

## New prudential regime for investment firms



Investment firms offer a variety of services and vary by their size, business model, risk profile and complexity. Considering that their activities and risk profiles were not always properly captured by the prudential framework resulting from the CRR/CRD IV regime, applicable to both credit institutions and investment firms, a new prudential regime comprising the Investment Firms Directive 2019/2034

("IFD ") and the Investment Firms Regulation 2019/2033 ("IFR ") was developed at EU level. The new EU regime became effective on 26 June 2021.

What's new? The Luxembourg Law of 21 July 2021 transposes IFD and implements certain operational aspects of IFR ("Law " – available in French). It brings significant amendments to the Law of 5 April 1993 on the financial sector, as amended ("LFS").

Why is it important? A number of changes brought to the LFS merit discussion.

The most important change introduced is a new classification of investments firms, generally referred to by way of the following 4 classes:

- Class 1 are investment firms considered as credit institutions in their own right and will continue to be subject to the CRR/CRD IV regime;
- Class 1b are investment firms which, considering their size and importance or their membership of a group, will remain subject to several CRR/CRD IV obligations.

Credit institutions and class 1 and class 1b investment firms are henceforth categorised as "CRR institutions".

- Class 2 represents the traditional investment firms subject to the IFR and the IFD;
- Class 3 concerns small and non-interconnected investment firms, which benefit from certain exemptions from the IFR/IFD framework in view of the proportionality principle.

Class 2 and class 3 investment firms will be referred to as "IFR investment firms". The new categorisation notably affects their capital requirements (application of new risk parameters defined by IFR, the so-called "K factors"), prudential supervision, governance and remuneration policies.

In addition, the Law brings about a modernisation of the status of certain professionals of the financial sector ("PFS"), including investment firms.

Henceforth, for investment firms, the existing Luxembourgish designations and provisions are abandoned. Investment activities and services carried out must be those listed in Section A of Annex 1 of Directive 2014/64/EU ("MiFID II"). Access to these activities and services is reserved to legal persons only. Existing authorisations to exercise investment services or activities remain valid but entities concerned have to regularise their situation in accordance with the provisions of the Law.

Furthermore, the Law introduces additional changes for PFS. The category "persons carrying out cash exchange operations" is abolished. Henceforth, only credit institutions will be allowed to carry out foreign currency cash purchase and sale operations. In addition, the categories of primary IT systems operators and secondary IT systems and communications networks operators of the financial sector are merged. A new category of operators of IT systems and communication networks of the financial sector is introduced.

Finally, the Law also transposes requirements of Directive (EU) 2021/338, which notably brought about certain changes to the MiFID II regime to facilitate the recovery from the pandemic, including the requirement that all MiFID client communications must be provided in electronic form although retail clients can still request the communication to be provided on paper. More details on this Directive can be found in the article on our website under this link.

What does it mean? Investment firms need to assess the impact of the IFR/IFD regime and determine in which class of investment firm they will be categorised, which will determine the changes they need to implement. A new authorisation comparable to that of a credit institution will be required for the largest CRR investment firms. Further guidance on practical aspects of the new regime is expected from the CSSF. A coordinated version of the LFS is available on the CSSF's website under this link .