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Capital Requirements Directive – Credit institutions and Investment firms

Draft Law 6660 implementing CRD IV

On 28 February 2014, the Luxembourg Government has submitted to the Chamber of Representatives the **draft Law 6660** implementing the **Capital Requirement 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. ("CRD IV" hereafter).

CRD global standards on bank capital adequacy (issued from Basel III rules) have already been partially implemented through the Regulation 575/2013/EU on prudential requirements for credit institutions and investment firms ("CRR" hereafter). Please refer to our **Deloitte Regulatory News Alert of 27/02/2014** regarding CSSF Regulation 14-01 on the implementation of certain discretions of CRR.

Context

This regulatory package is one of consequences of the financial crisis which has triggered an unprecedented level of failures of major financial institutions and serious adverse consequences for financial markets. This crisis has indeed revealed many weaknesses in the way financial institutions had been operating. Key improvement shall be introduced to face the highlighted weaknesses, as insufficient capital (quantitative and qualitative) compared to held assets and to cover the potential losses. Corporate governance and investigative powers available to national authorities need also to be improved, and more penalties are needed to deter these institutions from infringing rules on capital requirements.

Implementation

The topics distribution between the Draft Law 6660 implementing CRD IV, and CRR introduced by the circular CSSF 14/583 and supplemented by the CSSF Regulation 14-01 ("Luxembourg CRR package" hereafter) is:

Area	Draft Law 6660	Luxembourg CRR package
Access to taking-up / pursuit of business	X	
Exercise of freedom of establishment and free movement of services	X	

Corporate governance	X	
Capital		X
Capital buffers	X	
Large exposures		X
Counterparty credit risk		X
Liquidity		X
Leverage		X
Disclosure requirements		X
Prudential supervision	X	
Sanctions	X	

CRD IV and its national discretions will be implemented by the amendment of the following texts:

- Law of 5 April 1993 on the financial sector (“LFS” hereafter);
- Law of 23 December 1998 establishing a financial sector supervisory commission (CSSF); and
- Law of 12 July 2013 on alternative investment fund managers.

Capital buffers – New chapter 5 of LFS

This new chapter implements Chapter 4 Title VII of CRD and introduces capital buffers. Own funds held for capital buffers provide an increased protection to institutions in scope.

This new chapter is applicable to credit institutions and investment firms providing the following investment services (“institutions as per LFS Article 59-1” hereafter) :

- Dealing on own account; and
- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis.

The following table provide main information on each buffer:

Buffer	Ref to new LFS articles	Scope	Mandatory or discretionary	Level	Applicable as from
Capital conservation buffer **	LSF art. 59-5	Institutions as per LFS art. 59-1	Mandatory	2,5%	01/01/2014
Countercyclical capital buffer **	LSF art. 59-6 et 59-7	Institutions as per LFS art. 59-1	Mandatory	0 – 2,5%	01/01/2016

Buffer applicable to Global Systemically Important Institutions (G-SII) *	LSF art. 59-8 lu conjointement avec art 59-3.	G-SIIs only	Mandatory	1 – 3,5%	01/01/2016, progressive phase-in until 2019
Buffer applicable to Other Systemically Important Institutions (O-SII) *	LSF art. 59-9	O-SIIs only	Discretionary	0 – 2%	01/01/2016
Systemic risk buffer	LSF art. 59-10	All or some institutions as per LFS art. 59-1	Discretionary	No limit	01/01/2014

* The CSSF is in charge of identifying, on a consolidated basis, global systemically important institutions (G-SIIs), and, on an individual, sub-consolidated or consolidated basis, as applicable, other systemically important institutions (O-SIIs), which have been authorised within its jurisdiction.

** Subject to exemption under certain conditions.

Non-compliance to capital buffer requirements does not constitute a violation of the LFS which could lead to the withdrawal of approval, but it will result in restrictions on capital distributions (dividends, bonuses paid to employees, etc.) and the obligation to prepare a remedial action plan to the CSSF.

Corporate governance – New chapter 4bis of LFS

Corporate governance arrangements

CRD IV introduces additional requirements related to corporate governance arrangements and mechanisms for institutions. These rules concern the composition of boards, their functioning and their role in risk oversight and strategy in order to improve the effectiveness of risk oversight by boards. The status and the independence of the risk management function are also enhanced. Supervisors will play an explicit role in monitoring risk governance arrangements.

The key element added by CRD IV compared to Circular 12/552 relates to the maximum number of directorships which may be held by a member of the management body of an institution that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities. We will provide more details in a dedicated communication soon.

Remuneration

In addition to the current remuneration principles that are already reflected in Luxembourg regulation and local remuneration policies, the draft Law will add a clear distinction between the fixed and variable remunerations (new article 38-5 of LFS):

- Basic fixed remuneration, which shall reflect relevant professional experience and organisational responsibility as set out in an employee's job description as part of the terms of employment and;
- Variable remuneration which shall reflect a sustainable and risk adjusted performance as well as performance in excess of that required to fulfil the employee's job description as part of the terms of

employment

For variable remuneration, the two following principles shall apply (new article 38-6 of LFS):

- The variable component shall not exceed 100% of the fixed component of the total remuneration for each individual:
- Upon approval (> 66%) from the shareholders or owners of the institution (excluding people concerned by the ratio), the maximum level of the ratio can be higher, up to an overall maximum of 200% of the fixed component for each individual.

Diversity

The nomination committee (or, subject to proportionality, the Board itself) as defined per the new article 38-8 of LFS shall decide on a target for the representation of the underrepresented gender in the management body and prepare a policy on how to increase the number of the underrepresented gender in the management body in order to meet that target.

The target, policy and its implementation shall be made public as part of Pillar III disclosure (new article 38-10. (3) of LFS).

Transparency

As per the new article 38-3 of LFS, institutions shall disclose annually, specifying, by Member State and by third country in which it has an establishment, a set of information related to revenues and tax paid in various jurisdictions on a consolidated basis for the financial year.

The new article 38-4 of LFS states that Institutions shall disclose in their annual report among the key indicators their return on assets, calculated as their net profit divided by their total balance sheet.

Institutions shall maintain on their website (if any) explanations on their compliance with the requirements relating, amongst other to governance, remuneration and disclosures (new article 38-11 of LFS).

Resolution and recovery

The draft Law introduces in the Luxembourg regulatory framework a requirement to set-up a resolution and recovery plan in case of significant deterioration. The application of such provisions depends on the size, the business model and the interactions of the concerned institutions and shall be considered together with the **draft Law 6653** establishing a Systemic Risk Board.

Technical Standards

Technical standards issued by the European Banking Authority (E BA) related to CRD IV and CRR) can be consulted on **its website**.

We trust this information is of assistance and remain at your disposal for any further questions.

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