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Commission de Surveillance
du Secteur Financier

FAQ Virtual Assets – Credit institutions

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Q1 - Are credit institutions allowed to invest in virtual assets?

Published on 23 December 2021

Banking regulation does not prohibit credit institutions from directly investing in virtual assets.

When investing in virtual assets, the following accounting and capital-related considerations apply.

By definition, virtual assets lack physical substance, as do intangible assets. Based on IAS 38, virtual assets are to be recognised as intangible assets, unless they qualify for the accounting treatment applied to other asset classes like cash equivalents or financial instruments. The classification as well as the accounting approach retained - at cost or revaluation - shall be carefully assessed, duly documented and validated by the authorised management.

When risk-weighting virtual assets under the Capital Requirements Regulation (CRR), credit institutions shall adopt a conservative approach. Gross exposures to virtual assets shall receive a 1250% risk weight or alternatively be deducted from capital. The potential recognition of netting effects or the classification as cash or financial instruments shall be carefully assessed, duly documented and validated by the authorised management. Additional risks, in particular operational risks, not fully covered by CRR risk weights have to be capitalised under Pillar 2.

Q2 - Are credit institutions allowed to open accounts in virtual assets?

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Credit institutions may open accounts that allow customers to deposit virtual assets. Such accounts are comparable to securities accounts for the safekeeping of traditional financial instruments, but they come with their specific operational risks. Any such account has to be segregated from the bank's own assets. The safekeeping of virtual assets shall be handled as explained under Q4.

However, credit institutions cannot open bank accounts (e.g. current accounts) in virtual assets. Consequently, credit institutions cannot take deposits in virtual currencies and cannot facilitate or execute the settlement of payments in virtual currencies (e.g. direct transfer of virtual currency from payer to payee in the context of a market transaction).

Q3 - What registrations / notifications are needed for credit institutions that intend to provide virtual asset services?

Modified on 4 January 2022

A credit institution that intends to offer virtual asset services, either in scope of article 1 (20c) of the AML/CFT law or any other activity in relation to virtual assets (e.g. issuance of asset-referenced tokens and e-money tokens or dematerialised record-keeping via DLT), shall submit and present beforehand 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.

All requests in relation to virtual asset service provisions shall be submitted, unless otherwise communicated, to the supervised entities' usual contact persons within the banking supervision department of the CSSF.

Furthermore, if a credit institution intends to provide one or more of the services in scope of article 1 (20c) of the AML/CFT law[1], a complete application file for registration as a VASP needs to be submitted beforehand to the CSSF. Further details with respect to the VASP registration procedures can be found under Registration of a virtual asset service provider (VASP) – CSSF.

For the additional notifications in relation to depositary services, please also refer to Q4 and Q7.

Q4 - What are the expectations of the CSSF towards credit institutions that use specialised virtual assets exchange and custody platforms, in particular as regards custody services?

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Credit institutions shall avoid that operational disruptions and failures of virtual asset service providers spread to their regulated financial activities and ultimately result in financial losses harming their stakeholders. They shall also manage their concentration risk on such providers.

[1] *I.e. exchange between virtual assets and fiat currencies, including the exchange between virtual currencies and fiat currencies; exchange between one or more forms of virtual assets; transfer of virtual assets; safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets, including custodian wallet services; participation in and provision of financial services related to an issuer's offer and/or sale of virtual assets.*

Within the meaning of the civil law, a credit institution holding its customers' virtual assets as an off-balance sheet item would be required to compensate its customers in case of loss or theft of the virtual assets. Today, the CSSF observes that such assets are generally kept at external exchange or custody platforms. The corresponding counterparty risk of credit institutions towards the specialised virtual asset service providers may contractually be transferred to their customers. To be effective from a risk perspective, such transfer of counterparty risk would require customers to directly contract with the virtual asset service provider. A credit institution that does not effectively transfer the counterparty risk to its customers has to comply with the large exposure limits framework provided in the Capital Requirements Regulation (CRR) for the counterparty risk it incurs on custody or exchange platforms. Banks shall discuss with CSSF the approach they intend to choose when determining the exposure value and the concentration measure under the large exposure framework.

Currently Luxembourg banks do not directly safeguard the virtual assets themselves, but rely on an external virtual assets custodian. Credit institutions that envisage to directly safeguard virtual assets are required to inform the CSSF of such plans in a timely manner.

Q5 - What are the CSSF's requirements with regard to investor protection in the context of the provision of virtual asset services?

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Virtual assets are not deemed to be financial instruments within the meaning of the Law of 5 April 1993 on the Financial Sector and as such do not fall under the investor protection rules of MiFID. Nonetheless, given the strong similarities between investments in virtual assets and investments in financial instruments, the CSSF expects credit institutions facilitating investments in virtual assets to set up an effective investor protection framework. Credit institutions shall undertake sufficient steps in order to guarantee best execution, suitability and appropriateness of the investments and to inform investors accordingly on the underlying risks by way of educational material and transparent reporting regarding holdings in virtual assets.

Q6 - What are the general operational requirements that credit institutions have to comply with?

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The general principles of sound and prudent banking further to Circular CSSF 12/552 apply. Credit institutions that offer services or transact in virtual assets need the corresponding knowledge, competence and expertise, infrastructure and human resources, at the operational, control (2nd and 3rd lines of defence) and management (authorised management and supervisory body) levels. The ex-ante New Product Approval Process shall be duly applied. All risks have to be effectively mitigated to avoid any operational and financial contagion effects on the regulated financial activities of credit institutions.

Q7 - May a Luxembourg depositary act as depositary for investment funds investing directly in virtual assets?

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Luxembourg fund depositaries may be mandated to act as depositary for investment funds investing directly in virtual assets. In such case, they shall comply with the requirements under Q4 as well as the specific requirements that generally apply to Luxembourg fund depositaries. In this context, fund depositaries must put in place adequate organisational arrangements and an appropriate operational model, considering the specific risks related to the safekeeping of virtual assets. Moreover, depositaries shall notify the CSSF beforehand when they intend to act as depositary for an investment fund investing directly in virtual assets.

In relation to depositary services, for virtual assets that qualify as “other assets”, the depositaries’ liability in its depositary function is limited to safekeeping duties regarding ownership verification and record keeping in line with article 19 (8) (b) of the AIFM law and article 90 of the COMMISSION DELEGATED REGULATION (EU) no 231/2013 of 19 December 2012 (“DR 231/2013”).

Where the depositary does not offer safekeeping or administration type of services for the virtual assets and the IFM/investment fund directly appoints a specialised virtual asset service provider offering a “custodian wallet type of service”, the virtual assets are not recognised in the off-balance sheet of the depositary as the depositary is not liable for the restitution of the assets. Indeed, this liability is directly incumbent on the specialised virtual asset service provider. To that effect, the IFM/investment fund is required to have a direct contractual relationship with the specialised service provider.

A depositary providing administrative and depositary services to an investment fund investing in virtual assets triggers an obligation to register as a virtual asset service provider within the meaning of the AML/CFT law, if the depositary directly provides services related to the safekeeping or the administration of virtual assets, including the custodian wallet service, to its client. Under this setup, virtual assets are recognised in the off-balance sheet and the depositary has an obligation of restitution for the loss or theft of said assets within the meaning of the civil law. As foreseen in Q4, 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.

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