipate the consequences of the loss of UK firms' passporting right and to ensure the continuity of existing contracts and the orderly functioning and the stability of the financial markets in the event of a hard-Brexit (the **Brexit Act**). The main purpose of the Brexit Act is to maintain adequate protection to depositors, insurance policy holders and investors. It therefore aims at organising the regulatory framework applicable to UK firms currently benefiting from the EU passport in Luxembourg in the aftermath of a hard Brexit.

#### (b) *Regime*

UK firms having passported their activities into Luxembourg will benefit from a 12-month transitional period where they can continue to provide their services (including investment services) in relation to existing contracts after a hard Brexit (or to new contracts concluded with Luxembourg clients provided that they present a close link with existing contractual relationships).

#### (c) *Conditions*

In order to benefit from the TPR regime, a UK firm has to:

- (i) **provide services under a valid passport in Luxembourg** – the UK firm will be required to confirm that it has a valid EU passport to provide services in Luxembourg and that it is currently providing services in Luxembourg under its EU passport;
- (ii) provide services **in relation to existing contracts** (or new contracts with a close link to existing contracts) – the UK firm will have to indicate its post-Brexit strategy to the CSSF (i.e. whether an authorisation will be requested in Luxembourg or whether activities will stop in Luxembourg; and
- (iii) **fill-in the notification form available on the CSSF website before 15 September 2019** – Any notification sent after that date will not be received by the CSSF.

#### (d) *Practical notes*

- (i) The notifications for the TPR are available on the [eDesk portal](#) of the CSSF.
- (ii) They are straightforward forms which are notifications of intentions at this stage. Basic information should be provided to the CSSF which will require certain commitments (in the form) depending from the firm's Brexit strategy and comments can be added in the end of the notification form.

- (iii) An assessment period between the notification date and the date of Brexit will then take place and the CSSF will inform firms individually if they benefit from the TPR or not.

## 2.2 Establishing a presence in Luxembourg

### (a) *Objective*

In order to carry on its activities in Luxembourg beyond the transitional period, a UK firm may decide to establish either a branch or a subsidiary in Luxembourg, subject to applicable Luxembourg requirements (including staff, capital, internal governance, AML/CTF, conduct of business rules, etc.). The TPR (provided it was applied for by, and granted to, the UK firm) would offer a timeframe for the UK firm to file an application and obtain a licence as a branch or as a separate regulated entity to do regulated business in Luxembourg.

### (b) *Regime*

UK firms establishing a branch or a subsidiary in Luxembourg would have a fully-fledged Luxembourg licence and would be subject to the supervision of the CSSF in relation to their business with Luxembourg clients. Applications of subsidiaries applying to become credit institutions in Luxembourg will ultimately be assessed by the European Central Bank (ECB). The ECB will also directly supervise credit institutions qualifying as significant institutions under the Single Supervisory Mechanism<sup>3</sup>.

### (c) *Conditions*

In order to obtain a licence as a branch or as a subsidiary, the UK firm must file an application with the CSSF and comply with all the requirements of the CSSF in that regard.

As a third country firm (TCF), establishing a branch requires to follow the same process as for a subsidiary and the branch will have to comply with similar prudential and conduct of business requirements than a subsidiary. Establishing a Luxembourg branch to provide investment services to retail clients would however require certain additional conditions to be complied with during the application process.

### (d) *Practical notes*

- (i) Post-Brexit, a branch of a **UK firm will not be authorised to passport its activities** to other EU Member States (unless specifically authorised in such Member State – which should be checked on a case by case basis).
- (ii) A **subsidiary of a UK firm** authorised under either CRD 4<sup>4</sup>, PSD 2<sup>5</sup>, EMD 2<sup>6</sup> or MiFID 2<sup>7</sup> will, as any other EU firm authorised as such, **benefit from the right to passport** its activities throughout the EU.
- (iii) The **authorisation process of a Luxembourg branch is the exclusive competence of the CSSF** and the relevant ministry and there will be no involvement of the ECB or any other EU regulator (such as EBA or ESMA) at any point in time in that process. This is without prejudice to any home country requirements as regards the supervision of branch of a TCF.

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<sup>3</sup> See Regulation (EU) No 1024/2013.

<sup>4</sup> Directive 2013/36/EU.

<sup>5</sup> Directive 2015/2366/EU.

<sup>6</sup> Directive 2009/110/EC.

<sup>7</sup> Directive 2014/65/EU.

## 2.3 Intragroup exemption

### **(a) Objective**

The intention behind this exemption is to enable firms providing services exclusively on an intragroup basis to avoid the regulatory burden of applying for a fully-fledged licence in Luxembourg as the risk relating to its activity should, by definition, be limited.

### **(b) Regime**

A UK firm exempted under the intragroup exemption does not need any licence in the financial sector. If it however has a commercial activity (either intragroup or separate from the financial services provided intragroup), a business licence might still be required in Luxembourg. In that case, the business licence application would be a very formal and straightforward process.

### **(c) Conditions**

To benefit from this exemption, a UK firm must provide financial services (i) exclusively (i.e. it can, in principle, not have extra-group clients for the same service) on (ii) an intra-group basis (this includes any affiliates of that UK firm).

## 3. AVAILABLE OPTIONS FOR BANKING AND FINANCIAL SERVICES

### 3.1 Cross-border TCF regime (Article 32(5) Banking Act)

#### **(a) Objective**

The authorisation under Article 32(5) of the Banking Act 1993 applies to firms which are not established in Luxembourg but which occasionally and temporarily comes to Luxembourg in order, among others, to provide financial services (other than investment services).

#### **(b) Regime**

Article 32(5) of the Banking Act establishes a national cross-border authorisation regime pursuant to which TCF may provide banking and financial services (other than investment services) to clients established in Luxembourg without establishing a presence in Luxembourg. These services notably include deposit taking, lending activities or payment services.

#### **(c) Conditions**

The following cumulative criteria must be met for this authorisation to be applicable:

- (i) the firm is originating from a third country, i.e. a non-EU Member State;
- (ii) the firm does not have an establishment in Luxembourg;
- (iii) the firm performs and is authorised to perform an activity of a professional of the financial sector in its home country; and

- (iv) one or more of its agents travel occasionally and temporarily to Luxembourg to provide services covered by the Banking Act. It is not sufficient that the persons concerned direct their activities to Luxembourg from their home country (see section 3.2 below).

Requirements for this authorisation (applicable before and during the use of the authorisation) include notably:

- (i) being authorised to provide the relevant services granted by a public authority in its home country;
- (ii) the reputation of the directors
- (iii) the internal administrative organisation (organisational requirements, existence of human and technical resources, establishment of internal systems, resources and procedures)
- (iv) the existence of rules of conduct (including a complaint handling policy and procedures)
- (v) requirements relating to financial bases; and
- (vi) the membership in a deposit-guarantee scheme.

The form of a company with limited liability may also be a condition to obtain the authorisation.

#### **(d) Practical notes**

As any other person 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 to consumer protection.

A file must be communicated to the CSSF including at least a detailed description of the activities carried out in its home country and those contemplated or carried out in Luxembourg (summary business plan), as well as any relevant information and supporting documents allowing the CSSF to ensure that the activities are covered by the scope of article 32(5) of the Banking Act, and that the prerequisites for the authorisation are fulfilled (see below).

The CSSF considers that credit institutions whose home country is represented in the Basel Committee are presumed to be subject to authorisation and supervisory rules equivalent to the Banking Act (the same is not, per se, applicable to investment firms but a case by case approach is possible). The CSSF may request other credit institutions whose home country is not represented in the Basel Committee to provide an independent legal advice on the equivalence of the home country authorisation and supervisory rules with the Banking Act requirements.

### 3.2 Characteristic performance test and cross-border services

#### **(a) Regime**

The CSSF has taken the view (in the CSSF Circular 11/515) that a non-EU institution, which has clients domiciled in Luxembourg, does not *ipso facto* fall within the scope of the Banking Act when pursuing its activities (other than investment services) on a cross-border basis with its Luxembourg clients. Therefore the said firm does not need *ipso facto* an authorisation in accordance with Article 32(5) of the Banking Act (see section 3.1 above). It would be the case only if the firm is deemed to provided its services on the Luxembourg territory.

**(b) Conditions**

In order to determine whether a person carries out an activity in Luxembourg, it is necessary to “locate” the place of the “characteristic performance” of the service (that is, typically, the place where the core performance of the service is provided and for which a payment is due).

If a regulated service is not deemed to be provided in Luxembourg, then, in principle, no licence is required under Luxembourg law.

**(c) Practical notes**

The following examples might indicate the absence of provision of service within the Luxembourg territory:

- the firm refrains from sending employees or representatives in Luxembourg to receive orders from a client, but merely transacts with the clients on a strict cross-border basis (by email or telephone);
- the firm does not receive securities or cash of the clients on accounts opened in Luxembourg;
- the firm does not provide any other financial service in Luxembourg to the clients (such as investment advice, reception of orders from the clients, etc.);
- the firm does not operate an internet website that is directly or indirectly targeting the Luxembourg market/territory;
- the contractual documentation with the Luxembourg client is signed outside of Luxembourg.

In addition, the CSSF considers that coming on the Luxembourg territory temporarily in order to carry out an activity ancillary (preceding or following) to the financial activities themselves is not subject to authorisation. Thus, the following activities carried out in Luxembourg would not, per se, trigger the Article 32(5) authorisation or any other license requirement in Luxembourg:

- introductory visits;
- brand advertising; or
- road shows made by the persons concerned to their Luxembourg-based customers.

These activities could be carried on under the condition that these visits are not accompanied by the exercise of a banking service (like, for instance, the direct collection of deposits or an active invitation during such visits to Luxembourg-based customer to transfer funds, to carry out certain specific investment transactions or to take a loan).

## 4. AVAILABLE OPTIONS FOR INVESTMENT SERVICES

The below summary of available options to provide investment services in Luxembourg does not take into account the ESMA registration regime set out in Article 47 MiFIR, pursuant to which TCF would be able to register with the ESMA once the EU Commission has taken an equivalence decision in



relation to the relevant third country to provide services to eligible counterparties (**ECP**) and per se professional clients established in the EU (**Institutional Clients**).

#### 4.1 Cross-border TCF regime (Article 32-1(1) Banking Act)

##### (a) **Objective**

Article 32-1(1) of the Banking Act provides for a new TCF regime specifically applicable to investment services provided to Institutional Clients.

##### (b) **Regime**

Article 32-1(1) §1 of the Banking Act establishes a national cross-border authorisation regime for TCF to provide investment services to Institutional Clients in Luxembourg (the **CB National Regime**). It is substitutable to article 47 MiFIR for so long as the EU Commission does not take an equivalence decision at EU level.

##### (c) **Conditions**

In order to benefit from the CB National Regime, the following conditions must be met:

- (i) the TCF has to:
  - be **authorised in its home country** and subject to the supervision of a regulator;
  - provide **services to Institutional Clients exclusively**;
  - **fill-in the relevant form available on the CSSF website** and provide a series of documents<sup>8</sup> together with the completed form, to be submitted to the CSSF<sup>9</sup>;
- (ii) the CSSF must have taken an equivalence decision in relation to the supervision and authorisation rules applicable in the home country of the TCF (including notably conduct of business rules and anti-money laundering and counter terrorism financing framework). The CSSF may (but will not necessarily do so) ask to obtain an independent legal advice on the equivalence to the Banking Act of the authorisation and supervisory rules of the third country in which the firm has its head office in that regard; and
- (iii) the CSSF must have sufficient comfort that cooperation with the authority supervising the TCF in the relevant third country in relation to the rules assessed in the equivalence decision will take place.

##### (d) **Practical notes**

We outline below some practical aspects about the Article 32-1(1) §1 authorisation and the practical steps to be taken to obtain such authorisation.

- (i) *Elements to be taken into account when applying for the TCF authorisation*

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<sup>8</sup> The TCF will notably have to provide the following documents with the application form:

- an up-to-date version of the article of association of the TCF;
- the three last audited financial statements of the TCF (if available);
- a copy of the license (or similar) document confirming the activities or services that the TCF is authorised to carry out in the third country;
- a written confirmation of the TCF that it will not provide in Luxembourg services to clients other than Institutional Clients.

<sup>9</sup> We would, if possible, recommend to meet the CSSF in advance of the filing to discuss the exact scope of services to be provided to Luxembourg Institutional. Clients and to confirm the level of information the CSSF will need to grant the authorisation.



- We understand that many UK firms filed for this authorisation as part of their Brexit strategy and are currently under review. Apart from the UK, we are only aware of a Swiss TCF request but none from other countries like the US, Canada or APAC countries.
- The CSSF has not publicly issued any equivalence decision so far. We understand that this is mainly because processes are somehow on hold with respect to the UK applications due to the current uncertainty around Brexit date. We however expect the CSSF to officially grant these authorisations on Brexit date when it happens.
- With respect to any third-country, equivalence decisions will be taken only if the CSSF receives a request for authorisation from a firm in that third-country. The CSSF is currently working on an equivalence decision with the UK.
- Cooperation will, in principle, be ensured via a memorandum of understanding with the relevant third country authority. However, it is our understanding that the CSSF will accept other (bespoke) means of cooperation to meet the “cooperation” condition.

(ii) *Practical steps to obtain the authorisation*

- If the business is somehow complex, a meeting with the CSSF before officially filing an application would be recommended.
- The TCF must then duly fill-in the form available on the CSSF website and file it with the CSSF.
- The CSSF will carry out the equivalence assessment.
- The CSSF will grant the authorisation (in relation to UK firm, the granting of the authorisation will not happen before Brexit actually happens).

## 4.2 Reverse solicitation exemption

**(a) Objective**

The intention behind this exemption is to enable firms to provide investment services without the need for a licence when the service is provided at the own exclusive initiative of the client.

**(b) Regime**

A UK firm exempted under the reverse solicitation exemption would not need any licence in the financial sector. If it however has a commercial activity (either intragroup or separate from the financial services provided intragroup), a business licence might still be required in Luxembourg. In this case, this would be a very formal and straightforward process.

**(c) Conditions**

To benefit from this exemption, a UK firm must ensure that:

- (i) the service is provided at the own exclusive initiative of the client. Where 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, the service is not deemed to be provided at the own exclusive initiative of the client; and

- (ii) the third-country firm must not use a reverse solicitation to market new categories of investment products or investment services to the relevant client.

**(d) Practical notes**

(i) The CSSF construes interprets the reverse solicitation exemption in accordance with ESMA guidance in that regard. Accordingly, a solicitation, promotion or advertising from a TCF should be considered regardless of the person through whom it is issued: the TCF itself, an entity acting on its behalf or having close links with such TCF or any other person acting on behalf of such entity.

(ii) Every communication means used such as press releases, advertising on internet, brochures, phone calls or face-to-face meetings should be considered to determine if the client or potential client has been subject to any solicitation, promotion or advertising in the EU on the firm's investment services or activities or on financial instruments.

(iii) The client's own exclusive initiative must be assessed in *concreto* on a case by case basis for each investment service or activity provided.

### 4.3 Legacy clients receiving investment services

In a Brexit context, a client would most likely qualify as a legacy relationship if it was already in business with the UK firm on the day of Brexit (presumably 31 October 2019).

Our view as regards legacy clients receiving investment services (which is, in effect, a reverse solicitation argument) is that legacy business can be approached with similar confidence as the reliance on the reverse solicitation exemption. That is, we believe that, if a UK firm continues to provide only the services and only offer the products that were agreed upon in the legacy contract in place before Brexit, no specific authorisation would be required in that regard. As a consequence, the UK firm would not be able to leverage the legacy relationship to offer new products or services to the legacy client.

The above has however not yet been tested with the CSSF or before Luxembourg courts but should be in line with the reasoning behind the reverse solicitation exemption (see section 4.2 above).

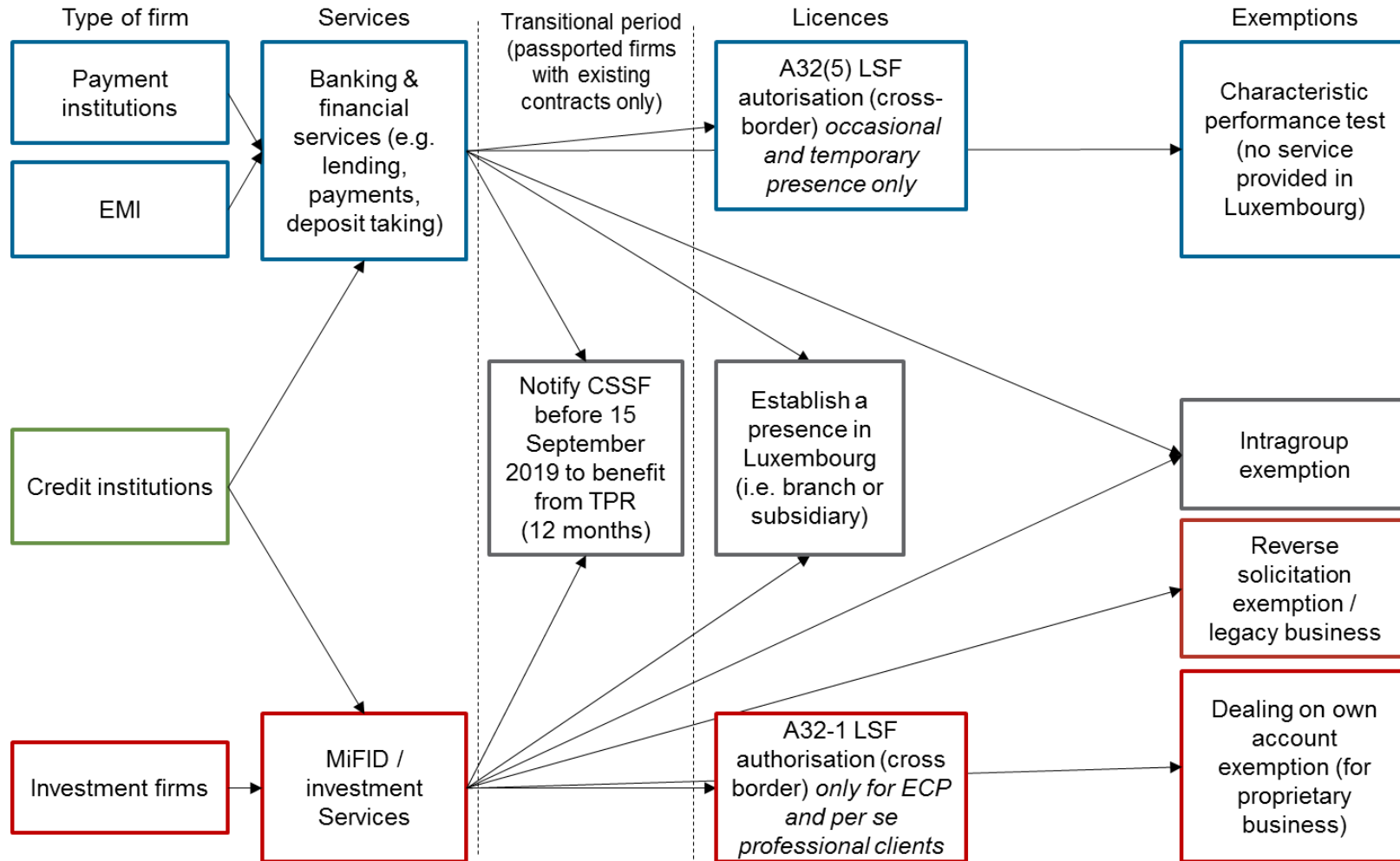
### 4.4 Dealing on own account exemption (applicable to proprietary trading)

The Banking Act foresees two exemptions in relation to firms dealing on own account:

- (i) persons dealing on own account in financial instruments other than commodity derivatives or emission allowances or derivatives thereof and not providing any other investment services or performing any other investment activities in financial instruments other than commodity derivatives or emission allowances or derivatives thereof, unless such persons:
  - are market makers;
  - are members of or participants in a regulated market or an MTF or have direct electronic access to a trading venue;
  - apply a high-frequency algorithmic trading technique; or

- deal on own account when executing client orders;
- (ii) persons dealing on own account, including market makers, in commodity derivatives or emission allowances or derivatives thereof, excluding persons who deal on own account when executing client orders, provided that:
- for each of those cases individually and on an aggregate basis this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of MiFID 2 or banking activities under CRD 4, or acting as a market-maker in relation to commodity derivatives;
  - those persons do not apply a high-frequency algorithmic trading technique; and
  - those persons notify annually the CSSF that they make use of this exemption and upon request report to the competent authority the basis on which they consider that their activity is ancillary to their main business.

## APPENDIX 1 POST-BREXIT OPTIONS IN LUXEMBOURG



## Your Allen & Overy contacts



**Henri Wagner**  
Partner – Luxembourg

Contact  
Tel: +352 44 44 5 5409  
[henri.wagner@allenoverly.com](mailto:henri.wagner@allenoverly.com)



**Thomas Berger**  
Counsel – Luxembourg

Contact  
Tel: +352 44 44 5 5196  
[thomas.berger@allenoverly.com](mailto:thomas.berger@allenoverly.com)



**Carole Schmidt**  
PSL-Counsel - Luxembourg

Contact  
Tel: +352 44 44 5 5275  
[carole.schmidt@allenoverly.com](mailto:carole.schmidt@allenoverly.com)



**Baptiste Aubry**  
Senior Associate – Luxembourg

Contact  
Tel +352 44 44 5 5245  
[baptiste.aubry@allenoverly.com](mailto:baptiste.aubry@allenoverly.com)

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts above or your usual Allen & Overy contact.

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