

CSSF Guidance on Virtual Assets New FAQ for UCI and credit institutions

Executive Summary

- The CSSF published two sets of FAQ providing guidance on virtual assets: one for undertakings for collective investments on 29 November 2021 and one for credit institutions published on 23 December 2021.
- The FAQ are expected to be updated by the CSSF from time to time (last update on 4 January 2022).
- The definition of “virtual assets” changes for each FAQ and should be carefully checked
- Undertakings for collective investments targeting retail investors may not invest in virtual assets (with the exception of financial instruments)
- AIFMs managing AIFs which intend to invest in virtual assets need to obtain an extension of authorisation from the CSSF
- Credit institutions which intend to provide services in relation to virtual assets shall submit and present beforehand a business case to the CSSF
- Credit institutions providing custody services in relation to virtual assets should monitor counterparty risk of external exchange or custody platforms unless they effectively transfer such risk to their customers

The new and evolving sector around virtual assets raises numerous questions from professionals under the supervision of the Luxembourg financial sector regulator (*Commission de Surveillance du Secteur Financier* - “CSSF”), notably questions in relation to investments in virtual assets by investment funds and credit institutions and the

provision of services in relation to virtual assets by credit institutions.

To respond to such recurring questions, the CSSF has recently provided guidance on virtual assets by publishing concise answers to a list of frequently asked questions (“FAQ”).

The FAQ were published in two sets: one for undertakings for collective investments (“UCI”) published on 29 November 2021 (the “FAQ-UCI”) and one for credit institutions published on 23 December 2021 (the “FAQ-CI”).

The FAQ are expected to be updated by the CSSF from time to time. Both the FAQ-UCI and the FAQ-CI were last updated on 4 January 2022.

This GSK Update provides a general overview of the FAQ and of a brief explanation of specific answers provided by the CSSF in its FAQ.

I. Definition of virtual assets

The definition of virtual assets is not clear for each FAQ and should be carefully checked.

Certain FAQ¹ explicitly target only those virtual assets defined in Article 1 (20b) of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the “AML/CTF Law”). Such definition includes virtual currencies that can be digitally traded, or transferred, and can be used for payment or investment purposes, but excludes virtual assets that

¹ See Question 1, Question 2 of the FAQ-UCI.

See also Q5 of the FAQ-CI generally stating that virtual assets do not qualify as financial instruments, in contradiction with Q1 of the FAQ-CI.



fulfil the conditions of electronic money² and the virtual assets that fulfil the conditions of financial instruments³

Certain FAQ⁴ explicitly refer to electronic money and financial instruments.

Most of FAQ, however, do not clarify whether the definition of “virtual assets” includes electronic money and financial instruments. An assessment should be carefully made on a case-by-case basis. In case of doubt, we would recommend to check with the CSSF beforehand.

II. UCI addressing non-professional customers and pension funds

According to Question 1 and Question 2 of the FAQ-UCI, UCITS and UCIs⁵ addressing non-professional customers and pension funds are not allowed to invest, directly or indirectly, in virtual assets.

Question 1 clarifies that assets which qualify as financial instruments, such as shares of companies active in the virtual asset ecosystem, could potentially fall within the scope of eligible investments for UCITS.

It should be noted that the definition of “virtual assets” used for Question 1 and Question 2 of the FAQ-UCI excludes virtual assets that fulfil the conditions of electronic money and the virtual assets that fulfil the conditions of financial instruments (e.g., security tokens). Nevertheless, it would be advisable for UCITS and UCIs addressing retail investors to verify with the CSSF beforehand whether direct or indirect investments in virtual assets (including electronic money and financial instruments) would be suitable for retail investors.

III. Requirements for AIFMs managing AIFs which invest in virtual assets

According to Question 3 of the FAQ-UCI, Luxembourg authorised AIFMs managing AIFs which intend to invest, directly or indirectly, in virtual assets have to obtain an extension of authorisation from the CSSF for this new investment strategy. In essence, AIFMs which intend to manage an AIF investing in virtual assets need to obtain prior authorisation from the CSSF for the strategy “Other-Other Fund-Virtual assets”. In this context, the CSSF expects to receive, *inter alia*, the following information/documents:

- description of the project and of the different service providers/delegates involved;
- information on whether or not the investments in virtual assets will be made directly or indirectly (by the means of derivatives for example);
- an updated risk management policy including in particular how the risks in relation to the virtual assets are managed;
- an updated valuation policy including the rules as to how the value of the virtual assets will be determined;
- description regarding the experience of the portfolio manager (and other involved entities in the investment management process) in virtual assets;
- description of how the custody of the assets will be organised by the depositary;
- information regarding the targeted investors, as well as any information on the distribution channels of the AIF;
- the AIFM’s AML/CTF analysis on the assets side.

² Within the meaning of point (29) of Article 1 of the Law of 10 November 2009 on payment services, as amended.

³ Within the meaning of point (19) of Article 1 of the Law of 5 April 1993 on the financial sector, as amended.

⁴ See Q1 and Q3 of the FAQ-CI.

⁵ The terms “UCITS” and “UCIs” are not defined in Question 1 of the FAQ-UCI. Based on the current market practice of the CSSF, it seems that Question 1 of the FAQ-UCI applies to all types of funds and the use of the term “UCIs” seems to cover all fund structures, including AIFs, RAIFs and SIFs.



In addition, the CSSF expects initiators of AIFs which intend to invest in virtual assets to present their project beforehand to the CSSF.

Furthermore, investment managers need to make a case-by-case assessment of the impact of these investments on the risk profile of the AIF. Investment managers will also have to ensure that investors are properly informed in a transparent and timely manner and that the relevant fund documentation is updated.

IV. Requirements for AIFMs managing AIFs which invest in virtual assets

According to the Question 5 of the FAQ-UCI and Q7 of the FAQ-CI, Luxembourg fund depositaries mandated to act as depositary for investment funds investing directly in virtual assets must put in place adequate organizational arrangements and an appropriate operational model, considering the specific risks related to the safekeeping of virtual assets. In addition, depositaries shall notify the CSSF beforehand when they intend to act as depositary for investment funds investing directly in virtual assets.

Moreover, a depositary providing administrative and depositary services to investment funds investing in virtual assets triggers an obligation to register as a virtual asset service provider, if the depositary directly provides services related to safekeeping or the administration of virtual assets, including custodial services, to its client. Besides, fund depositaries that envisage to directly safeguard virtual assets are required to inform the CSSF of such plans in a timely manner. This requirement is additional to the registration as a virtual asset service provider.

V. Requirements for Credit institutions which intend to provide services in relation to virtual assets

According to Question 3 of the FAQ-CI, additional obligations apply to credit institutions that intend to offer virtual asset services.

In essence, credit institutions which intend to provide services in relation to virtual assets must submit in advance a detailed business case to the CSSF including a risk-benefit assessment, required adaptations to their governance and risk management frameworks, the effective

handling of counterparty and concentration risk and the implementation of investor protection rules.

VI. Counterparty risk of external exchange or custody platforms

As virtual assets are generally kept at external exchange or custody platforms, the counterparty risk of credit institutions towards the specialized virtual asset service providers may contractually be transferred to their customers.

Per Question 4 of the FAQ-CI, credit institutions that do not transfer the counterparty risk to their customers must comply with the exposure limits framework provided in the Capital Requirements Regulation ("CRR") for the counterparty risk they incur on custody or exchange platforms.

In all circumstances, credit institutions that plan to directly safeguard virtual assets must inform the CSSF of such plans in a timely manner.

VII. Conclusions

In light of the above, CSSF supervised entities interested in pursuing an activity involving virtual assets or already involved in virtual asset activities need to closely follow any relevant regulatory developments, should adopt a prudent approach and should proactively engage with the CSSF when planning any activity involving virtual assets.

Valerio Scollo

Local Partner
GSK Stockmann SA
Valerio.Scollo@gsk-lux.com

Nick Lampiris

Associate
GSK Stockmann SA
Nick.Lampiris@gsk-lux.com



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www.gsk-lux.com

GSK STOCKMANN

BERLIN

Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

FRANKFURT/M.

Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

HAMBURG

Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG

GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 2718 02-00
F +352 2718 02-11
luxembourg@gsk-lux.com

HEIDELBERG

Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

MUNICH

Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

