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18 October 2023

Overview of the CSSF Annual Report 2022: challenges for the next years

This newsletter marks the last publications of a six-part series, offering an overview of the CSSF Annual Report for the year 2022. This edition of this series is dedicated to the key challenges market participants will face in the next years.

On the 25 August 2023, the CSSF published its annual report focusing on the overview of the CSSF activities and initiatives in 2022. This publication aims to provide valuable information to assist relevant entities in gaining an understanding of areas requiring attention based on the CSSF observations.

In the first publication, we focused on highlighting the outcomes of on-site inspections.

In the previous publications, we provided an overview of the key institutions under CSSF's supervision, offering insights into various aspects of CSSF's supervisory practices. Additionally, we highlighted significant past and forthcoming priorities, along with key findings from off-site inspections.

In this last publication, we focus on the noteworthy regulatory changes that unfolded in 2022, providing a glimpse into anticipated developments for the years ahead.

This is just an illustrative overview. Please refer to the official CSSF Annual Report 2022.

Financial Innovation - Challenges for the following years

Financial innovation is progressing rapidly: the CSSF will play an active role in contributing to and endorsing the European framework. The **CSSF Innovation Hub** is monitoring and supporting startups and supervised entities during their digital transition journey, providing guidance through comprehensive Q&As, white papers, and other informative publications.

Regulatory Updates

Digital Operational Resilience Act (DORA)

The proposed measures relate to ICT governance, ICT risk management, ICT-related incident reporting process, digital operational resilience testing, management of risks associated with ICT third-party service providers and information sharing.

- Entry into force: **16 January 2023**
- Date of application: **17 January 2025**

Network and Information Security Directive (NIS2)

NIS2 updates the existing legal framework (NIS1) expanding the scope to new sectors and aiming to establish a higher level of cybersecurity and resilience.

- Entry into force: **16 January 2023**
- Date of application: **18 October 2024**

DLT Pilot Regime

Regulation (EU) 2022/858 establishes a system allowing market infrastructures to bypass standard financial regulations and use DLT for securities trading and settlement.

- Date of publication: **2 June 2022**
- Date of application: **23 March 2023**

Markets in Crypto-Assets Reg. (MiCA)

The proposed measures sets uniform rules for crypto-assets not covered by existing financial laws. ESMA is releasing the MiCA consultation packages in sequence, the packages including the mandates are expected to be published in Q1 2024.

- Entry into force: **June 2023**
- Date of application: **12-to-18-month deadline**

Artificial Intelligence (AI) Act

The AI Act in its draft form represents the inaugural effort to establish a comprehensive regulation spanning the entire AI landscape. This proposed legal framework concentrates on the specific application of AI systems and the associated risks they pose.

- EU Parliament agreement: **14 June 2023**
- Currently **under review** by EU Member States

Data Act

The objective of the Data Act is to enhance the EU data economy by facilitating access to and utilization of industrial data, while also promoting the growth of a competitive and dependable European Cloud Market.

- EU Parliament agreement: **28 June 2023**
- Currently **under review** by EU institutions

eIDAS 2 Regulation

The revised eIDAS (Electronic Identification, Authentication, and Trust Services) regulation aims to include additional cross-border digital services, such as authentication and device identification and establishing a framework for the creation and use of digital identities.

- Currently **under review** by EU institutions

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Financial Crime - Challenges for the following years

The primary components of **off-site supervision** regarding ML/TF risk encompass: (i) Reviewing the annual AML questionnaires; (ii) The annual reports from the compliance and internal audit functions; (iii) Examining the work conducted by the accredited audit firm as part of the comprehensive report, when applicable; and (iv) Conducting a critical evaluation of the ML/TF policies and procedures of these entities.

The CSSF identified the following deficiencies for the relevant entities:

- **Credit institutions and Central Securities Depositaries:** Severe deficiencies in relation the name screening process;
- **Investment firms:** Inadequate frequency of name screening against the lists of financial sanctions, too weak definition of the entity's risk appetite, material deficiencies detected in the AML/CFT procedures.

2022 Overview and Regulatory Updates

National AML/CFT Framework

- **The Law of 22 June 2022** in Luxembourg focused on the management and recovery of seized or forfeited assets and established two national offices: (i) **Asset Management Office (BGA)** (ii) **Asset Recovery Office (BRA)**. Alongside the Law of 28 October 2022, the Law of 22 June 2022 amended the **Law of 25 March 2020** which established a central electronic data retrieval system for IBAN accounts and safe-deposits boxes.
- **The Law of 29 July 2022** introduced minor amendments to the laws related to ML/TF. These changes include: (i) Clarifying professionals' obligations, such as always identifying beneficial owners; and (ii) Mandating consultation of the Beneficial Owner Register (RBE) and of the register on fiducies and trusts throughout the entire business relationship;
- The **Grand-ducal Regulation of 25 October 2022** abolished the provision regarding numbered accounts within the Grand-ducal Regulation of 1 February 2010 on AML/CFT;
- The CSSF emphasized the need for professionals to register with the **RBE**;
- Luxembourg completed its first **Vertical Risk Assessment** (VRA) on terrorist financing and on legal persons and legal arrangements in 2022, building on the National Risk Assessment of Money Laundering and Terrorism Financing (NRA) from 2018 and 2020.

Financial Action Task Force (FAFT)

The year 2022 witnessed significant developments from the FATF, with a focus on:

- **Digital Transformation**: Addressing digital transformation challenges;
- **Asset Recovery Strategies**: Strategies to enhance effective asset recovery actions and outcomes;
- **Transparency and Beneficial Ownership**: Emphasizing transparency and beneficial ownership.

In 2022, the FATF conducted mutual evaluations of Germany, France, and the Netherlands.

The Luxembourg AML/CFT framework underwent evaluation, including an on-site visit, as part of the FATF Mutual Evaluation process. This evaluation involved close collaboration between the CSSF, ministries, and other stakeholders, including private sector representatives. The final report on Luxembourg evaluation is expected to be adopted in June 2023 and published in September 2023.

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Sustainable Finance - Challenges for the next years

As per Annual Report, in 2023, the CSSF will prioritize the **inclusion of sustainability requirements** across:

- Implementing a risk-based supervisory strategy founded on reliable data;
- Promoting awareness and enhancing financial education;
- Engaging in global discussions to standardize sustainable finance criteria.

Regulatory Updates

Transparency requirements and taxonomy

Transparency requirements and the development of a European taxonomy to categorise activities considered sustainable were introduced with the SFDR and the Taxonomy Regulation. The regulations entered into force with a first and a second RTS in Q1 2023. Regarding the European taxonomy, non-financial firms must disclose alignment from 3 January 2023, while financial institutions will start in 2024.

Corporate Governance and Risk Management arrangements

To enhance the financial sector's resilience to climate-related risks, incorporating sustainability factors into conventional risk management and corporate governance tools has become a key focus of the evolving regulatory framework, drawing significant attention from international institutions. In December 2022, the Implementing Technical Standards (ITS) were released, outlining specific formats, templates, and instructions aimed at standardizing the disclosure of ESG risk exposures for credit institutions.

MiFID Rules

Starting from 2 August 2022, investment advisors and portfolio managers have been mandated to gather specific information regarding their clients' sustainable investment preferences.
“Guidelines on certain aspects of the MiFID II suitability requirements" by ESMA will be published on 3 October 2023. Furthermore, 2023 will see the implementation of ESMA's guidelines on product governance requirements.

CSSF: Supervisory Priorities

- A review of compliance with **CSSF Circular 21/773** on the management of climate-related and environmental risks for the Less Significant Institutions (LSI) and third countries branches;
- The targeted review of financial and non-financial disclosures by issuers for which significant climate-related risks have been identified;
- The inclusion of sustainability-related aspects in **on-site inspections**.

New financial and extra-financial standards

On 28 November 2022, the **Corporate Sustainability Reporting Directive** (CSRD) was adopted, marking the completion of the SFDR and Taxonomy Regulation. Its purpose is to facilitate the development of a comprehensive and trustworthy database of information on sustainable development within the financial markets.

In 2023, the **European Taxonomy Sustainability Reporting Standards** (ESRS) are scheduled to be adopted. These standards aim to establish uniform accounting guidelines for implementing the directive.

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Main new Circulars and Updates

New CSSF Circular 22/811 on UCI administrators

- In May 2022, the CSSF released Circular 22/811, which serves the purpose of delineating principles of sound governance and internal organization applicable to administrators of UCIs;
- This Circular 22/811 applies to UCI administrators overseeing both regulated and non-regulated entities, regardless of whether they are based in Luxembourg or elsewhere. Notably, Circular 22/811 entirely supersedes Chapter D of IML 91/75 wherein UCIs were previously limited to UCITS and Part II funds.

New CSSF Circulars on long form report

- For credit institutions, CSSF Circular 22/821 introduces SAQs, Attestation d'Usage Pratique (AUP) reports, safeguarding reports, and separate AML/CTF Report;
- For IFMs and UCIs, in December 2021 the CSSF published Circulars CSSF 21/788, 21/789 and 21/790, introducing a new CSSF AML/CFT external report to be prepared by the approved statutory auditor, new requirements and regulatory framework for all authorised IFMs, SIAGs and FIAAGs and the regulated UCIs.

New CSSF Circular 22/806 on outsourcing agreements

- The publication of CSSF Circular 22/806 consolidated CSSF expectations on various outsourcing, including IT outsourcing, transitioning from prior authorization to prior notification for most critical or important outsourcing arrangements. New templates and internal procedures were introduced in 2022 and early 2023;
- As per Annual Report, in 2023, the CSSF plans to further enhance its strategy by introducing additional tools and means to support it and by providing feedback to supervised entities.

Guidelines for Remuneration

- The following guidelines are applicable since 31 December 2022:
    - The revised guidelines on the benchmarking exercises on remuneration practices, the gender pay gap and approved higher ratios under Directive (EU) 2013/36;
    - The guidelines on the benchmarking exercises on remuneration practices and the gender pay gap under Directive (EU) 2019/2034;
    - The revised guidelines on the data collection exercises regarding high earners under Directive (EU) 2013/36 and under Directive (EU) 2019/2034.

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Publication Timeline

This newsletter, the **last** in a series of 6 publications.

1. **On-site Inspections** *Published 13/09/2023*
2. **Credit Institutions** *Published 20/09/2023*
3. **IFMs and UCIs** *Published 27/09/2023*
4. **PFS** *Published 04/10/2023*
5. **Payment, Electronic Money Institutions and VASPs** *Published 11/10/2023*
6. **Challenges for the next years** *Published 18/10/2023*

Why Mazars for you?

Joined-up Mazars engagement team

As a truly integrated partnership and firm, we operate seamlessly across borders. Our commitment to clients is absolute – we furnish you with a seasoned senior team well-versed in the intricacies of the field. You will benefit of senior leaders 'on the ground', poised to deliver not just insights but transformative, value-enhancing recommendations.

Tailored, pragmatic, joined-up approach

In these challenging times, Mazars is committed to support you navigating the regulatory challenges. As a service provider, our work is practical, and our conclusions and action plans will be pragmatic and fine-tuned to our clients' needs. We will tailor our approach to ensure our work meets each and every client's specific requirements.

Personal and personable approach

We strongly believe that this sets us apart from the competition. Our commitment is to invest time and effort in truly understanding the unique environment of each entity we engage with. We approach every interaction with a willingness to listen, to empathize, and to adapt.

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