



ANNUAL
REPORT
2018



COMMISSION
DE SURVEILLANCE
DU SECTEUR
FINANCIER

Commission de Surveillance du Secteur Financier

283, route d'Arlon

L-2991 LUXEMBOURG

Tel.: (+352) 26 251-1

Fax: (+352) 26 251-2601

Email: direction@cssf.lu

Website: <http://www.cssf.lu>

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In 2018, the Grand Duchy evolved in an international economic environment that I would qualify as moderately optimistic. Global growth reached a peak in 2017 and then started to slow down in 2018. The same goes for the euro area, the GDP of which increased by 1.8% in 2018 compared to 2.4% in 2017. This trend will continue in 2019 and the European Commission recently lowered its forecast for 2019 to 1.2%. As regards non-performing loans in Europe, they decreased by a third over the last three years. This said, the overall amount remains high at about EUR 700 billion, notably in some Southern European countries, still negatively impacting the economic growth, including the profitability of banks and their capacity to grant loans to SMEs. It is also worth

pointing out that Italy entered into recession at the end of 2018 following a negative GDP for two consecutive quarters.

Three years after the referendum on Brexit in the United Kingdom, no agreement on the exit conditions and transitional period is in sight. The probability of a hard Brexit increases which would have negative consequences on the economy on both sides of the Channel. In the absence of an agreement on financial services, several multilateral agreements were signed regarding prudential supervision, which will allow the entities from EU-27 to continue cooperating with UK firms after Brexit. Two laws voted by the Luxembourg parliament will allow Luxembourg regulators to take time-limited measures in order to mitigate possible adverse effects of a hard Brexit.

The geopolitical environment remains affected by a recrudescence of tensions in the Middle East, by the spectre of trade wars between the United States and China and the European Union, and by the nationalist and protectionist trends also present in the European Union.

As regards the Luxembourg financial sector, 2018 was an overall positive year.

Whereas the number of banks slightly decreased, the balance sheet increased by 3%. Some banks changed into branches and this trend should continue in the following years. At the same time, two new banks were established in the Grand Duchy and other banks showed interest for establishing in Luxembourg. In 2018, the net results of Luxembourg banks dropped by 3.2% compared to 2017, as a result of the fall in “other income”, on the one hand (net interest income and commissions having increased by 2% and 5.4%, respectively), and the persistent growth of general expenses, on the other hand. The latter increased by 6%, primarily due to a rise in staff costs, but mainly due to significant IT investments. The cost-to-income ratio grew to 57% in 2018, against 53% in 2017. Twenty-one banks active for over three years even recorded a cost-to-income ratio greater than 100%. The non-performing loans ratio remains below 1% in Luxembourg, but we have to stay vigilant, notably in the area of mortgage credits to private individuals, as the Grand Duchy is displaying a fast growth in housing prices (+9.3% in 2018) and interest rates continue to be historically low. As regards the investment fund industry, we observed an increase in the number of authorised fund managers (Chapter 15 management companies and alternative investment fund managers) from 306 in 2017 to 314 in 2018. The total number of undertakings for collective investment registered on the official list slightly fell to 3,908, whereas the number of sub-funds slightly increased to 14,898. The total net assets of Luxembourg UCIs dropped by 2.3% to EUR 4,065 billion at the end of 2018 compared to 2017, due to a negative market effect which was greater than the positive inflow of new capital. The number of persons employed in the financial sector under our supervision increased in 2018 by 3% and reached almost 50,000 employees in terms of direct employment.

The CSSF continues to be particularly watchful towards the non-compliance risk and the connected reputational and legal risks. The on-site inspections carried out in 2018 showed that non-compliance was often due to absence of appropriate governance, absence of a clear definition of risk appetite by the board of directors and its implementation by the management, inappropriate internal control and compliance functions which were sometimes overly dependent on the management. Adequate corporate governance and culture

are essential and the CSSF encourages the nomination of independent administrators in the board of directors or supervisory board of supervised entities.

In the coming years, the Luxembourg financial sector will face the challenges of a double transition, i.e. digital and ecological.

As regards the digital transition, there are two certainties. The first is that, even if the timings and pace are difficult to assess, there will be a deep transformation in all business areas of the Luxembourg financial sector. The second is that computers will not replace human beings. Assuming that artificial intelligence exists, human intelligence will have to control it and not the other way around. The clients of financial institutions, as well as the regulator, will never fully trust robotics. We should not be afraid of digitalisation but use it in an efficient manner. The future belongs to the professionals which will combine (i) the know-how of experts in finance, (ii) the different new technologies used together and (iii) optimized working process. A good use of new technologies will also contribute to build a financial system that is more efficient, cheaper, less vulnerable and more inclusive. That being said, the digital transition will also change some professional profiles necessary for the financial centre and not all existing profiles will be converted into professions of tomorrow. Consequently, there will be, at first, a negative impact on employment in the financial sector which is and will remain one of the driving forces of the Luxembourg economy in the coming years. Another collateral impact of the digitalisation will be the decrease in tax revenue generated by the financial sector which will have to be offset by other income sources - will we have to tax robots in addition to natural and legal persons one day?

Ecological transformation has become urgent due to climate change and the environmental damage which must be quickly thwarted. This transformation must be part of the realisation of the COP21 goals, on the one hand, and the 17 UN Sustainable Development Goals, on the other. In March 2018, the European Commission presented an ambitious strategy regarding sustainable finance, the purpose of which is to foster the transition towards an economy with low-carbon emission. Such a transition cannot be achieved without the funding by the private sector. The relevant roadmap includes a unified classification system for 'sustainable' investments, EU labels, the obligation for asset managers and institutional investors to take into account sustainability in the investment process, the integration of sustainability in the prudential requirements and the disclosure of financial information on climate. The Grand Duchy, with some EUR 4,500 billion of assets under management, should aspire to have at least 10% of these assets invested in short-term sustainable investments and become a leader in this area, as it had been thirty years ago with respect to investment funds.

The digital and ecological transformations, beyond the most important players and professional associations adhering in principle, should be an integral part of the corporate strategy and culture and should be taken into account by the board of directors (which should use experts in this field), as well as by the management, for the investment decisions and other important managerial decisions. These dimensions should also be integrated in the remuneration system; moreover, they are not incompatible with the business objectives of the financial sector players. On the contrary, ignoring these dimensions will surely have a negative impact on the future profitability of these players.

The CSSF itself will have to transform within five to seven years in light of these changes, notably the vertical disintegration of classic players, the arrival of new players in the financial industry value chain (among others, FinTech), the increasing use of new technologies and an in-depth revision of the working process.

The CSSF will have to authorise and supervise more the activities, rather than just these players. Some providers playing a significant role in the value chain of classic players will not necessarily be supervised by our authority. Conversely, new players will wish to fall under our prudential supervision, to reassure the market, the investors or the clients.

The training of our agents in new technologies and their use in the financial services value chain will be crucial and cannot be limited to agents appointed for the supervision of information systems. Moreover, the CSSF will have to continue to inform the market about the conditions in which the use of new technologies is acceptable, as it has done for the use of cloud (public, private or hybrid), or similarly with the publication of a white paper on artificial intelligence in 2018. We are currently working on recommendations regarding the use of DLT or blockchain technology.

The CSSF itself will use new technologies: for example, we started a research project with the SnT regarding machine learning and artificial intelligence. This use is part of the multi-year strategy plan called CSSF 4.0.

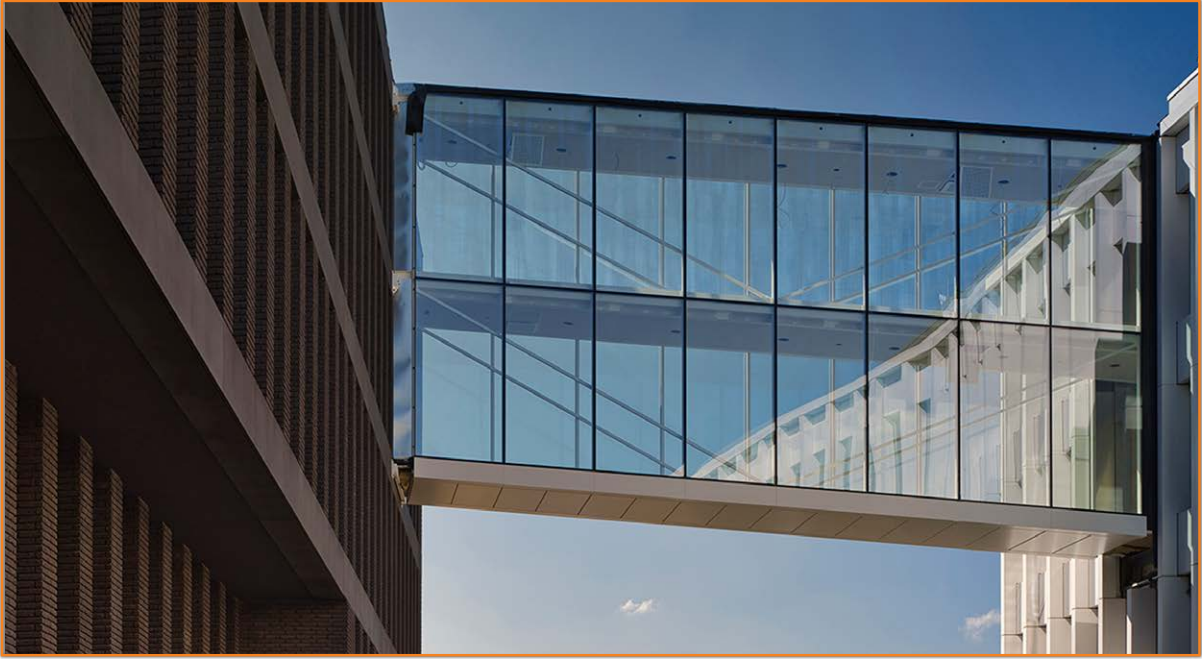
As the supervised entities will have an interest in automating the regulatory reporting as much as possible, the CSSF will make available secured transmission channels to the entities of all business areas, it will try to standardise requests and reporting as much as possible and it will work, as far as possible, on an automated data processing. This should enhance the transparency of interaction and the speed, and ultimately generate savings for the parties concerned.

Finally, I would like to point out that, after 35 years at the CSSF, the directors Ms Simone Delcourt and Mr Claude Simon made use of their right to a well-deserved retirement at the end of 2018. I would like to thank them for the exceptional work they accomplished throughout their career. They contributed to make of the Grand Duchy the financial centre we know today, combining efficiency and reliability of supervision. Many thanks also to the almost 900 CSSF agents for their remarkable work throughout the year.

I wish you a pleasant reading!



Claude Marx
Director General



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CHAPTER I

GOVERNANCE AND FUNCTIONING OF THE CSSF

1. PRINCIPLES

The CSSF, established by the Law of 23 December 1998, with effect on 1 January 1999, is a public institution with legal personality and financial autonomy. It operates under the authority of the Minister responsible for the financial centre, i.e. the Minister of Finance Mr Pierre Gramegna.

1.1. CSSF bodies

The CSSF's Board is composed of seven members appointed by the Grand Duke on the proposal of the Government in Council for a period of five years. The powers conferred upon the Board notably include the annual adoption of the CSSF's budget and the approval of the financial statements and of the management report of the CSSF's Executive Board, which are submitted to the Board before being presented to the Government for approval. It also sets the general policy as well as the annual and long-term investment programmes which are submitted to it by the Executive Board before being submitted for approval to the Minister of Finance. The meetings and deliberations of the Board take place according to its internal rules. The Board is not competent to intervene in the CSSF's prudential supervisory matters.

The Resolution Board is the internal executive body of the CSSF in charge of the resolution function, i.e. the duties and powers conferred on the CSSF as the resolution authority by the Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRM Regulation) and their implementing measures.

The Council for the Protection of Depositors and Investors (CPDI) is the internal executive body of the CSSF in charge of managing and administering the Fonds de garantie des dépôts Luxembourg (FGDL) and the Système d'indemnisation des investisseurs Luxembourg (SIIL). Its missions and powers are assigned to it by Part Three

of the BRRD Law. Its functioning is governed by the provisions of Section 4-2 of the Law of 23 December 1998 establishing the CSSF. The CPDI is the designated authority referred to in point (18) of Article 2(1) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes. It notably cooperates, within the limits of its duties, to the drawing-up of reports and other documents to be submitted to the CSSF's Board.

In order to facilitate decision-making, to enhance exchange of information and efficient cooperation between the FGDL and the CPDI and to ensure swift repayment of depositors, the members of the CPDI are also the members of the FGDL's Management Committee.

The senior executive authority of the CSSF is the Executive Board, composed of a Director General and of two to four Directors, appointed by the Grand Duke on the proposal of the Government in Council for a period of five years. The Executive Board develops the measures and takes the decisions it deems useful and necessary for the fulfilment of the CSSF's mission and its organisation. Moreover, it sets up a five-year "target contract" with the Minister of Finance. The Executive Board is responsible for the reports and proposals it must submit to the Board and the Government as part of its responsibilities.

1.2. Decision-making process

According to its internal rules, the Executive Board must meet collectively at least once a week to take the decisions required to accomplish the CSSF's mission. The Executive Board is responsible collectively even if each individual member runs one or several departments.

The decisions taken by the CSSF as part of its mission may be referred to the *Tribunal administratif* (Administrative Court), which decides on the merits of the case. These remedies must be filed, under penalty of foreclosure, within one month from the notification of the decision.

1.3. Drawing-up of regulations

The CSSF has the power to make regulations within the limits of its competences and missions, in accordance with Article 9(2) of the Law of 23 December 1998. Depending on the topics, draft regulations must be submitted to the Consultative Committee for Prudential Regulation, the Consultative Committee for the Audit Profession or the Consultative Committee for Resolution. The CSSF's regulations are published in the Official Journal of the Grand Duchy of Luxembourg.

The legislative framework applicable to the financial sector is complemented by circulars issued by the CSSF with a view to specifying how legal provisions should be applied and issuing recommendations on conducting business in the financial sector.

Following the example of international fora and counterpart authorities, the CSSF has established a broad consultation procedure, which involves, while the regulations and circulars are being drafted, the financial sector players as well as any other person concerned, notably via expert committees and ad hoc working groups.

1.4. Financing of the CSSF and account auditing

The CSSF is authorised to levy taxes on supervised persons and undertakings to cover its staff, financial and operating costs. The Grand-ducal Regulation of 21 December 2017 lays down the amounts applicable and guarantees full financing of the operating costs.

The Government appoints a *réviseur d'entreprises agréé* (approved statutory auditor) on the proposal of the CSSF's Board for a period of three years. The mission of the *réviseur d'entreprises agréé* is to audit and certify the CSSF's accounts and to submit a detailed report on the CSSF's accounts to the Board and the Government at the close of the financial year. The *réviseur d'entreprises agréé* may be entrusted by the Board with making specific checks.

The CSSF is subject to the control of the Court of Auditors (*Cour des comptes*) as to the appropriate use of the public financial participation it receives.

2. GOVERNING BODIES

Board

Chairwoman	Isabelle Goubin	Director of the Treasury, Ministry of Finance
Members	Daniel Croisé	Member of the Board of the Institut des réviseurs d'entreprises
	Serge de Cillia	Director General of the Luxembourg Bankers' Association
	Marny Schmitz	<i>Attaché</i> , Ministry of Finance
	Camille Thommes	Director General of the Association Luxembourgeoise des Fonds d'Investissement
	Pascale Toussing	Director of the Administration des contributions directes
	Claude Wirion	Chairman of the Executive Board of the Commissariat aux Assurances
Secretary	Danielle Mander	<i>Conseiller</i> , CSSF

Resolution Board

Chairman	Romain Strock	Director Resolution, CSSF
Members	Isabelle Goubin	Director of the Treasury, Ministry of Finance
	Gaston Reinesch	Director General, Banque centrale du Luxembourg
	Claude Simon	Director, CSSF (until 31 December 2018)
	Claude Wampach	Director, CSSF (as from 1 January 2019)
	Karin Guillaume	<i>Premier conseiller</i> to the <i>Cour d'appel</i> (Court of Appeal)
Secretary	Nicole Lahire	<i>Conseiller</i> , CSSF

Council for the Protection of Depositors and Investors

Chairman	Claude Simon	Director, CSSF (until 31 December 2018)
	Claude Wampach	Director, CSSF (as from 1 January 2019)
Members	Isabelle Goubin	Director of the Treasury, Ministry of Finance
	Gaston Reinesch	Director General, Banque centrale du Luxembourg
	Serge de Cillia	Director General of the Luxembourg Bankers' Association
	Karin Guillaume	<i>Premier conseiller</i> to the <i>Cour d'appel</i> (Court of Appeal)
Secretary	Laurent Goergen	<i>Attaché</i> , CSSF

Executive Board

Director General	Claude Marx
Directors	Simone Delcourt (until 31 August 2018)
	Claude Simon (until 31 December 2018)
	Françoise Kauthen
	Jean-Pierre Faber
	Marco Zwick (as from 1 September 2018)
	Claude Wampach (as from 1 January 2019)



Executive Board of the CSSF

Left to right: Marco ZWICK, Françoise KAUTHEN, Claude MARX, Jean-Pierre FABER, Claude WAMPACH

3. COMMITTEES

3.1. Consultative committees

3.1.1. Consultative Committee for Prudential Regulation

The Government may seek advice from the committee, constituted by the Law of 23 December 1998 establishing the CSSF, on any draft law or grand-ducal regulation in the field of supervision of the financial sector falling within the remit of the CSSF. The CSSF's Executive Board seeks the opinion of the committee on any draft CSSF regulation other than those related to statutory audits and the audit profession. Members of the committee may also seek its advice concerning the implementation or application of prudential regulation overall or specific questions. The external members of the committee are appointed by the Minister of Finance.

Committee composition:

Executive Board of the CSSF:	Claude Marx (Chairman), Françoise Kauthen, Jean-Pierre Faber, Marco Zwick, Claude Wampach
Members:	Anouk Agnes, Serge de Cillia, Alain Feis, Isabelle Goubin, Robert Scharfe, Carlo Thill, Camille Thommes
Secretary:	Danielle Mander

3.1.2. Consultative Committee for the Audit Profession

The Government may seek advice from the committee, established by the Law of 18 December 2009 concerning the audit profession, on any draft law or grand-ducal regulation related to statutory audits and the audit profession subject to the oversight of the CSSF. The CSSF's Executive Board seeks the opinion of the committee on any draft CSSF regulation related to statutory audits and the audit profession. Members of the committee may also seek its advice concerning the implementation or application of the legislation regarding the oversight of the audit profession in its whole or for specific issues. The external members of the committee are appointed in accordance with Article 15-1 of the Law of 23 December 1998 establishing the CSSF.

Committee composition:

Executive Board of the CSSF: Claude Marx (Chairman), Françoise Kauthen, Jean-Pierre Faber, Marco Zwick, Claude Wampach

Members: Anouk Agnes, Daniel Croisé, Serge de Cillia, Yasmin Gabriel, Philippe Meyer, Daniel Ruppert, Philippe Sergiel, Anne-Sophie Theissen, Claude Wirion

Secretary: Danielle Mander

3.1.3. Consultative Committee for Resolution

The Government may seek advice from the committee, constituted by the Law of 18 December 2015 on the failure of credit institutions and certain investment firms, on any draft law or grand-ducal regulation in the field of resolution falling within the competence of the CSSF. The Resolution Board seeks an opinion of this committee on any draft CSSF regulation relating to resolution. Members of the committee may also seek its advice concerning the implementation or application of the regulations on resolution overall or for specific questions. The external members of the committee representing banks and investment firms, respectively, are appointed by the Minister of Finance. The external member of the Institut des réviseurs d'entreprises is designated by the latter.

Committee composition:

Resolution Board: Romain Strock (Chairman), Isabelle Goubin, Karin Guillaume, Gaston Reinesch, Claude Wampach

Members: Jean-Louis Barbier, Claude Eyschen, Thierry Lopez, Gilles Pierre, Philippe Sergiel, Vincent Thurmes

Secretary: Nicole Lahire

3.2. Permanent and ad hoc expert committees

The expert committees assist the CSSF in analysing the development of the different financial sector segments, give their advice on any issue relating to their activities and contribute to the drawing-up and interpretation of the regulations relating to the specific areas covered by the respective committees. In addition to the permanent committees listed below, ad hoc committees may be set up to discuss specific issues.

The permanent expert committees are the following:

- Anti-Money Laundering Committee;
- Banks Issuing Covered Bonds Committee;
- Banks and Investment Firms Committee;
- Bank and Investment Firm Accounting Committee;
- Depositories Committee;
- Investment Fund Managers Committee;
- Corporate Governance Committee;
- Capital Markets Committee;
- Financial Consumer Protection Committee;
- Audit Technical Committee;
- Securitisation Committee.

4. HUMAN RESOURCES

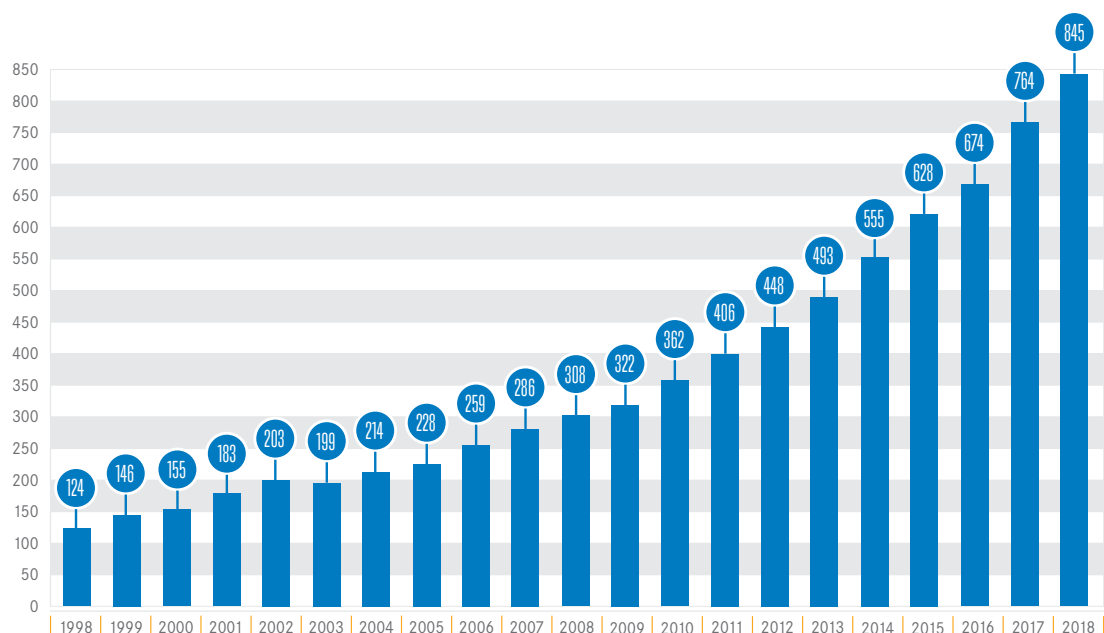
4.1. CSSF staff

In constant growth since 2010, the CSSF staff continued to increase in 2018 with the recruitment of 108 new hires. Following the resignation of 27 agents during that same year, total employment reached 845 people as at 31 December 2018, representing a 10.60% increase compared to 2017. This is the equivalent of 751.68 full-time jobs, i.e. a 10.14% growth compared to 2017.

Following the reform within the Luxembourg Civil Service which brings about greater ease in working part-time and taking leave without pay, the number of CSSF agents benefitting from part-time employment, partial leave, parental leave or unpaid leave as at 31 December 2018 rose to 196, i.e. 23.36% of total staff.

In 2018, the CSSF received 3,050 job applications (-23% as compared to 2017) and participated in several recruitment events (UniCareers, European Meeting of Luxembourg Students, Plug&Work, Business-Students Meeting, Forum Est-Horizon and Dogfinance Connect). Recruitment was mainly based on language skills and the search for experienced profiles.

Movements in staff numbers



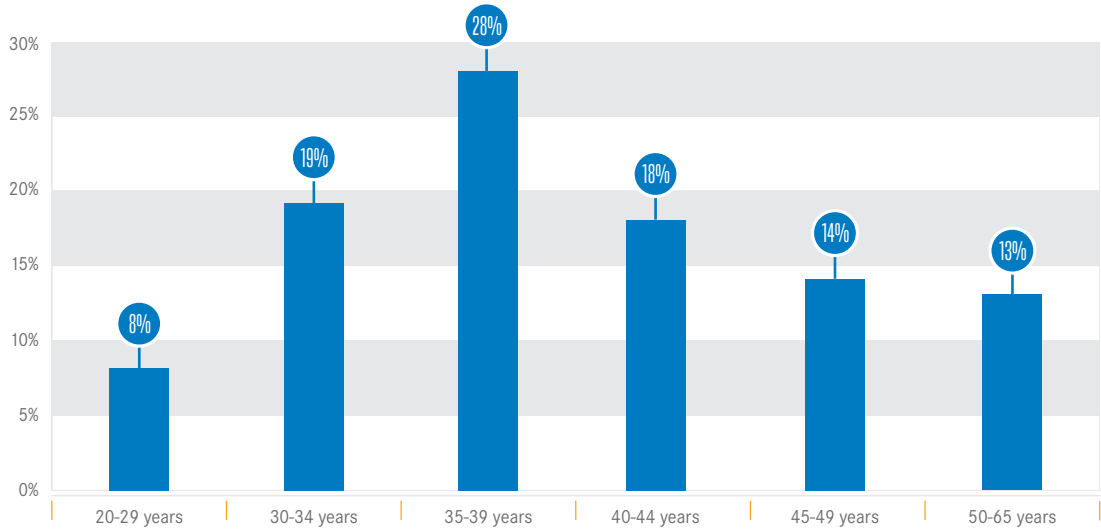
CSSF agents represent 15 nationalities, the Luxembourg nationality being the most represented with 52.90% of total staff. This percentage decreases from year to year.

Breakdown of staff by nationality

Nationality	Number of agents
Luxembourgish	447
French	210
Belgian	91
German	47
Italian	14
Portuguese	8
Austrian	5
Romanian	5
Dutch	4
Polish	4
Spanish	4
Bulgarian	3
Greek	1
Hungarian	1
Irish	1
Total	845

The average age of the CSSF staff members slightly increased from 39.38 years as at 31 December 2017 to 39.62 years at the end of 2018. Women make up 45.92% of total staff and men 54.08%.

Breakdown of staff by age



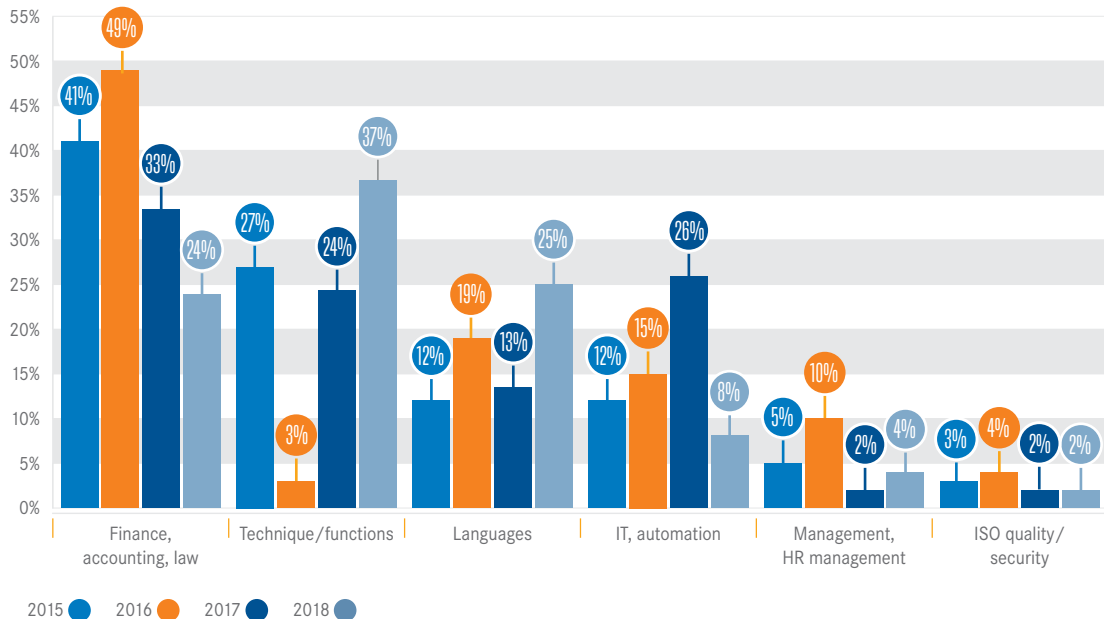
4.2. Staff training

In 2018, CSSF staff attended in total 41,010 training hours, which represents an average of 8.3 training days per agent. As it is capital that the agents' expertise is at all times in adequacy with the speed of evolution of markets and financial products, as well as with the work methods and techniques of the supervised entities, training is highly encouraged.

The training courses consist of both continuing education, offered to CSSF staff throughout their professional career, and training undertaken during the internship to become a civil servant.

The number of training hours organised in the context of the civil servant internship significantly increased as three groups took some courses simultaneously in 2018. As the courses concerned the category "Technique/functions", the number of training courses taken in this category in 2018 registered a substantial increase compared to the previous years.

Breakdown of training according to topic



4.3. Organisation chart

The organisation chart of the CSSF is available on the CSSF’s website (About the CSSF > General organisation > Useful documents).

5. IMPLEMENTATION OF THE CSSF 4.0 STRATEGY

Two years ago, the CSSF started a major project of organisational and IT transformation with the purpose of making the institution more agile in its organisation for the tasks incumbent on it and taking into account its current and future size.

This transformation goes along with a restructuring of the CSSF’s IT tools and the analysis of new trends available for data exploitation via effective IT systems.

In its 4.0 strategy, the CSSF describes in five themes its IT vision for the supervisory institution of the future.

The main objective of the CSSF 4.0 strategy is the real-time exploitation of data transmitted electronically and digitally, to enable the CSSF to perform its prudential role in an agile manner. The institutions will thus be able to interact with the CSSF via standardised processes, supported by efficient IT tools.

Moreover, the CSSF intends to interact dynamically, via a specific electronic portal, with the supervised entities. In this context, the portal will improve transparency of the statuses of all pending files, guaranteeing a real-time update of the data included in the CSSF’s unique database. All the steps of this dematerialised process will allow substantial time savings and an increased reactivity as compared to the standard processes and requests. The supervised entities will thus have access to their data which is included in the CSSF’s tools in order to update it according to the entity’s lifecycle.

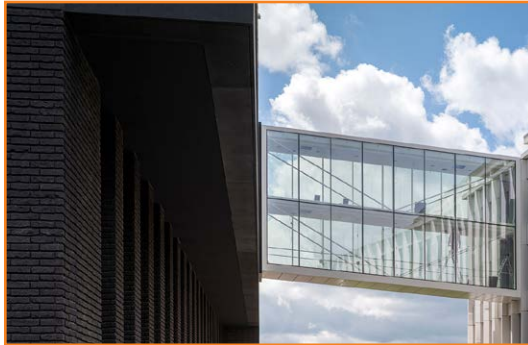
By supplementing the CSSF’s unique database, the steps that have already been taken in the context of the CSSF’s digital transformation allow an increased quality of the assessment of risks associated with the supervised entities’ activities, notably with the aim of adapting the prudential supervision accordingly.

These processes go together with a set of training sessions for all CSSF staff members in the area of digitalisation, as for example, the implementation of a strategy for the exploitation of the data collected and improved through the secured regular interactions via artificial intelligence projects.



6. MOONLIGHT BUILDING

The CSSF's choice of the "LINK-UP" theme for the office lay-out in the Moonlight building was deliberately made to show the importance of the connection between the staff members and the buildings Aubépines and Moonlight, just as the walkway connecting the two buildings does.



The new office space in which the CSSF will move, representing 67% of the Moonlight building, will allow a new way of working fostering cooperation between activities and departments, as well as with the supervised entities. Indeed, the Moonlight building will be the meeting point for the public and the CSSF as from July 2019.

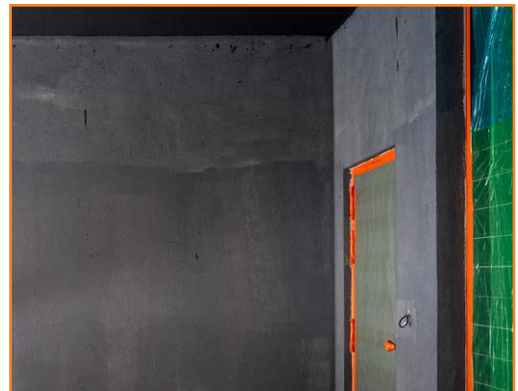
The new offices, together with the Aubépines building, will not challenge the CSSF's supervisory functions, where thoroughness, reliability and confidentiality are key elements. Only the way of

working and performing the prudential mission of the CSSF will be adapted to the size of the institution and to the new working organisation methods.

With its right-angled corners, the architecture of the buildings underlines the sobriety and neutrality with which the CSSF carries out its daily mandate. The extended cooperation between the CSSF agents, the use of digitalisation techniques and the implementation of the CSSF 4.0 strategy are all elements aiming at adapting the institution to the new challenges that the Luxembourg financial centre is facing.



The choice of the materials, the cooperative spirit within the working spaces as well as the modern working methods promote the image and values of the CSSF. The significant increase of reception and meeting areas (internal and external), the adaptation of the agents' training tool, the modernisation of the IT tools and the implementation of new exchange portals with the supervised entities are the main implementation elements of the CSSF's modernisation.



7. CSSF SOCIAL RESPONSIBILITY

One of the CSSF's objectives is to carry out its supervisory tasks based on a voluntarily socially responsible attitude towards the economic players, the environment and the society it serves within the context of corporate social responsibility (CSR).

Becoming socially responsible means for the CSSF integrating social and environmental issues in its daily management and in its interactions with the different players of the financial centre, its employees and the environment.

By formalising a certain number of values which are essential to it, the CSSF shows its willingness to be recognised as a socially responsible public institution and its efforts of sustainable development. In this context, its values encompass social commitment, security and health, transparency, integrity, multiculturalism, diversity and environment.

8. CSSF LIBRARY

The CSSF library is a reference library which is part of the Luxembourg libraries' network bibnet.lu since 2009. It is specialised in banking and financial law as well as financial economy. It contains around 3,400 books and around 50 periodicals and update publications. The library also has a certain number of specialised electronic databases.

All the books in the library are listed in the general catalogue of the bibnet.lu network. The unified search engine of the collections of the network (www.a-z.lu) enables an easy search of the books available in the CSSF library and in all Luxembourg libraries.

The library is open to the public on prior request and by appointment, Monday through Friday from 9 a.m. to 11 a.m. and from 2 p.m. to 4 p.m.

9. CSSF BUDGET AND ANNUAL ACCOUNTS - 2018

9.1. CSSF budget

Budget planning is integrated in the CSSF's management cycle and it is part of a multi-year planning of the CSSF's results; it thereby allows guaranteeing the financial balance of the CSSF in the long term.

The 2018 budget was drawn up in accordance with the principles which have proved their worth in the previous years. It was approved by the Board of the CSSF on 11 December 2017.

The key factors that have affected the 2018 budget are the following.

- In the context of a survey on the longer-term real estate strategy, the Board mandated the Executive Board of the CSSF to enter into negotiations as regards the renting of office space in an adjacent building ("Moonlight"), allowing the accommodation of not less than 250 office desks.
- Following the experience deriving from the implementation and consolidation of the new EU banking supervisory architecture by the ECB (Single Supervisory Mechanism and Single Resolution Mechanism), the 2018 budget took into account the related increase in staff members.
- The on-site inspection departments required further increase of staff for on-site inspections to be carried out at banks and investment fund managers.
- In accordance with the Board's recommendations, the CSSF continued to give, for the 2018 budget, special emphasis on the quality of the IT infrastructure and operation, as information management and its dissemination have become key elements. The aim is to improve interaction between employees, processes and information to remain flexible towards the requirements that the CSSF has to meet and to prevent any criminal attack on this infrastructure.

The CSSF's finance division closely monitors the budget and draws up monthly reports for the Executive Board. An analysis detailing the gaps between the budgeted figures and the real figures is made at the end of every financial year. It should be noted that, as at 31 December 2018, the amount of operating costs and investment costs remained below the budgeted amounts set for 2018.

9.2. CSSF annual accounts - 2018

BALANCE SHEET AS AT 31 DECEMBER 2018

Assets	EUR
Fixed assets	60,524,240.49
- Intangible fixed assets	4,529,294.35
Development costs	2,002,117.61
Payments on account and intangible assets in progress	2,527,176.74
- Tangible fixed assets	55,994,946.14
Land and constructions	52,764,821.90
Other fixtures, fittings, tools and equipment	1,637,806.08
Payments on account and tangible assets in progress	1,592,318.16
Current assets	75,581,536.23
- Debtors	5,178,608.85
Trade debtors with a residual term of up to one year	5,151,567.52
Other debtors with a residual term of up to one year	27,041.33
- Cash at banks, in postal cheque accounts, cheques in hand	70,402,927.38
Prepayment and accrued income	4,582,770.00
BALANCE SHEET TOTAL (ASSETS)	140,688,546.72
Liabilities	
Own capital	76,108,169.36
- Profit brought forward	61,118,536.37
- Result for the financial year	14,989,632.99
Provisions	7,384,234.21
- Other provisions	7,384,234.21
Liabilities	57,058,010.40
- Amounts owed to credit institutions	51,988,124.91
with a residual term of up to one year	4,572,432.72
with a residual term of over one year	47,415,692.19
- Debts on purchases and provision of services	3,453,588.86
with a residual term of up to one year	3,453,588.86
- Other debts	1,616,296.63
Tax debts	274,429.25
Social security debts	1,149,426.18
Other debts with a residual term of up to one year	192,441.20
Prepayment and accrued income	138,132.75
BALANCE SHEET TOTAL (LIABILITIES)	140,688,546.72

PROFIT AND LOSS ACCOUNT AS AT 31 DECEMBER 2018

	<i>EUR</i>
Net turnover	125,785,383.39
Other operating income	188,071.72
Raw materials and consumables and other external charges	14,537,806.89
- Raw materials and consumables	454,155.62
- Other external charges	14,083,651.27
Staff costs	88,172,356.17
- Wages and salaries	82,215,799.19
- Social security costs	3,327,951.96
relating to pensions	602,214.77
other social security costs	2,725,737.19
- Other staff costs	2,628,605.02
Value adjustments	4,650,679.30
- on formation expenses and tangible and intangible fixed assets	4,650,679.30
Other operating charges	2,743,964.79
Other interests and financial revenues	15,474.43
- Other interests and financial revenues	15,474.43
Interests and other financial charges	894,489.40
- Other interests and financial charges	894,489.40
Result for the financial year	<u>14,989,632.99</u>

Financial controller EY



CHAPTER II

THE EUROPEAN DIMENSION OF THE SUPERVISION OF THE FINANCIAL SECTOR

1. SUPERVISION OF BANKS

1.1. Single Supervisory Mechanism (SSM)

1.1.1. CSSF participation in the governance of the SSM

In 2018, the CSSF participated in 15 meetings of the SSM Supervisory Board and contributed to over 1,600 decisions concerning significant banks and significant banking groups directly supervised by the European Central Bank (ECB). With regards to the supervision of Luxembourg banks, the CSSF actively participated in several Joint Supervisory Teams (JSTs) for the direct supervision of significant banking groups located in Luxembourg and cooperated with the ECB for the supervision of less significant banking groups located in Luxembourg which remain under the direct supervision of the CSSF. Finally, the CSSF contributed at technical level to the work of a large number of committees and working groups set up by the ECB.

One of the working groups that the CSSF contributed to was mandated to make proposals regarding the simplification of the SSM processes. Proposals focused on improvements in the decision-making procedures, information access for the Supervisory Board members, improving team work within the JSTs, planning and organisation of supervisory activities and tasks, digitalising processes, and optimising the current IT infrastructure.

The work on simplification of processes lead, for example, to the extension of the scope of the existing delegation framework for decision-making powers, which permits that certain types of routine supervisory decisions may be adopted by ECB senior managers instead of the Supervisory Board and the Governing Council. Delegation was extended to decisions on own funds reduction, the classification of Common Equity Tier 1 (CET1) instruments and, where required by national law (such as in Luxembourg), to the classification of Additional Tier 1 (AT1)/Tier 2 instruments. The extension of the delegation framework will make the decision-making process within the SSM simpler and allow the Supervisory Board to focus on the most relevant topics.

1.1.2. Developments regarding the supervision of significant institutions in the SSM

A topic which required major supervisory attention in 2018 was Brexit. The SSM mainly focused on assessing relocation plans of banks moving from the UK to the euro area and on analysing the preparedness of banks located in the euro area that operate in the UK. In the assessment of the relocation plans, special attention is put to the presence of adequate local risk management and sufficient staffing in order to avoid the setting-up of “empty shells” in the euro area. Credit institutions looking to relocate should consult the ECB banking supervision website¹ and its FAQs on Brexit² which provide details on supervisory expectations.

Another topic of attention of the SSM continued to be the volume of non-performing loans (NPLs) in the euro area. In March 2018, the SSM published an addendum to its 2017 NPL³ guidance setting clear expectations for minimum levels of prudential provisions for newly classified NPLs as of 1 April 2018. In concrete terms, the addendum foresees that significant banks are expected to provide full coverage for the unsecured portion of new NPLs after two years at the latest and for the secured portion after seven years at the latest. The addendum is not binding but serves as a basis for the supervisory dialogue between the significant banks and the ECB. In July 2018, the ECB announced that it will define bank-specific expectations for the provisioning of the NPL stock based on benchmarking of comparable banks and guided by individual banks’ current NPL ratio.

The targeted review of internal models (TRIM), which aims at harmonising internal model supervision, remained also one of the most important projects of the SSM in 2018.

During the same period, the ECB published a number of guides that aim to provide banks with more transparency and understanding of the ECB’s supervisory expectations. Some important themes that are covered by separate guides include internal models, internal capital and liquidity adequacy assessment processes (ICAAP and ILAAP), and on-site inspections.

1.1.3. Developments regarding the supervision of less significant institutions (LSIs) in the SSM

While national competent authorities remain responsible for the supervision of LSIs, the ECB also has an oversight function for LSIs where it aims to ensure that high supervisory standards are applied across the euro area. In 2018, the ECB further streamlined its oversight framework for LSIs through the development and implementation of additional joint supervisory standards and common methodologies.

Throughout the year 2018, the ECB published several guides, some of which also apply to LSIs. The majority of licensing procedures (approximately 81%) in 2018 for the SSM area related to the establishment of new LSIs. In March 2018, a guide to assessments of licence applications⁴ and a guide to assessments of fintech credit institution licence applications⁵ were published. They are now being applied in the assessment of new licensing cases.

Finally, an important milestone in 2018 was the start of the application of a common methodology for the Supervisory Review and Evaluation Process (SREP) for high-priority LSIs. The methodology is similar to the one applied to significant institutions. The common SREP methodology will be applied to all LSIs by 2020.

¹ <https://www.bankingsupervision.europa.eu/home/html/index.en.html>.

² <https://www.bankingsupervision.europa.eu/banking/relocating/html/index.en.html>.

³ https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803.en.pdf.

⁴ https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_credit_inst_licensing_appl.en.pdf.

⁵ https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/licensing_and_fintech/ssm.guide_on_assessment_for_licensing_of_fintech_credit_insts_draft.en.pdf.

1.2. European Banking Authority (EBA)

In 2018, the EBA's work continued to focus on issues relating to the practical application of the regulatory requirements under the CRD IV/CRR framework⁶, the Bank Recovery and Resolution Directive (BRRD)⁷ and the Deposit Guarantee Schemes Directive (DGSD)⁸.

The practical implications and the mitigation of the consequences linked to Brexit were also dealt with in detail.

A growing number of subjects relating to the practical application of the provisions of the Payment Services Directive 2 (PSD2)⁹, which entered into force in 2018, as well as topics that have been raised in the context of FinTech and consumer protection were also discussed.

All EBA publications are available on the website www.eba.europa.eu.

1.2.1. Scope of prudential consolidation and regulatory perimeter issues

Following the consultation period announced in the CSSF Annual Report 2017, the draft regulatory technical standards (RTS) on the methods of prudential consolidation in accordance with Article 18 of the CRR remain at this stage under development as some amendments have been introduced into the CRR2 package.

1.2.2. Large exposures regime

On 5 July 2018, the EBA Guidelines on connected clients (EBA/GL/2017/15) as defined in the CRR have been adopted through Circular CSSF 18/693. The aim of the Guidelines, which apply from 1 January 2019, is to clarify the criteria to be observed by institutions for the grouping of clients and their monitoring as a single risk in case of connections due to a control relationship or an economic dependency. The provisions of the Guidelines apply to all areas of the CRR where the concept of "group of connected clients" is used (large exposures, credit risk, liquidity, etc.) including technical standards and other EBA guidelines that refer to that concept. The Guidelines also provide instructions regarding the assessment of interconnectedness among shadow banking entities, as targeted in the EBA Guidelines on limits on exposures to shadow banking entities (EBA/GL/2015/20).

1.2.3 Own funds

The EBA is in charge of monitoring the quality of own funds instruments in accordance with Article 80 of the CRR. In 2018, the EBA continued to review the compliance with the CRR of new issuances of Common Equity Tier 1 (CET1) and Additional Tier 1 (AT1) capital of institutions as well as the compliance of CET1 instruments that were issued before the entry into force of the CRR.

In this context, the EBA released on 20 July 2018 its report on the monitoring of CET1 instruments issued by EU institutions¹⁰ together with the latest update of the EBA list of CET1 instruments that are eligible under the CRR¹¹. There has been no modification as regards the types of instruments recognised for Luxembourg. The EBA report provides a source of information as regards the EBA's expectations to ensure compliance of CET1 instruments with the CRR.

⁶ Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) and Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR).

⁷ Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD).

⁸ Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes (DGSD).

⁹ Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (PSD2).

¹⁰ <https://eba.europa.eu/documents/10180/2087449/CET1+report+Q2+2018+update.pdf>.

¹¹ <https://eba.europa.eu/documents/10180/530928/EBA+updated+CET1+list-Q3+2018.xlsx>.

1.2.4. EBA opinions and communications on Brexit

Following the first EBA Opinion on Brexit¹² published in October 2017, the EBA released in June 2018 a second Opinion on preparations for the withdrawal of the UK from the EU¹³. This publication aims to ensure that financial institutions (i.e. credit institutions, investment firms, payment institutions, electronic money institutions, creditors and credit intermediaries) adequately assess the risks deriving from the UK withdrawal from the EU without a ratified agreement. In essence, this second Opinion recalls the need for financial institutions to maintain their efforts in effective contingency planning in an appropriate timeframe, to carefully assess their obligations towards customers and to take the necessary actions to ensure the continuity of customer services. As a follow-up, the EBA issued in December 2018 a press release¹⁴ urging the financial institutions affected by Brexit to take its June 2018 Opinion into careful consideration and to swiftly proceed with advising customers on the specific implications stemming from the UK withdrawal from the EU.

1.2.5. Supervisory convergence

With a view to assist the EBA in strengthening the convergence of supervisory practices across the EU jurisdictions, the EBA's Review Panel periodically organises and conducts peer reviews of some of the activities of the authorities concerned.

On 10 July 2018, the EBA issued a peer review report with respect to the RTS on passport notifications¹⁵ which applies in the context of the exercise of the right of establishment and the freedom to provide services for credit institutions within the EU. This exercise aimed at assessing both the effective application across the different EU jurisdictions as well as in EEA countries of the provisions set out in this RTS and the processes and practices implemented by the competent authorities to manage the passporting process as well as the level of cooperation reached between home and host competent authorities.

The EBA Review Panel also initiated its work on the peer review of the RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile in the context of remuneration packages.

1.2.6. Payment services

The Standing Committee on Payment Services (SCPS) and its working groups continued developing and defining the mandates entrusted to the EBA under Directive (EU) 2015/2366 on payment services (PSD2).

In 2018, the following mandates were finalised and published by the EBA:

- Final RTS on Home-Host cooperation under PSD2;
- Final Guidelines on fraud reporting under PSD2;
- Final Guidelines on the conditions to be met to benefit from an exemption from contingency measures under Article 33(6) of Regulation (EU) 2018/389 (RTS on SCA & CSC).

The RTS were transmitted to the European Commission for adoption.

Moreover, the SCPS contributed to the drafting of the Single rulebook Q&A on payment services.

1.2.7. Governance

On 30 June 2018, the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2017/12), as well as the EBA Guidelines on internal governance (EBA/GL/2017/11) entered into force. These Guidelines form an integral part of the legal framework designed to address weaknesses in corporate governance that were identified during the financial crisis.

¹² <https://eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+BREXIT+Issues+%28EBA-Op-2017-12%29.pdf>.

¹³ <https://eba.europa.eu/documents/10180/2137845/EBA+Opinion+on+BREXIT+preparations+%28EBA-Op-2018-05%29.pdf>.

¹⁴ <https://eba.europa.eu/-/the-eba-calls-for-more-action-by-financial-institutions-in-their-brex-it-related-communication-to-customers>.

¹⁵ <https://eba.europa.eu/documents/10180/2087449/Report+on+the+peer+review+of+the+RTS+on+passport+notifications.pdf>.

Besides, following the public consultation that took place in 2018, the EBA is about to finalise the EBA draft Guidelines on outsourcing arrangements that will apply to competent authorities across the EU, as well as to credit institutions and investment firms on a solo and consolidated basis, to payment institutions and to electronic money institutions. Following their adoption by the EBA, the new Guidelines will enter into force on 30 September 2019.

1.2.8. Transparency

With regard to transparency, the EBA published, on 16 January 2018, its guidelines on the uniform disclosure format for Pillar 3 in accordance with which the disclosures required under Article 473a of the CRR should be made (transitional arrangements for mitigating the impact of the introduction of IFRS 9). The purpose of these uniform disclosures is to provide a comparison of own funds, risk-weighted assets and leverage ratio with and without the application of transitional arrangements for IFRS 9. The CSSF published Circular CSSF 18/687 dated 27 March 2018, making these guidelines applicable to the Luxembourg banks concerned.

The EBA also drafted guidelines on non-performing exposures in order to provide meaningful information on this issue, while ensuring consistency of the information between FINREP/COREP reporting and the Pillar 3 report. These guidelines have been published on 17 December 2018.

1.2.9. Consumer protection

In 2018, the EBA published the following documents in respect of consumer protection:

- EBA Financial Education Report 2017/18;
- Consumer Trends Report 2018-2019;
- Joint ESAs Warning on Virtual Currencies (12 February 2018);
- Joint Committee Guidelines on complaints-handling for the securities (ESMA) and banking (EBA) sectors, updated on 31 July 2018;
- Communication on Brexit of 17 December 2018, following up on the opinion of the EBA of 25 June 2018 on financial institutions' preparedness for the UK withdrawal from the EU.

1.2.10. IFRS 9

In December 2018, the EBA published its report on the preliminary assessment on the post-implementation impact of IFRS 9 on EU banks which presents the conclusions of the quantitative analysis of IFRS 9 as implemented by EU banks. The quantitative analysis was based on the same sample of 54 banks on which the EBA based its 2017 impact assessment of IFRS 9.

The increase in provisions following the introduction of IFRS 9 is of 7.4% for SA banks (banks applying the standardised approach for calculating own funds requirements for credit risk) and of 11.4% for IRB banks (banks applying the internal ratings-based approach for calculating own funds requirements for credit risk). The negative CET1 impact corresponds to 47 bps.

2. SUPERVISION OF FINANCIAL MARKETS

2.1. European Securities and Markets Authority - ESMA

All the publications of ESMA are available on the website www.esma.europa.eu. For 2018, the following topics in relation to the activities of ESMA, its working groups and its task forces should be highlighted.

2.1.1. Collective investment management

As regards collective investment management, also called fund management, the following publications¹⁶ were made in 2018, among others.

On 27 March 2018, ESMA published the official translations of its Guidelines on stress tests scenarios under Article 28 of Regulation (EU) 2017/1131 of 14 June 2017 on money market funds (MMF Regulation). This represents part of the follow-up on ESMA's publication of its final report on MMFR, on 13 November 2017, which summarised the feedback received to the public consultation of May 2017 (ref.: ESMA34-49-82).

In a public statement published on 12 July 2018 (ref.: ESMA42-110-998), ESMA warned that there is no assurance that a transition period will be agreed upon between the United Kingdom and the EU, and that, consequently, entities need to consider the scenario where a hard Brexit would take place on 30 March 2019. ESMA informed the groups concerned to make sure that they have a fully authorised legal entity located in the EU at that date which may continue providing services in the EU Single Market. It should be noted that ESMA published, on 1 February 2019, a press release announcing that written no-deal Brexit agreements (Memoranda of Understanding - MoUs) had been concluded between EU/EEA securities regulators and the UK Financial Conduct Authority (FCA) as well as between ESMA and the FCA.

Whereas the MMF Regulation is applicable since 21 July 2018 for newly created funds, some implementation questions remained unanswered. On 20 July 2018, ESMA sent a letter to the European Commission to request a clarification on the share cancellation mechanism, also called reverse distribution mechanism in the context of the MMF Regulation (ref.: ESMA34-49-128). In its letter dated 4 October 2018, Commissioner Valdis Dombrovskis confirmed that the above-mentioned mechanism is incompatible with the legal framework established by the MMF Regulation.

On 7 August 2018, ESMA replied to some questions addressed by EIOPA with respect to the AIFMD and concerning the definition of AIFs and leverage (ref.: ESMA34-32-427).

On 28 September 2018, ESMA launched a public consultation on the draft guidelines on stress test scenarios of money market funds (ref.: ESMA34-49-131). The consultation was open until 1 December 2018 and ESMA intends to finalise the guidelines in the first half of 2019. In the same context, starting from the end of the first quarter of 2020, European money market funds will also have to disclose some information under this regulation to their national competent authorities. In order to anticipate these obligations, ESMA launched, on 13 November 2018, a public consultation on its draft guidelines providing specifications on how to fill in the reporting template to be sent by money market funds to their national competent authority (ref.: ESMA34-49-144). Stakeholders were requested to send their comments to this consultation until 14 February 2019.

Following the mandate entrusted to ESMA by the European Commission in July 2018, ESMA launched three public consultations on 19 December 2018 on measures promoting sustainability on EU capital markets, among which the consultation paper on integrating sustainability risks and factors in the level 2 texts relating to UCITS and AIFs (Directive 2010/43/EU and Delegated Regulation (EU) No 231/2013) which aims at incorporating these risks and factors in the provisions relating to the organisational requirements, resources, senior management responsibility, conflicts of interest, due diligence requirements and risk management (ref.: ESMA34-45-569). The consultation ended on 19 February 2019. ESMA intends to submit a draft technical advice to the European Commission by the end of April 2019.

During 2018, ESMA published several updates of its Q&As on the application of the AIFMD (ref.: ESMA34-32-352) and the Q&As on the application of the UCITS Directive (ref.: ESMA34-43-392).

¹⁶ <https://www.esma.europa.eu/regulation/fund-management>.

ESMA also worked on a consultation paper relating to the Guidelines on liquidity stress testing in UCITS and AIFs. This document was published on 5 February 2019 (ref.: ESMA34-39-784) and stakeholders were requested to submit their comments by 1 April 2019.

2.1.2. Consumer protection

On 30 May 2018, ESMA published the “Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments subject to the Bank Recovery and Resolution Directive” in relation to consumer protection.

In 2018, ESMA also prepared and published new Q&As concerning MiFID II/MiFIR.

On 1 June 2018, ESMA published a “Notice of ESMA’s Product Intervention Decisions on CFDs and binary options” on ESMA’s intervention measures under MiFIR relating to CFDs and binary options. On 9 November 2018, in connection with these intervention measures, ESMA published the “Questions and Answers on ESMA’s temporary product intervention measures on the marketing, distribution or sale of CFDs and binary options to retail clients”.

On 19 December 2018, ESMA published a “Reminder to firms on their MiFID obligations on disclosure of information to clients in the context of the United Kingdom withdrawing from the European Union”.

Moreover, ESMA published several guidelines related to investor protection, i.e.:

- Guidelines on MiFID II product governance requirements (5 February 2018); and
- Guidelines on certain aspects of the MiFID II suitability requirements (6 November 2018).

3. COOPERATION WITHIN OTHER EUROPEAN BODIES

3.1. European Insurance and Occupational Pensions Authority (EIOPA)

EIOPA, composed of the representatives of the EEA insurance and occupational pensions authorities (including the CSSF), assists the European Commission in the preparation of technical measures relating to EU legislation on insurance and occupational pensions and ensures the harmonised and continuous application of the European legislation in the Member States. One of EIOPA’s key missions is the protection of the policyholders as well as of the members and beneficiaries of occupational pension schemes.

3.2. Committee of European Auditing Oversight Bodies (CEAOB)

Established by Regulation (EU) No 537/2014, the CEOB is the body for cooperation between the different public audit oversight authorities in the EU. Among its members are the representatives of the European national authorities, including the CSSF, the European Commission and ESMA. Representatives of the EEA national authorities also participate in the meetings, as well as the EBA and EIOPA as observers.

The objective of the CEOB’s work is to consistently support audit quality and, consequently, to keep and increase confidence of investors and the broader public in financial reporting in the EU. The supervision of auditors on a national level and the audit firms’ operations on an EU and global level need to be addressed by providing a practical, consistent and comprehensive platform for cooperation of audit regulators under the CEOB framework. To this end, the CEOB’s 2019 work programme has been designed to reflect the following four pillars: cooperation, communication, interconnectivity and monitoring.



CHAPTER III

MACROPRUDENTIAL SUPERVISION OF THE FINANCIAL SECTOR

Macroprudential supervision aims at ensuring a global supervision of the financial system as a whole and ensuring that financial stability is maintained at a system-wide level. This is essential for the proper functioning of the financial system and the mitigation of threats that could translate to the real economy. The macroprudential policy framework supplements the microprudential approach to banking supervision. At the CSSF, the macroprudential policy division is embedded in the SSM department and contributes to work at national and international level. Both areas are strongly intertwined and the coordination is essential.

1. MACROPRUDENTIAL SUPERVISION IN THE EUROPEAN AND NATIONAL CONTEXT

1.1. European Systemic Risk Board (ESRB)

The European Systemic Risk Board (ESRB) is the authority in charge of the macroprudential oversight at European level. The ESRB deals with financial stability issues for the whole financial sector, including banks, insurance companies, financial markets and non-bank financial intermediation in the EU. The ESRB analyses the dependencies, interconnectedness and contagion mechanisms between sub-sectors of the economy. The work of the ESRB complements that of the Financial Stability Board (FSB) at global level. As designated macroprudential authority under the CRD/CRR, the CSSF participates in the ESRB work through its committees and working groups. The ESRB issues recommendations and opinions which may be addressed to the Systemic Risk Committee (Comité du Risque Systémique), the Luxembourgish macroprudential authority, and thus affect the financial sector in Luxembourg.

1.2. European Central Bank (ECB)

The SSM Regulation, which put in place the Single Supervisory Mechanism (SSM), assigned certain powers to the ECB that are specific to macroprudential supervision. The ECB is empowered to impose more stringent macroprudential measures than those originally envisaged by the national authorities (the so-called top up power) under the CRD IV. At the ECB level, the aspects linked to the field of macroprudential policy are discussed within the Macro-Prudential Joint Forum, which gathers the members of the Governing Council of the ECB and of the SSM Supervisory Board. The work of the Macro-Prudential Joint Forum is prepared by the Financial Stability Committee (FSC), in which all the SSM member authorities, including the CSSF, participate.

1.3. Systemic Risk Committee (SRC) - Comité du Risque Systémique (CdRS)

The SRC has been established as the Luxembourg macroprudential authority by the Law of 1 April 2015¹ with the mandate to coordinate the implementation of macroprudential policy at national level. The SRC has been established in the form of a college composed of the Ministry of Finance, the BCL, the CSSF and the Commissariat aux Assurances. The SRC is chaired by the Minister of Finance and the BCL is entrusted with the secretariat. The SRC is entitled to issue opinions, recommendations and warnings when it identifies risks that pose significant threats to financial stability in Luxembourg. The opinions, recommendations and warnings adopted by the SRC may be made public, if deemed appropriate. The CSSF is the national designated authority under CRD IV. As such, it is in charge of implementing macroprudential policies in consultation with the BCL and after requesting the opinion or recommendation of the SRC.

In 2018, the SRC met two times in order to discuss the risks and vulnerabilities to financial stability and related issues. The discussions focussed in particular on risks relating to residential real estate, cyclical risk, systemic institutions in Luxembourg and linkages between banks and investment funds and non-bank credit intermediation in Luxembourg. Specific examples of the work of the SRC in 2018 are the preparatory work for a legal framework for borrower-based measures in the real estate market that was transmitted to the Minister of Finance as well as analyses of the evolution of credit to the domestic private sector in Luxembourg and its underlying drivers.

In 2018, the SRC also issued four recommendations on the setting of the countercyclical capital buffer, an opinion on the institutions considered as systemically important at national level and a recommendation regarding the reciprocation of a macroprudential measure implemented in Finland.

¹ Law of 1 April 2015 establishing a Systemic Risk Committee and amending the law of 23 December 1998 concerning the monetary status and the Banque centrale du Luxembourg, as amended.

Opinions and recommendations of the SRC and the corresponding CSSF decisions

SRC recommendation/opinion	CSSF relevant decision
Recommendation of the Systemic Risk Committee of 26 February 2018 concerning the setting of the countercyclical buffer rate for the second quarter of 2018 (CRS/2018/001)	CSSF Regulation N° 18-01
Recommendation of the Systemic Risk Committee of 6 April 2018 concerning the reciprocation of the 15% minimum average risk weight measure for exposures secured by a mortgage on housing units in Finland adopted by Finanssivalvonta (CRS/2018/002)	
Recommendation of the Systemic Risk Committee of 14 June 2018 concerning the setting of the countercyclical buffer rate for the third quarter of 2018 (CRS/2018/003)	CSSF Regulation N° 18-04
Recommendation of the Systemic Risk Committee of 10 September 2018 concerning the setting of the countercyclical buffer rate for the fourth quarter of 2018 (CRS/2018/004)	CSSF Regulation N° 18-05
Opinion of the Systemic Risk Committee of 18 September 2018 concerning the annual designation and buffer calibration of other systemically important institutions (CRS/2018/005)	CSSF Regulation N° 18-06
Recommendation of the Systemic Risk Committee of 10 December 2018 concerning the setting of the countercyclical buffer rate for the first quarter of 2019 (CRS/2018/006)	CSSF Regulation N° 18-07

2. IMPLEMENTATION OF MACROPRUDENTIAL POLICY UNDER THE CRD IV/CRR

The CRD IV framework has endowed national authorities with the capacity to set capital buffers and other requirements that address macroprudential concerns in the financial system. The capital conservation buffer is a general buffer to protect bank capitalization. The (G-SII) O-SII buffer addresses systemic importance of institutions at the (global) domestic level. The countercyclical buffer is intended to strengthen bank resilience in the face of strongly increasing credit to the economy. The measures under Article 458 of the CRR can introduce other, more specific, instruments to address macroprudential vulnerabilities. In order to increase the efficiency of macroprudential supervision and minimize the potential for spillovers, the ESRB can also recommend the reciprocation of measures of other countries' authorities. The CSSF activates its macroprudential tools when systemic risk is increasing and threatens stability in the financial system and the real economy. The decisions on macroprudential measures in Luxembourg are taken by the CSSF, in consultation with the BCL, after requesting the opinion or recommendation of the SRC and duly taking into account the comments of the ECB.

2.1. Luxembourg real estate market

The Luxembourg real estate market has been buoyant for many years. A strong growth in the population combined with a limited supply in housing drove up the residential property prices. Banks have accommodated the real estate demand through a strong increase in housing credit. This contributes to increasing levels of household indebtedness. At macroprudential level, these developments generate financial stability concerns. The repayment capacity of households is strongly linked to the evolution of interest rates and the value of household wealth depends on the continuous growth of real estate prices. For several years, the CSSF and the BCL have been closely following the developments on the Luxembourg real estate market. The follow-up of these analyses features regularly on the agenda of SRC meetings.

In November 2016, the ESRB issued public warnings for eight countries, including Luxembourg, on medium-term residential real estate vulnerabilities. Moreover, in May 2017, the IMF published its Financial System Stability Assessment for Luxembourg following the Financial Sector Assessment mission that took place in September and December 2016. Among the several IMF findings and recommendations, the IMF recommended the Luxembourg authorities to “enhance the macroprudential policy toolkit to include borrower-based lending limits”, to “continue to strengthen risk-based monitoring of the residential real estate market” and to “close remaining related data gaps”. As a follow-up of the ESRB warning and the IMF recommendations, the SRC prepared a bill implementing a legal framework for borrower-based measures. The Luxembourg Government deposited the bill in Parliament in December 2017. The bill would enable the SRC in cooperation with the BCL and the CSSF to enact borrower-based measures such as loan-to-value and debt service-to-income limits. This bill has not been voted yet given the reservations emitted by the different stakeholders including the State Council.

In November 2016, the ESRB also published the “Recommendation on closing real estate data gaps” (ESRB/2016/14), inviting Member States to collect a set of indicators from the residential and commercial real estate markets to better assess the risks arising from the real estate sector. As a follow-up to the ESRB and IMF recommendations, the CSSF was invited in 2017 by the SRC to work on the quality of the data provided by banks on both residential and commercial real estate loans in order to achieve harmonised definitions and reporting and improve cross-bank comparisons. To this end, the CSSF set up a dedicated working group which gathers all the banks active in the residential real estate market. The work performed has resulted in the publication of Circular CSSF 18/703 requiring lenders in residential real estate to report borrower-based risk metrics. This circular requires all banks active in the residential real estate sector in Luxembourg to report on their exposures and lending practices.

Finally, the CSSF plans to start publishing a regular newsletter regarding developments in the real estate sector in the course of 2019.

2.2. Cyclical risk

In order to limit cyclical risk stemming from excessive credit growth and to mitigate pro-cyclicality of regulatory capital requirements, the Basel Committee on Banking Supervision introduced a countercyclical capital buffer. The countercyclical capital buffer (CCyB) is a key macroprudential instrument to mitigate systemic risks so as to enhance the resilience of the banking sector and, in so doing, reduce the pro-cyclicality of the financial system. This is achieved by ensuring that bank capital buffers are built up in a timely manner during a financial upswing and released when risks materialize so as to support lending. The framework for setting the CCyB in the EU is based on the Basel Committee guidance from 2010, the CRD IV and ESRB Recommendation 2014/1.

Every quarter, the CSSF calculates a benchmark rate for the constitution of the countercyclical capital buffer which, together with risk assessments by the BCL, is submitted to the SRC. The calibration process considers the evolution of a set of indicators reflecting the credit cycle and taking into account the specificities of the Luxembourg economy. The growth rate of credit to the Luxembourg non-financial sector has been high in recent quarters and has required the need for an early intervention. Considering the complementary analyses of the BCL and the CSSF indicating an increase in cyclical risk alert indicators, the SRC has recommended to set the countercyclical buffer rate in Luxembourg at 0.25%. The rate has been announced on 31 December 2018 and will be applicable as of 1 January 2020².

2.3. Structural risk

Structural systemic risks are to be addressed through the O-SII buffer³. The O-SII capital buffer is one of the instruments available in the CSSF’s macroprudential toolkit aiming at strengthening the resilience of institutions that are structurally important to the local financial system and the local economy by imposing an additional capital buffer. It can help to increase the stability of the financial system by reducing the probability of default of the designated institutions and the impact such default would have on the real economy.

² Please refer to CSSF Regulation N° 18-07 (<http://www.cssf.lu/surveillance/surveillance-macroprudentielle/macroprudential-instruments/ccyb/>).

³ O-SII stands for “Other Systemically Important Institutions” and designates financial institutions that are systemically important from a domestic perspective. This is in opposition to “Globally Systemic Institutions” as determined by the FSB (www.fsb.org).

In 2018, the CSSF, acting as designated authority, identified eight domestic financial institutions as systemically important. These institutions were designated in a step-wise approach. As a first step, systemically important institutions are designated according to the EBA standard methodology. The main identification criteria of this methodology are the size, the importance for the economy, the complexity and the degree of interconnection with the financial system. In a second step, the assessment framework is augmented to take into account interconnectedness with other banks and the fund industry and the importance for the investment fund sector. Based on these criteria, the CSSF in cooperation with the BCL and after recommendation of the SRC, designated eight institutions which are required to hold an O-SII buffer in 2019.

Buffer rates for systemically important institutions in Luxembourg

Denomination	Buffer rate as of 1 January 2018	Buffer rate as of 1 January 2019
Banque et Caisse d'Épargne de l'État, Luxembourg	0.375%	0.50%
Banque Internationale à Luxembourg - BIL	0.375%	0.50%
BGL BNP Paribas	0.375%	0.50%
Clearstream Banking S.A.	0.375%	0.50%
Deutsche Bank Luxembourg S.A.	0.375%	0.50%
Société Générale Bank & Trust	0.75%	1% ⁴
J.P. Morgan Bank Luxembourg S.A.	0.375%	0.50%
RBC Investor Services Bank S.A.	0.375%	0.50%

The first six banks were automatically designated as O-SIIs based on their score of systemic importance computed in accordance with the EBA Guidelines. J.P. Morgan Bank Luxembourg S.A. and RBC Investor Services Bank S.A. were identified through a supervisory judgement based on the information obtained from the supplementary indicators. The buffer requirements of each institution were gradually phased-in from 1 January 2016 to 1 January 2019. As of 2019, the banks need to comply with the fully phased-in buffer requirements.

2.4. Reciprocation of macroprudential measures

The macroprudential measures implemented in a country may directly or indirectly impact other countries. To reduce potential for arbitrage of financial institutions between Member States, the ESRB introduced, for the application of macroprudential tools rooted in the CRD IV, a framework for reciprocating measures of other authorities in case no automatic reciprocity is foreseen. This reciprocation is however subject to a materiality threshold. In 2018, the CSSF did not reciprocate the implemented measures by other EU countries as exposures of Luxembourg banks toward the implementing countries were below the materiality threshold.

2.5. Non-bank financial intermediation and interconnectedness between banks and investment funds

Non-bank financial intermediation (NBFI)⁵ has gained considerable attention at international level since the financial crisis. The term describes credit intermediation that takes place outside of the regulated banking system. Several international institutions including the ESRB at European level and the FSB investigate this sector and provide an overview at global level. This is necessary given the international scope of global finance.

The CSSF closely follows and contributes to the ESRB analyses on NBFI. In September 2018, the third edition of the report "EU Shadow Banking Monitor" jointly prepared by the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC) was published⁶. The report assesses structural changes in the shadow banking sector and gives an overview of the main risks associated with shadow banking activities that may affect financial stability in Europe.

⁴ In accordance with Article 59-9 (4) of the Law of 5 April 1993 on the financial sector, the buffer rate applicable to Société Générale Bank & Trust has been lowered from 2% to 1%.

⁵ Formerly, the term "shadow banking" was used. Since 2018, it has been replaced with the term "non-bank financial intermediation" which is more precise with respect to the described phenomenon.

⁶ https://www.esrb.europa.eu/pub/pdf/reports/esrb.report180910_shadow_banking.en.pdf.

The CSSF participated in 2017 and 2018 in the FSB shadow banking monitoring exercise, renamed in the course of 2018 “non-bank financial intermediation monitoring exercise”. In the context of this exercise, the authorities reported detailed data on non-bank financial intermediation and interconnectedness between financial sectors. To this end, the “Global Monitoring Report on Non-Bank Financial Intermediation” was published in February 2019⁷. This report presents the results of the FSB’s eighth annual monitoring exercise. It covers data up to end-2017 from 29 jurisdictions, which together represent over 80% of global GDP. As in previous years, the report compares the size and trends of financial sectors in aggregate and across jurisdictions based primarily on sectoral balance sheet data. The report also focuses on those parts of NBFIs that may pose bank-like financial stability risks.

The developments in the shadow banking system are also closely monitored by the SRC. In-depth analyses have been conducted by the members of the SRC in previous years through the work of different sub-groups.

The CSSF also participated in the discussion within the ESRB to establish commonly recognized liquidity and leverage management tools. This effort covers liquidity management tools, liquidity stress testing for investment funds and a harmonized reporting framework in leverage. The work came to fruition in the ESRB recommendation ESRB/2017/6 on liquidity and leverage risks in investment funds, which was published on the ESRB website in February 2018.

⁷ <http://www.fsb.org/wp-content/uploads/P040219.pdf>.



CHAPTER IV

THE INTERNATIONAL DIMENSION OF THE CSSF'S MISSION

1. BASEL COMMITTEE ON BANKING SUPERVISION

The CSSF participates in the work of the Basel Committee, the main sub-committees (Accounting Experts Group, Policy Development Group and Supervision and Implementation Group) and some working groups which are particularly relevant for the prudential supervision in Luxembourg, notably the Anti-Money Laundering Expert Group, the Large Exposures Group and the Working Group on Liquidity.

In 2018, the Basel Committee completed its work on market risk, supplementing the “Basel III” reforms finalised in 2017. The revision of the prudential treatment for market risk is a response to the lessons learned from the 2008 financial crisis. The framework proposes an adequate prudential approach for trading books exposed to market risk. The new rules, published on 14 January 2019, should apply as from 1 January 2022. The Luxembourg banking sector has no major exposure to market risk.

Other publications of the Basel Committee in 2018 included the criteria for identifying simple, transparent and comparable short-term securitisations and their capital treatment (14 May 2018) and a report on bank, regulatory and supervisory cyber-resilience practices with respect to the malicious use of information and communication technologies (4 December 2018). Finally, the Basel Committee issued a revised version of its stress testing principles on 17 October 2018.

In conjunction with its regulatory work, the Basel Committee continued its monitoring and assessment programme for the implementation of the agreed reforms (RCAP programme). In 2018, peer reviews covered liquidity rules (NSFR) and large exposures.

All the publications of the Basel Committee and information on its mission and organisational structure are available on the website www.bis.org.

2. INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

2.1. 43rd Annual Conference of the International Organization of Securities Commissions (IOSCO)

The securities markets regulators, including the CSSF, and other members of the international financial community met in Budapest from 7 to 11 May 2018, on the occasion of the 43rd Annual Conference of IOSCO.

During this conference, which focussed on the main challenges facing securities regulators, the IOSCO Board and its different committees advanced their initiatives aimed at protecting investors, ensuring fair, efficient and transparent markets and mitigating systemic risk.

It has been agreed to:

- develop a Support Framework to assist members in addressing the domestic and cross-border issues stemming from ICOs (Initial Coin Offerings, i.e. a method to raise funds via the issuance of exchangeable digital assets against crypto-currencies) which could impact investor and consumer protection; members also discussed the strengthening of efficient practices aiming to protect retail investors from the risks stemming from the offer of binary options and other OTC leveraged products;
- assess the consistency in implementation by various IOSCO members of money market fund (MMF) reforms against IOSCO's 2012 recommendations for MMFs;
- establish an information-sharing network among IOSCO members to gain insight into the issues around sustainability, including the details of issuer disclosure and its relevance to investor decision making;
- launch a FinTech network to serve as a forum for collaborative work on regulatory issues, trends and emerging risks.

Finally, as a reminder, IOSCO introduced, in 2017, an enhanced version of the 2002 Multilateral Memorandum of Understanding concerning consultation and cooperation and the exchange of information. This Enhanced Multilateral Memorandum of Understanding (EMMoU) expands the range of enforcement powers that signatories may use to improve the efficiency, integrity and stability of their markets. The number of signatories grew from 118 IOSCO members to 146.

2.2. Work of the IOSCO Committees

In 2018, IOSCO published the following documents, drafted by its Committee 5 on Investment Management:

- the reports "Recommendations for Liquidity Risk Management for Collective Investment Schemes" (ref.: FR01/2018) and "Open-ended Fund Liquidity and Risk Management - Good Practices and Issues for Consideration" (ref.: FR02/2018);
- the consultation paper "Leverage" (ref.: CR08/2018), based on the final recommendations of the Financial Stability Board (FSB) published on 12 January 2017, which aims at collecting comments on a draft framework to measure the use of leverage in investment funds which, under certain circumstances, could pose a risk to financial stability.

At the end of 2018, IOSCO launched the "5th Hedge Fund Survey" with the participating Member States industry (including Luxembourg) on data as at 30 September 2018. It also continues its work on investor-related issues and arbitrage and trading issues concerning ETFs (Exchange Traded Funds).

The CSSF is also an active member of the IOSCO Assessment Committee as well as of its Implementation Task Force Sub-Committee. The Assessment Committee was established in February 2012 in order to organise and structure a programme to identify and assess implementation of IOSCO's Objectives and Principles of Securities Regulation and other IOSCO standards and policies across the IOSCO membership. By ensuring implementation of these standards, IOSCO seeks to improve investor protection, enhance market efficiency and reduce systemic risks. Thus, the Assessment Committee conducts thematic reviews of particular IOSCO Principles and Standards across IOSCO membership and country reviews for jurisdictions whose regulation of securities is not part of the IMF or World Bank programmes. Another objective of the Assessment Committee is to maintain the IOSCO Principles and Methodology, which involves supporting users of the methodology, updating the methodology and assessing the need to update the IOSCO Principles.



Agents hired in 2018 and 2019: Departments “UCI on-site inspections”, “Authorisation and supervision of investment fund managers and securitisation undertakings”, “Operations and coordination of the UCI departments’ specific IT tools” and “Prudential supervision and risk management”

From left to right: Monica BAJAN, Thomas KLEIS, Nathan HENRY, Raquel CIRIA GASPAS, Ludovic GORGEU, Sandra LADHIBI, Mario ZARDONI, Karine EVORA, Roland KREMER

Absent: Edin DAUTBASIC, Magalie HUART



CHAPTER V

FINANCIAL INNOVATION

The financial technologies, commonly called FinTech, affect all the financial sector activities and increasingly reshape the way these activities are carried out and the related financial services are used by clients.

Integration of evolving technology based innovation in financial services and markets is a continuing challenge for regulators such as the CSSF, calling:

- on the one hand for a proactive flexible regulatory approach in order to not hinder new opportunities and benefits by putting excessive regulatory barriers for innovation; and
- on the other hand for a prudent risk based regulatory approach in order to perform the CSSF duties of prudential supervision and supervision of the markets for the purposes of ensuring the safety and soundness of the financial sector with a special focus on consumer protection, confidence in markets and AML issues.

Bearing in mind the international and crossborder nature of the Luxembourg financial sector as well as the European regulatory dimension, the CSSF has taken the decision not to put into place a so called “Sandbox” because of its inherent limited national business scope, but to develop a combination of different regulatory FinTech approaches of wider reach, i.e. open dialogue and meetings with existing and new FinTech actors, guidance to the industry, interaction with market players, communications on specific trends, participation in international initiatives and working groups as well as cooperation agreements.

Within this framework, in order to gain the best possible understanding of FinTech developments and expectations of the industry and to address the forthcoming challenges, the CSSF is in permanent contact with market players. The CSSF has indeed the intention to play an active role in the changes initiated by the technological innovations in the financial sector and to accompany these changes so as to enable a gradual adaptation and smooth transition towards a more digitalised environment, while protecting the high standards of the financial sector concerning risk management and consumer protection.

To reach this goal, the CSSF invites not only start-ups with new business models, that require a regulatory response (notably in the payment sector) or guidance, to submit their project, but also those firms that, in

their quality as provider of “digital services supporting financial activities” (e.g. RegTech firms), may potentially contribute to future reshaping of partial or whole traditional business lines of incumbent actors of the financial sector. With a view to being proactive and promoting the dialogue, the CSSF remains open to consultation regarding the development and application of regulation and encourages market actors to contact the “Innovation and payments” division of the “Innovation, payments, markets infrastructures and governance” department or to send an email to innovation@cssf.lu in order to either present an innovative project, request information on the regulatory framework applicable to a project or to initiate a dialogue on new technologies or regulation that may impact the financial sector. These requests are handled by a dedicated team of FinTech specialists composed of lawyers and IT specialists and, if needs be, may include specialists from the different traditional business lines of the CSSF.

The CSSF is thus promoting a constructive and open dialogue with the FinTech industry, in the broadest sense of the term.

By enhancing the communication with the market players, the CSSF also ensures it monitors market evolution in order to anticipate challenges whilst extending its own knowledge. In this particular context, the CSSF further deepened the dialogue with the financial sector stakeholders on specific topics, such as the use of clouds, Distributed Ledger Technology (DLT) infrastructures or digital assets, to exchange views and enhance its capacity to address the challenges arising from FinTech. The CSSF tries to anticipate technological trends on which FinTech relies in order to acquire the essential elements for understanding prudential issues and the associated risks.

With that in mind and in order to promote visibility for the industry, as well as for the consumers, the CSSF created a page dedicated to FinTech on its website. The objective is to make all the CSSF publications and any relevant information related to FinTech easily accessible to the public.

In order to inform the public of its position on certain topics, the CSSF also published in 2018 a certain number of documents in the context of FinTech, among which its position on Robo-advice, an update of its “Frequently asked questions on AML/CTF and IT requirements for specific customer on-boarding/KYC methods” and a Whitepaper on “Artificial Intelligence, opportunities, risks and recommendations for the financial sector” and participated in several events and conferences to communicate its approach on FinTech to the financial sector.

The CSSF is taking a technology neutral approach as far as possible but the range of tools indicated above which are used by the CSSF to communicate with the industry is a good illustration of the fact that issues arising around FinTech impact on financial sector activities and markets might not always find an immediate one-size-fits-all solution in the existing actual regulatory framework. Thus, the CSSF will actively continue to follow evolutions for topics where it has already issued some guidance, as for example the use of clouds or digital customer onboarding, as well as for multiple unsolved fields, as for example prudential regulation of crypto assets exchanges or DLT risk mitigation.

Within this context, the CSSF also hosted several meetings of the working group dedicated to the FinTech sector which is composed of financial sector and CSSF experts in the FinTech area. Its objective is to monitor the evolutions in FinTech in order to better identify the implications, in particular, for the financial sector and the regulatory approach. In 2018, the FinTech Working Group concentrated on topics such as the use of clouds, Robo-advice, DLT Governance or digital assets.

Notwithstanding these national initiatives, the CSSF is also well aware that for the transfer towards an integrated and competitive FinTech sector, it is not sufficient that the CSSF adapts to the growing FinTech sector in Luxembourg only, but keeps aware of the global evolution. Therefore the CSSF is actively following and supporting the FinTech Action Plan adopted by the European Commission in March 2018, which notably considers that enhancing the convergence of supervisory practices and supporting the scaling-up of technological innovation in the financial sector across the EU are two key objectives.

Thus, the CSSF considers that national legislative initiatives and positions applying existing regulatory framework to new technologies should not foster further discrepancies between European legislations, and that more efforts must be deployed to promote convergence and consistency in the authorisation and supervision of the FinTech firms and digital assets, in order to interpret existing European legislations in the same way and to submit the same activities to the same rules and, thus, offering a level playing field between Member States for market actors and a comprehensive investor protection. Therefore, a common and harmonised response from the regulators of the financial sector is key for a successful development of a European FinTech sector.

In this context, the CSSF participates actively in different international working groups in order to enhance the Luxembourg position in the FinTech sector on the international scene and works with its European and international peers on the preparation of European and international standards for managing FinTech players.

On a European level, the CSSF was notably involved in working groups organised by the EBA and ESMA on issues related to the transposition of Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (PSD2), on reports and advice prepared on digital assets, innovation hubs and sandboxes. Moreover, the CSSF takes part in working groups organised by the ECB in particular on the impact of FinTech on credit institutions.

On an international level, the CSSF participates in the SIG Task Force on Financial Technology of the Basel Committee on Banking Supervision and in the FinTech Network organised by IOSCO, in order to study the financial innovations and the views of the foreign authorities in this area and strengthen its relationships with other national competent authorities.

It should also be mentioned that on 4 October 2018, the CSSF entered into a Cooperation Agreement with the Australian Securities and Investments Commission, providing a framework for information sharing between the two regulators on FinTech and RegTech and that on 22 November 2018, the CSSF entered into a Cooperation Agreement with the Abu Dhabi Global Market Financial Services Regulatory Authority which provides a framework for cooperation as regards referrals of innovator businesses. This agreement enables the authorities to refer these businesses to their respective innovation functions and to share information, in order to further the promotion of innovation in their respective markets.



Agents hired in 2018 and 2019: Department “On-site inspection”

From left to right: Saïd QACEME, Lucian MURGULET, Davina SINZINKAYO, Bertrand INIGUES, Yawei GUAN, Lucie BEDROSSIAN, Stefano HEINEN, Sandrine KAYSER-MEUNIER, Arno KALKBRENNER, Sara FAUTSCH, Guillaume BÉNARD, Stefanie FRISCH, Moritz BITTER, Bastien STEINMETZ

Absent: Maida ALIBASIC, Olivier DE COLNET, Konstantin BURGER, Pedro DA SILVA MOREIRA



Agents hired in 2018 and 2019: Departments “Executive Board secretariat”, “Information systems and supervision of support PFS”, “Resolution”, “Supervision of securities markets” and “Innovation, payments, market infrastructures and governance”

From left to right: Raoul DJEUTANÉ, Aikaterini HÖGL, Susanne GOLDACKER, Sylvie MOTA, Gaëlle ARCADIAS, Sakia BOULEHAIS, Clément COTEL, Carlos LIPARI, Delphine BAYON, Maikel VELOSO, Alix KHALDI

Absent: Caroline DRESSE, Patrick NEUMANN, Danielle NORRBY, Muamer TABAKOVIC



CHAPTER VI

SUPERVISION OF BANKS

1. DEVELOPMENTS IN THE BANKING SECTOR IN 2018

1.1. Characteristics of the Luxembourg banking sector

The Luxembourg banking legislation provides for two types of banking licences, namely that of universal banks (132 institutions had this status on 31 December 2018) and that of banks issuing covered bonds (three institutions had this status on 31 December 2018). The main characteristics of the banks issuing covered bonds are the monopoly of covered bond issuance and the prohibition to collect deposits from the public.

Depending on their legal status and geographical origin, the banks belong to one of the following three groups:

- banks incorporated under Luxembourg law (number: 89 on 31 December 2018);
- branches of banks incorporated in an EU Member State or assimilated (number: 32 on 31 December 2018);
- branches of banks incorporated in a non-EU Member State (number: 14 on 31 December 2018).

Furthermore, there is one special case: the *caisses rurales* (number: 13 on 31 December 2018) and their central establishment, Banque Raiffeisen, are to be considered as a single credit institution according to the law on the financial sector.

1.2. Development in the number of credit institutions

With 135 entities authorised at the end of the financial year 2018, the number of banks dropped by four entities as compared to 31 December 2017 when 139 entities were active.

Six banks were deregistered from the official list during 2018:

- Danieli Banking Corporation S.A. 18 May 2018: Change of corporate purpose and change of name to Danieli Finance Solutions S.A.
- Standard Chartered Bank, Luxembourg Branch 31 May 2018: Cessation of activities.
- UniCredit Luxembourg S.A. 20 July 2018: Merger with UniCredit Bank AG, München.
- Société Générale LDG S.A. 15 October 2018: Cessation of activities.
- BNP Paribas Wealth Management (Luxembourg) 1 November 2018: Merger with BGL BNP Paribas.
- BTG Pactual Luxembourg S.A. 27 December 2018: Cessation of activities.

Two banks started their activities in 2018:

- Banco Santander (Brasil) S.A., Luxembourg Branch 23 March 2018: The bank carries out the activity of commercial banking and global wholesale banking.
- UniCredit Bank AG, Luxembourg Branch 26 June 2018: The bank carries out credit activities in the area of corporate finance and trade finance.

The total number of branches established by Luxembourg credit institutions in other EU/EEA Member States amounted to 77 as at 31 December 2018. On the same date, the number of branches set up in Luxembourg by credit institutions originating from other EU/EEA Member States totalled 32 entities.

Branches established in the EU/EEA as at 31 December 2018 broken down by Member State

Country	Branches of Luxembourg banks established in the EU/EEA	Branches of EU/EEA banks established in Luxembourg
Austria	1	-
Belgium	9	1
Cyprus	1	1
Denmark	2	-
Finland	1	-
France	8	4
Germany	4	15
Greece	1	-
Ireland	5	1
Italy	9	-
Netherlands	6	1
Norway	1	-
Poland	4	-
Portugal	3	2
Spain	9	1
Sweden	4	2
United Kingdom	9	4
Total	77	32

1.3. Development in banking employment

As at 31 December 2018, the number of employees in Luxembourg credit institutions amounted to 26,317, compared to 26,149 as at 31 December 2017, representing an increase of 168 people on an annual basis.

Whereas employment remained stable in 11.3% of the banks, the staff increase in 52.5% of the banks offset the reduction in staff numbers recorded in 36.2% of the financial centre's banks.

Compared to the figures of December 2017, the distribution of employment according to men and women remained almost unchanged. However, an increase in the number of employees with an academic background higher than the "BAC+5" (master's) degree was noticeable (+4.7%), whereas employees whose education is equivalent or below the "BAC" degree declined (-3.8%).

1.4. Development of balance sheet and off-balance sheet items

1.4.1. Balance sheet total of credit institutions

Overall, the banking activity, as evidenced by the balance sheet total, recorded a sound development in 2018. The 3.0% increase of the balance sheet total is attributable to 59% of the financial centre's banks, representing 73% of the balance sheet total at the end of 2018.

The banking market concentration, as evidenced by the balance sheet total per bank, remained stable compared to the index of 2017.

1.4.2. Development of the aggregate balance sheet structure

As regards assets, the most significant increase, expressed as an absolute amount, was recorded in **loans and advances to customers** (+5.8%). The steady progress of banking intermediation has been beneficial to households as well as non-financial undertakings, whereas the credits granted to financial undertakings declined.

The trend towards a significant increase of **loans and advances to central banks and general governments**, observed since 2016, continued in 2018. Loans and advances to central banks grew by 9.0% to EUR 116 billion at the end of 2018. The surge of loans and advances to central banks is explained by the objective to comply with the Liquidity Coverage Requirement (LCR).

In the absence of an exemption granted by the competent authorities as provided for in Article 8 of Regulation (EU) No 575/2013 of 26 June 2013, credit institutions made more use of deposits with central banks deemed as high quality liquid assets eligible for the calculation of the LCR. This trend led towards a greater fragmentation of financial flows within the euro area and contributed to a deterioration of the profitability outlook for banks, particularly against the backdrop of the current application of negative interest rates on deposits by the ECB.

As far as liabilities are concerned, **amounts owed to customers**, consisting of deposits made by non-financial and financial undertakings, private customers and/or retail customers, as well as of current accounts of investment funds, continued to rise considerably in 2018 (+4.4%). The automatic exchange of financial information between Member States did thus not lead to a decline of this important financing source of Luxembourg credit institutions. On the contrary, throughout 2018, it recorded a positive development for all types of customers.

The year-by-year decrease of **capital and reserves** is due to the restructuring of one bank of the financial centre. Excluding the negative development of capital and reserves of this bank, the level of capital and reserves of the other Luxembourg credit institutions remained stable.

Aggregate balance sheet total - in million EUR

ASSETS	2017 ¹	2018 ²	Variation	LIABILITIES	2017	2018 ³	Variation
Loans and advances to central banks and general governments	116,375	123,553	6.2%	Amounts owed to central banks	8,370	7,059	-15.7%
Loans and advances to credit institutions	266,448	276,379	3.7%	Amounts owed to credit institutions	232,617	240,736	3.5%
Loans and advances to customers	219,344	232,116	5.8%	Amounts owed to customers	362,106	378,189	4.4%
Fixed-income securities	120,044	119,420	-0.5%	Amounts owed represented by securities	62,065	65,973	6.3%
Variable-yield securities	7,784	7,444	-4.4%	Liabilities (other than deposits) held for trading	4,943	6,127	24.0%
Fixed assets and other assets	21,579	15,466	-28.3%	Provisions	3,427	3,042	-11.2%
				Subordinated liabilities	4,117	3,953	-4.0%
				Other liabilities	13,409	12,427	-7.3%
				Capital and reserves	60,520	56,872	-6.0%
Total	751,574	774,378	3.0%	Total	751,574	774,378	3.0%

Structure of the aggregate balance sheet

ASSETS	2017	2018 ⁴	LIABILITIES	2017	2018 ⁵
Loans and advances to central banks and general governments	15.48%	15.96%	Amounts owed to central banks	1.11%	0.91%
Loans and advances to credit institutions	35.45%	35.69%	Amounts owed to credit institutions	30.95%	31.09%
Loans and advances to customers	29.18%	29.97%	Amounts owed to customers	48.18%	48.84%
Fixed-income securities	15.97%	15.42%	Amounts owed represented by securities	8.26%	8.52%
Variable-yield securities	1.04%	0.96%	Liabilities (other than deposits) held for trading	0.66%	0.79%
Fixed assets and other assets	2.87%	2.00%	Provisions	0.46%	0.39%
			Subordinated liabilities	0.55%	0.51%
			Other liabilities	1.78%	1.60%
			Capital and reserves	8.05%	7.34%
Total	100.00%	100.00%	Total	100.00%	100.00%

¹ The final figures for 2017 concerning "loans and advances to customers" and "fixed assets and other assets" published in the 2018 Annual Report are substantially different from the preliminary figures for 2017 published in the 2017 Annual Report. This difference is the result of a reclassification of these two items by a bank after the editorial deadline for the 2017 Annual Report.

² Preliminary figures.

³ Preliminary figures.

⁴ Preliminary figures.

⁵ Preliminary figures.

1.4.3. Use of derivative financial instruments by credit institutions

The use of derivative instruments by credit institutions mainly takes place in the context of hedging of own positions and transactions on behalf of their clients.

Notional amounts of derivative financial instruments

Notional amounts (in bn EUR)	2017	2018 ⁶	Variation		Structure	
			in volume	en %	2017	2018 ⁷
Interest rate derivatives	175.1	207.8	32.7	18.7%	24.5%	25.5%
Equity derivatives	18.3	18.2	-0.1	-0.5%	2.6%	2.2%
Foreign exchange derivatives	510.4	575.0	64.6	12.7%	71.3%	70.6%
Credit derivatives	12.0	13.1	1.1	9.2%	1.7%	1.6%
Total	715.8	814.1	98.3	13.7%	100.0%	100.0%

1.4.4. Off-balance sheet

As at 31 December 2018, the contingent exposures of the Luxembourg banking sector through loan commitments and financial guarantees amounted to EUR 125.7 billion, against EUR 151.2 billion at the end of 2017, which represents a 16.9% decrease over a year.

1.5. Development in the profit and loss account

Net profit for the year 2018 dropped by 3.2% compared to the financial year 2017. Despite the positive development of income generated by the main businesses of the credit institutions, i.e. net interest income and net fee and commission income, the sharp fall of other net income and the ongoing growth of general expenses contributed to the negative result at aggregate level.

Development in the profit and loss account – in million EUR

	2017	Relative share	2018 ⁸	Relative share	Variation	
					in volume	in %
Net interest income	4,886	42%	4,986	43%	100	2.0%
Net fee and commission income	4,706	40%	4,959	42%	253	5.4%
Other net income	2,166	18%	1,741	15%	-425	-19.6%
Banking income	11,758	100%	11,686	100%	-72	-0.6%
General expenses	-6,253	-53%	-6,627	-57%	374	6.0%
<i>of which: staff costs</i>	-3,161	-27%	-3,253	-28%	92	2.9%
<i>of which: general administrative expenses</i>	-3,092	-26%	-3,374	-29%	282	9.1%
Profit before provisions	5,505	47%	5,059	43%	-446	-8.1%
Net creation of provisions	-956	-8%	-710	-6%	-246	-25.7%
Taxes	-827	-7%	-747	-6%	-80	-9.7%
Net profit for the year	3,722	32%	3,602	31%	-120	-3.2%

⁶ Preliminary figures.

⁷ Preliminary figures.

⁸ Preliminary figures.

1.5.1. Negative developments of the profit and loss account

The development of **other net income** was marked again by strong volatility which notably resulted from non-recurring effects usually registered by a limited number of banks. The main reasons for the decline in this item were the following, in decreasing order of importance: (i) a drop of other income, in particular following accounting reclassifications to the item “net fee and commission income”, (ii) a decrease in the gains arising from securities portfolios, (iii) an increase in other expenses, and (iv) a decrease in dividends received.

With an increase of 6.0% year-on-year, **general expenses** continued their upward trend recorded these last years. Since 2014, the growth of general expenses has accelerated to an average annual rate of 7.3%, compared to a long-term average annual growth rate of 3.6% measured between 2001 and 2018. The rise in general expenses has greatly contributed to the negative development of the net profit for the year 2018. Among general expenses, general administrative expenses registered the most significant increase with 9.1% during 2018. Whereas one part of general administrative expenses was due to investments in new technical infrastructures and other productive projects, another substantial part of these expenses was directly linked to the compliance by the banks with steadily accumulating new accounting and regulatory standards.

The growth in expenses linked to banking business gradually contributed to an erosion of profitability in a growing number of the financial centre’s banks. In fact, besides cases specific to each bank, the lack of economies of scale represented the main challenge to make operations profitable. Twenty-one banks (18 at the end of 2017), active for at least three years, had a cost-to-income ratio exceeding 100%; they represented 6% (4% at the end of 2017) of the balance sheet total of the financial centre and 8% (3% at the end of 2017) of overall employment in the banking sector. Overall, the Luxembourg banking sector recorded a decline in aggregate profitability as evidenced by the cost-to-income ratio which has risen from 53% in 2017 to 57% in 2018.

1.5.2. Positive developments of the profit and loss account

In 2018, **net interest income** (+2.0%) recorded a positive development year-on-year. The increase of this item was shared by 56% of the credit institutions, representing 50% of the aggregate banking income of the financial centre. The progress of the net interest income during the last years, despite the persistence of extremely low interest rates, resulted from, among others, a growth in the volume of activities as well as a better rate of return on assets for most of these banks. For a limited number of them, the application of negative interest rates to institutional customers also contributed to an improvement of net interest income. Nevertheless, the prolongation of low interest rates continues to be challenging for credit institutions with respect to their banking intermediation activity.

Net fee and commission income, which mainly results from asset management activities on behalf of private and institutional customers, including the financial services provided to investment funds, grew by 5.4%. The increase of net fee and commission income, largely linked to the average favourable development of financial markets in 2018, was shared by 56% of the Luxembourg banks.

Net creation of provisions declined by 25.7%. Whereas the extent of this contraction was determined only by a limited number of banks, the positive trend of this item greatly contributed to a mitigation of the loss in profitability of credit institutions at aggregate level.

Long-term development of profit and loss account – in million EUR

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 ⁹
Net interest income	5,807	4,761	4,960	4,671	4,281	4,066	4,496	4,717	4,886	4,986
Net fee and commission income	3,132	3,587	3,832	3,727	3,962	4,101	4,720	4,602	4,706	4,959
Other net income	1,614	1,201	76	1,401	2,213	2,217	2,262	3,038	2,166	1,741
Banking income	10,553	9,549	8,868	9,799	10,456	10,384	11,478	12,357	11,758	11,686
General expenses	-4,451	-4,609	-4,789	-4,994	-5,198	-5,005	-5,942	-6,040	-6,253	-6,627
<i>of which: staff costs</i>	-2,449	-2,497	-2,535	-2,622	-2,745	-2,624	-3,065	-3,109	-3,161	-3,253
<i>of which: general administrative expenses</i>	-2,002	-2,112	-2,253	-2,372	-2,453	-2,381	-2,878	-2,931	-3,092	-3,374
Profit before provisions	6,102	4,940	4,080	4,805	5,258	5,379	5,535	6,317	5,505	5,059
Net creation of provisions	-3,242	-498	-1,572	-765	-865	-327	-577	-757	-956	-710
Taxes	-804	-625	-18	-503	-762	-799	-888	-820	-827	-747
Net profit for the year	2,056	3,817	2,490	3,537	3,631	4,253	4,070	4,740	3,722	3,602

1.6. Prudential ratios

1.6.1. Solvency ratios

In accordance with the EU regulations, Luxembourg credit institutions must comply with the following three structural ratios relating to solvency since 1 January 2014:

- a Common Equity Tier 1 capital ratio of 4.5%;
- a Tier 1 capital ratio of 6%; and
- a total capital ratio of 8%.

These ratios include the sum of components of the respective eligible own funds elements (after own funds deductions) in the numerator and the total risk-weighted exposure amount in the denominator.

Next to the level of minimum capital requirements and, where appropriate, the specific capital requirements to be fulfilled in the context of the supervisory review and evaluation process (Pillar 2), Luxembourg banks must hold a Common Equity Tier 1 capital conservation buffer equal to 2.5% of the total risk-weighted exposure amounts. As a result, the above-mentioned three ratios that the credit institutions must comply with equal 7%, 8.5% and 10.5%, respectively.

In addition, following the opinion of the Systemic Risk Committee, the CSSF identified eight credit institutions as other systemically important institutions. As other systemically important institutions, these banks must hold additional capital buffers of 0.5% or even 1%. These capital buffers must be phased in over two years as from 1 January 2017.

Moreover, in accordance with the law on the financial sector, the banks maintain a countercyclical capital buffer which varies according to the geographical composition of the assets held by the banks and the countercyclical buffer rates that the macroprudential authorities apply at national level so as to mitigate the risk of excessive credit growth in their respective countries. The countercyclical buffer rate applicable to the relevant exposures located in Luxembourg was set at 0% for the last quarter of 2018 in CSSF Regulation N° 18-05. Finally, reference is made to point 2.3.2. which describes Pillar 2 capital requirements that banks must comply with aside from those of Pillar 1 described above.

As at 31 December 2018, nine banks were authorised to use the internal ratings-based approach regarding credit risk, six of which have used advanced methods allowing own estimates not only of probabilities of default but also of the loss given default and/or of the conversion factors. These banks are exclusively significant banks within the meaning of the SSM. They represented 30.8% of the aggregate balance sheet total of the financial centre as at 31 December 2018.

⁹ Preliminary figures.

As regards operational risk, eight banks (among which six significant banks within the meaning of the SSM) had an authorisation to use the AMA approaches. The other banks used the basic indicator approach (60 banks) and the standardised approach (20 banks, among which two used the alternative standardised approach) to determine the regulatory capital requirements.

Moreover, only one Luxembourg bank (significant within the meaning of the SSM) used an internal model to calculate the capital requirements for market risk. No bank established in Luxembourg applied for approval to use the internal model method (IMM) with respect to counterparty credit risk.

Information on the internal models used by banks is also available under “Review of the approaches used to calculate the risk-weighted exposure amounts” hereunder.

• Capital ratios

At aggregate level, the total weighted average capital ratio for the financial centre was 25.2% as at 31 December 2018, representing a slight drop compared to the weighted average ratio of 25.9% as at 31 December 2017. Hence, it largely exceeded the minimum threshold of 8% and 10.5% (minimum threshold of 8% plus the capital conservation buffer of 2.5%), respectively.

The Tier 1 capital ratio, whose numerator only includes own funds which absorb losses in going concern situations, was 24.4% as at 31 December 2018 (a decrease compared to 25.1% at the end of 2017). The Common Equity Tier 1 capital ratio (CET1 ratio) was 23.8% as at 31 December 2018 (a fall compared to 24.5% at the end of 2017). The levels of the CET1 and Tier 1 capital ratios, which largely exceeded the regulatory minima (including the capital conservation buffer) of 7% and 8.5%, respectively, attested to the robust solvency and to the preponderance of high-quality capital items in the banking sector. It should be remembered that for banks whose total ratio falls below 10.5%, restrictions in terms of bonus and dividend payments apply.

The high level of capitalisation was also reflected at disaggregate level. As illustrated in the following table, no bank was within the weaker capitalisation bands with respect to the total capital ratio, as at 31 December 2018.

Distribution of the capital ratios

Common Equity Tier 1 capital ratio (CET1)	Number of banks	Tier 1 capital ratio	Number of banks	Total capital adequacy ratio	Number of banks
0%-7%	0	<6%	0	<8%	0
7%-8%	0	6%-8.5%	0	8%-10.5%	0
8%-10%	0	8.5%-9%	0	10.5%-11%	1
10%-12%	4	9%-10%	0	11%-12%	0
12%-15%	7	10%-11%	2	12%-13%	4
>15%	77	>11%	86	>13%	83
Total	88		88		88

• Components of own funds

Aggregate own funds, eligible for the purpose of complying with prudential capital standards, amounted to EUR 48,342.6 million as at 31 December 2018, i.e. a decrease of 6.2% compared to 31 December 2017. This net reduction of own funds is mainly attributable to the downsizing or cessation of activities by four banks.

Components of own funds

	2017		2018	
	Amount (in million EUR)	Relative share	Amount ¹⁰ (in million EUR)	Relative share
Own funds	51,542.9	100.0%	48,342.6	100.0%
Tier 1 capital	49,990.5	97.0%	46,863.9	96.9%
Common Equity Tier 1 capital (CET1)	48,831.9	94.7%	45,705.4	94.5%
Capital instruments that qualify as CET1 capital	27,009.8		24,120.9	
Retained earnings, other reserves, funds for general banking risks	25,357.4		24,025.4	
Other accumulated comprehensive income	1,164.5		916.4	
Minority interests	8.3		9.2	
Adjustments of CET1 deriving from prudential filters	-106.3		-237.3	
(-) Intangible assets, goodwill and differed tax assets	-2,127.6		-2,044.3	
(-) Holdings in financial instruments of financial sector entities	-227.5		-208.5	
(-) Other deductions	-2,241.4		-876.5	
Additional Tier 1 capital (AT1)	1,158.6	2.2%	1,158.5	2.4%
Capital instruments that qualify as AT1 capital	1,158.6		1,158.5	
Other items that qualify as AT1 capital	0.0		0.0	
(-) Deductions from AT1 capital	0.0		0.0	
Tier 2 capital (T2)	1,552.3	3.0%	1,478.7	3.1%
Capital instruments and subordinated loans that qualify as T2 capital	1,544.7		1,526.6	
Other items that qualify as T2 capital	81.7		26.4	
(-) Deductions from T2 capital	-74.1		-74.3	

• Risk-weighted exposure amounts

The risk-weighted exposure amounts decreased by EUR 7,146.9 million (i.e. -3.6%) between the end of 2017 and the end of 2018 to EUR 192,042.7 million. This development was almost entirely due to the reduction of risk-weighted exposure amounts for credit risk which dropped by EUR 7,210.9 million and largely explained by the downsizing of activities of two banks of the financial centre. Credit risk remained the most important type of risk for the financial centre's credit institutions with 86.3% of the risk-weighted exposure amounts, followed by operational risk with 11.8%.

As at 31 December 2018, the average credit risk weight of banks in the financial centre amounted to 27.2%. This reflects the fact that the banks had exposures to obligors (mainly to rated institutions, rated corporations and central governments) which benefited from a good credit assessment as well as exposures for which the credit risk was mitigated by eligible mitigation techniques. These weights were in line with the low amount of non-performing exposures (NPE), whose average rate was 0.9% and the weighted average rate was 0.8% at the end of December 2018.

¹⁰ Preliminary figures.

Risk-weighted exposure amounts

<i>(in million EUR)</i>	2017	in %	2018¹¹	in %
Total risk-weighted exposure amount	199,189.6	100.0%	192,042.7	100.0%
Risk-weighted exposure amounts for credit risk, counterparty credit risk and dilution risks and free deliveries	172,890.5	86.8%	165,679.6	86.3%
<i>of which: Standardised Approach (STA)</i>	<i>125,810.7</i>	<i>63.2%</i>	<i>117,247.2</i>	<i>61.1%</i>
<i>of which: Internal ratings-based approach (IRB)</i>	<i>47,078.9</i>	<i>23.6%</i>	<i>48,431.4</i>	<i>25.2%</i>
Risk-weighted exposure amounts for settlement risk	1.2	0.0%	8.1	0.0%
Risk-weighted exposure amounts for position risk, foreign-exchange risk and commodity risk	1,800.0	0.9%	1,443.4	0.8%
Risk-weighted exposure amounts for operational risk	22,072.2	11.1%	22,587.3	11.8%
Risk-weighted exposure amounts for credit valuation adjustment risk	1,101.4	0.6%	904.0	0.5%
Other risk-weighted exposure amounts	1,324.2	0.7%	1,420.3	0.7%

- **Review of the approaches used to calculate the risk-weighted exposure amounts**

The internal ratings-based approaches used by banks to determine the risk-weighted exposure amounts in accordance with the CRD IV/CRR framework require prior authorisation by the competent authorities. In addition, these internal models are subject to controls as provided for in Articles 78 and 101 of CRD IV, transposed into Luxembourg law through Articles 23 and 24 of CSSF Regulation N° 15-02 relating to the supervisory review and evaluation process that applies to CRR institutions. In Luxembourg, the internal models which exclusively cover credit and operational risks are used, with a few exceptions, by significant banks within the meaning of the SSM.

The reconsideration of the degree of observed undue variability of risk weights due to internal models as well as the increased harmonisation of rules (via the EBA) and practices (within the SSM) led to the enhancement of the controls laid down in Articles 23 and 24 of CSSF Regulation N° 15-02.

The CSSF supports the ECB, as the competent authority for the supervision of significant banks, in the implementation of prudential processes relating to the use of internal models: network of experts in internal models, handling of authorisation files, planning and performance of on-site inspections or ongoing model monitoring (OMM), including relevant supervisory measures. In the context of its prudential supervision, the CSSF analysed in 2018, among others, the adequacy of the internal model validation and quality assurance as well as the assessment of the EBA benchmarking results for Luxembourg significant banks whose EU parent undertaking was domiciled in Luxembourg.

Regarding credit risk, the ECB carried out two on-site inspections under the authority of a CSSF head of mission in 2018, including one cross-border mission and one mission at a Luxembourg bank using the internal ratings-based approach. These inspections were linked to requests for authorisation of new models as well as to changes of internal models requiring permission. With the implementation of the SSM, these inspections are governed by common processes and procedures within the SSM.

In addition to the inspections described above, the ECB continued the TRIM project (Targeted Review of Internal Models) which aims to restore confidence in and credibility of the internal ratings-based approaches. This major project, which spans over a period of several years, mobilises significant resources, including at the CSSF. Six CSSF agents were assigned to the review and supervision of the internal models in 2018.

¹¹ Preliminary figures.

1.6.2. Liquidity ratios

• Regulatory framework

Regulation (EU) No 575/2013 lays down three structural ratios relating to liquidity:

- Liquidity Coverage Requirement (LCR) in accordance with Delegated Regulation (EU) 2015/61;
- Asset encumbrance ratio pursuant to Implementing Regulation (EU) 2015/79; and
- Net Stable Funding Ratio (NSFR). Pending the revision of Regulation (EU) No 575/2013 (CRR II), this ratio is not yet binding. However, it is used as an instrument to monitor liquidity.

• Liquidity Coverage Requirement (LCR)

As at 31 December 2018, the weighted average of the LCR of Luxembourg banks and Luxembourg branches of banks that have their registered office outside the EU amounted to 194% as compared to 236% at the end of December 2017. The regulatory minimum to be observed amounted to 100% at the end of December 2018. The difference between 2017 and 2018 was mainly due to one bank which recorded unusual ratios. When excluding this bank, the weighted LCR is 188% in 2017 and 179% in 2018.

At aggregate level, a significant concentration of the liquid assets buffer within Level 1 assets stood out. The short-term deposits made at the BCL represented once more the major part of Luxembourg banks' liquid assets.

During 2018, the CSSF was confronted with a very small number of breaches of the minimum regulatory threshold of 100%. After analysis, these breaches were due to involuntary negligence rather than to real liquidity insufficiencies. Every breach led to a monitoring of the swift restoration of compliance with the regulatory minimum as well as to an examination of the root causes of the breach and an assessment of the measures taken to avoid repetition. As at 31 December 2018, no breach was noted.

As regards reporting, Commission Implementing Regulation (EU) 2017/2114 of 9 November 2017 is applicable since March 2018. This regulation supplements the reports on additional monitoring elements regarding liquidity with a maturity ladder which allows capturing maturity mismatches of an institution.

• Net Stable Funding Ratio (NSFR)

The weighted average of the NSFR of Luxembourg banks and Luxembourg branches of banks having their registered office outside the EU, calculated with the proxy tool developed by the EBA, amounted to 127% in December 2018, as against 179% at the end of December 2017. This proxy tool remains approximate until new reporting tables are implemented which will be based on common rules introducing the NSFR as a binding regulatory standard.

• Asset encumbrance ratio

Luxembourg banks have a low asset encumbrance ratio. As at 31 December 2018, this ratio amounted to 8.04% on weighted and aggregate basis, showing that most of the Luxembourg banks' assets were unencumbered. Only eight banks had an asset encumbrance ratio exceeding 15% due to their business model. This was especially the case of banks issuing covered bonds. As a consequence, these banks were subject to additional reporting requirements.

Furthermore, credit institutions usually have significant liquidity reserves in the form of received and reusable collateral.

• General situation regarding liquidity

Generally, the overall liquidity situation in the Luxembourg banking sector can be considered as comfortable. The year 2018 saw only one single case of a bank which faced a liquidity gap.

Due to their wealth management and investment fund activities, most credit institutions in Luxembourg had liquidity surpluses which guaranteed them, if need be, a stable refinancing. Liquidity surplus was often invested via the interbank market with counterparties which generally belonged to the same group as the bank in Luxembourg. As regards the banks which, as a result of their credit activities, had a net funding need, their liquidity shortage was covered using resources of the group. The liquidity management of Luxembourg banks was thus widely integrated in that of their respective group.

1.6.3. Interest rate risk in the banking book (IRRBB)

• Regulatory framework

As regards interest rate risk in the banking book (IRRBB), Article 30(4) of CSSF Regulation N° 15-02 relating to the supervisory review and evaluation process that applies to CRR institutions provides that the CSSF must take measures at least in the case of CRR institutions with own funds whose economic value would drop by more than 20% under the interest rate scenarios laid down in the regulations. This requirement is governed by the provisions of Circular CSSF 08/338 regarding the implementation of a stress test in order to assess the interest rate risk arising from non-trading book activities.

• Structural interest rate risk evaluation ratio

The analysis of the stress test results according to Circular CSSF 08/338 confirmed that, as at 30 June 2018, the Luxembourg banking sector as a whole was only moderately exposed to structural interest rate risk. Indeed, the average of regulatory IRRBB ratios (reporting simulated losses following a scenario of changes in the interest rates over eligible own funds) amounted to -3.5%. In other words, the impact of an immediate 2% variation in overall interest rates would have cut the intrinsic value of the financial centre's banks only by about 3.5% of their own funds.

As far as dispersion of results is concerned, 65% of the banks in Luxembourg had a regulatory IRRBB ratio higher than or equal to -5% and no bank had a ratio of less than -15%. In 2018, the CSSF has not identified any bank whose regulatory IRRBB ratio was less than -20%, a threshold which requires the authorities to take measures pursuant to CRD IV (as transposed by Article 30(4) of CSSF Regulation N° 15-02). However, the CSSF asked several banks for additional information with respect to significant variations of the regulatory IRRBB ratio. After analysis, it was decided that an on-site inspection would be carried out at one of these banks in 2019.

Supervision of the interest rate risk according to Circular CSSF 08/338 has not led the CSSF to adopt other specific measures in 2018. Given the current context of historically low interest rates and the concomitant pressure on income, the CSSF continues to closely monitor the banks' structural interest rate risk positions. In general, the CSSF reminds banks of their obligation to manage interest rate risks in a sound and prudent manner in accordance with Article 14 of CSSF Regulation N° 15-02 and with Chapter 8 of Part III of Circular CSSF 12/552.

In July 2018, the EBA published revised guidelines on the management of interest rate risk arising from non-trading book activities (EBA/GL/2018/02) which are based on the standards of the Basel Committee on Banking Supervision published in April 2016. These rules provide for an early warning signal in case of a decline in economic value that is greater than the 15% of Tier 1 capital calculated based on the six shock scenarios on the term structure of interest rates. Moreover, the reference threshold under CRD IV, set at 20% of total own funds, remains in force. These guidelines apply as from 30 June 2019.

1.7. Other major events in 2018: suspension of payments by ABLV Bank Luxembourg S.A.

On 13 February 2018, the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) published a "Notice of Proposed Rulemaking" (NPRM) regarding a significant risk of money laundering at ABLV Bank, AS and its Luxembourg subsidiary ABLV Bank Luxembourg S.A. (ABLV LUX), both subject to direct supervision of the ECB. The NPRM triggered a wave of withdrawals and requests for withdrawals of deposits and

a limited ability to access liquidity in Latvia. The ECB, as the authority in charge of the prudential supervision of ABLV LUX, sent a letter, dated 18 February 2018, to the CSSF inviting it to consider a moratorium and safeguards similar to those imposed by the Latvian supervisory authority (FCMC) on ABLV Bank, AS. Thus, on 19 February 2018, the CSSF filed with the registry (*greffe*) of the *Tribunal d'arrondissement* (District Court) an application requesting the suspension of payments for ABLV Bank Luxembourg S.A. based on Article 122 of the Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law).

On 23 February 2018, the ECB declared ABLV LUX failing or likely to fail in accordance with Article 18(1) of Regulation (EU) No 806/2014 and informed immediately the Single Resolution Board (SRB) thereof. On the same day, the SRB decided not to adopt resolution actions concerning ABLV LUX, having regard, in particular, to the absence of public interest for such actions. Following the decision of the SRB of 23 February 2018 not to take any resolution action concerning ABLV LUX, on 26 February 2018, the Resolution Board of the CSSF (CODERES) considered that there was no need to take any resolution action, stated that it supported the dissolution and liquidation of the bank and declared that it was in favour of an application for the dissolution and liquidation of ABLV LUX. Consequently, on 27 February 2018, the CSSF represented by its Executive Board and, where necessary, by the CODERES, filed with the registry (*greffe*) of the *Tribunal d'arrondissement* (District Court) an application requesting, primarily, to open proceedings for the judicial winding-up of ABLV LUX (following, notably, the decision of the CODERES) under Article 129 of the BRRD Law and, secondarily, to open proceedings for the suspension of payments by ABLV LUX within the meaning of Article 122 of the BRRD Law, including the first request of the CSSF dated 19 February 2018. On 9 March 2018, the *Tribunal d'arrondissement* (District Court) of Luxembourg granted the second request but rejected the request for the judicial winding-up and, thus, authorised the suspension of payments by ABLV LUX for a period of six months and appointed Me Alain Rukavina and Deloitte Tax & Consulting S.à r.l., represented by Mr Eric Collard, as administrators in order to control the management of the bank's assets. Finally, the *Tribunal* (Court) extended the suspension of payments by ABLV LUX through a series of decisions until 2019 in order to allow for a possible takeover of the bank.

2. PRUDENTIAL SUPERVISORY PRACTICE

2.1. Organisation of the supervision

Since the introduction of the SSM on 4 November 2014, the direct supervision of significant banks is carried out by the ECB. Less significant entities continue to be supervised directly by the CSSF, under the oversight of the ECB. The ECB authorises also any new bank which intends to be established in Luxembourg, any acquisition of qualifying holdings and all the withdrawals of licenses of banks established in Luxembourg.

At the end of 2018, 53 banks established in Luxembourg were directly supervised by the ECB, either because they exceeded the criteria for being considered as significant institutions (SIs) at solo or consolidated level, or because they were part of a group considered as significant. These banks represented 68.6% of the total assets of the Luxembourg banks.

Sixty-eight banks were considered as less significant institutions (LSI), among which eight had the status of high-priority LSI for which the ECB requested more intensive supervision by the competent authority. Fourteen entities were branches of banks whose registered office was established outside the EU and which did not fall within the scope of the SSM.

Supervision of significant banks is exercised by the Joint Supervisory Teams (JSTs) formed of staff members from the ECB and from the national competent authorities. At the end of 2018, the CSSF took part in 27 JSTs for as many banking groups. A total of 36 CSSF agents were involved in this supervision, i.e. 23 supervisors and 13 experts.

Banks established in Luxembourg by category

SSM status	Number of banks	In % of assets
Significant institutions - SIs	34	49.6%
Branches of an SI	19	19.0%
<i>High-priority less significant institutions - High-priority LSIs</i>	8	8.8%
Less significant institutions - LSIs	53	11.0%
Branches of an LSI	7	2.1%
Outside the scope of SSM	14	9.5%
Total	135	100.0%

The national competent authorities remain responsible for the supervision of less significant entities and the ECB ensures quality checks thereof. In the context of this quality assurance, the CSSF is required to send a certain number of ex ante or ex post notifications concerning the measures taken during the supervision of these entities. It is noteworthy that the ECB continues its effort to harmonise the supervision of less significant banks.

The SSM's supervisory approach is described in detail in the document "Guide to banking supervision"¹².

It should be borne in mind that the competence of the ECB is strictly limited to prudential supervision and does not include non-prudential areas like anti-money laundering or consumer protection or areas covered by sectoral non-banking legislation such as, for example, the function of depositary bank for investment funds.

2.2. Authorisations

The CSSF mainly intervenes in three banking-related authorisation processes.

2.2.1. Authorisation of new credit institutions

Since the introduction of the SSM, the ECB is exclusively competent for the authorisation of new credit institutions in all SSM countries. The competence for the authorisation of branches of non-EU credit institutions remains at national level.

However, the CSSF is still the entry point for the submission of all the authorisation files. Upon receipt of an application, the CSSF first informs the ECB thereof and then analyses the file in order to verify compliance with legal and regulatory requirements. Particular attention is given to the compliance with the laws and regulations on the fight against money laundering and terrorist financing (AML/CFT), notably with respect to the good repute of the shareholders and *dirigeants* (managers) of new credit institutions and the origin of funds, as well as the ML/FT risks inherent in the proposed business models. After the examination of the file, the CSSF prepares a proposal and submits it for decision to the ECB, in the case of Luxembourg credit institutions, or to the Minister of Finance, in the case of branches of non-EU institutions.

In 2018, the CSSF worked on seven authorisation requests for new credit institutions and branches of non-EU banks. One authorisation was granted to a credit institution by the ECB in 2018. One authorisation request for a branch of a non-EU bank was approved by the Minister of Finance. The examination of four authorisation files has started in 2018 and still continues in 2019. Moreover, the CSSF met with about 10 entities which were interested in opening a bank in Luxembourg.

¹² <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidebankingsupervision201411.en.pdf?404fd6cb61dbde0095c8722d5aff29cd>. In this regard, see also the annual reports of the ECB published under <https://www.ecb.europa.eu/pub/annual/html/index.en.html>.

2.2.2. Acquisitions of qualifying holdings

Like the authorisation of a new institution which requires prior examination of the file by the CSSF, the subsequent acquisitions of shareholdings that reach or exceed 10% of the capital or that gives significant influence over the institution concerned (qualifying holding) are also examined by the CSSF and authorised by the ECB in accordance with the applicable legal and regulatory requirements. During the examination, particular attention is given to compliance with AML/CFT legislation, in particular with respect to new shareholders and the origin of their money, and to the ML/FT risks resulting from the proposed acquisition.

In 2018, the CSSF examined 15 qualifying holding files, 10 of which were authorised by the ECB during the year.

2.2.3. Authorisation of directors and managers of banks

In 2018, the CSSF dealt with 196 nominations of new directors and authorised managers in Luxembourg credit institutions. Such files are examined in order to verify the compliance of the candidates, notably concerning their good repute, their experience and professional availability, with legal and regulatory requirements. Particular attention is given to compliance with AML/CFT legislation. The nominations in significant institutions (SIs) which are subject to direct supervision of the ECB under the SSM are transferred to the ECB for authorisation, following the examination of the file by the CSSF, whereas the nominations in less significant institutions (LSIs) and in branches of non-EU institutions are directly authorised by the CSSF.

2.3. Banking supervision

2.3.1. Supervisory review and evaluation process (SREP)

The banking supervision in the EU is based on rules and principles harmonised to a great extent via Directive 2013/36/EU (CRD IV). Article 97 of this directive establishes the supervisory review and evaluation process (SREP) which requires the competent authorities to examine the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with the CRD IV/CRR framework and to ensure a sound management and coverage of their risks. In this context, the competent authorities must, in particular, assess the risks to which the banks are or might be exposed, the risks that a bank poses to the financial system and the risks revealed by stress testing.

In Luxembourg, the SREP is codified in Article 21 of CSSF Regulation N° 15-02 relating to the supervisory review and evaluation process that applies to CRR institutions. The SREP is applied in a proportionate manner to credit institutions according to a supervisory examination programme established having regard to the nature, scale and complexity of their activities and risks and, if relevant, their situation within the group.

The supervisory examination programme mainly provides for two types of complementary controls, namely on-site supervision, carried out via on-site inspections, and off-site prudential supervision which is based on information collected by other means.

• Off-site supervision

Off-site supervision consists in analysing key figures and periodic reports that the banks must submit to the competent authorities. It is supplemented by meetings with the authorised management and key function holders and, if necessary, by additional information requests. This supervision aims to assess compliance with the applicable regulations and the capacity of banks to remain in conformity with these rules.

The key figures are submitted via the legal reporting, which includes the following information, in particular:

- own funds and risk exposure amounts;
- financial information (balance sheet, profit and loss accounts and relating detailed tables);
- losses stemming from mortgage lending;
- large exposures;
- leverage ratio;
- asset encumbrance;
- liquidity coverage requirements;
- net stable funding requirements.

The analysis of key figures focusses particularly on regulatory ratios (solvency, liquidity and large exposures), and other indicators of risks and profitability (e.g. the amount and development of non-performing loans, interest rate risk in the banking book or development of the main items of the profit and loss account). These analyses are mainly quantitative and aim to assess compliance with the regulatory ratios and the extent of the risks taken compared to the capacity of the banks to bear these risks.

Besides the legal reporting, the CSSF relies on the following information to evaluate and assess the quality of the organisation and the risks incurred by the banks:

- analytical reports prepared by the *réviseurs d'entreprises agréés* (approved statutory auditors);
- management letters issued by the *réviseurs d'entreprises agréés*;
- reports prepared by the banks' internal auditors;
- reports of the Compliance function;
- reports of the risk control function;
- ICAAP/ILAAP reports¹³.

The CSSF requires, on a yearly basis, a long form report from every Luxembourg credit institution as well as from Luxembourg branches of non-EEA credit institutions. Furthermore, the credit institutions supervised on a consolidated basis are required to submit, on a yearly basis, a consolidated long form report and individual long form reports for each subsidiary included in the consolidation and carrying out an activity of the financial sector. The CSSF examines these long form reports which, by design, complete the on-site supervision carried out by the CSSF teams.

Management letters drawn up by the *réviseurs d'entreprises* for the attention of the banks' management are an additional source of condensed information on the quality of the credit institutions' organisation. The CSSF analyses these management letters in which the external auditors state, in particular, weaknesses in the internal control framework identified during their audit.

The CSSF meets, on an ad hoc basis and at least once a year, with representatives of the main audit firms in order to discuss topics relating to the audit work in banks.

Moreover, the CSSF takes into account the work of the internal control functions when assessing the quality of the organisation and risk management by analysing the summary report prepared every year by the internal auditor and the reports of the Compliance function and the risk control function in accordance with the provisions of Circular CSSF 12/552.

In the last years, the CSSF increased the number of regular meetings with the authorised management and the persons responsible for the banks' internal control functions. This dialogue is an important means to discuss the business strategies of the banks, their prospects and the evolution of their risks. It also allows expressing regulatory expectations and meeting the banks' expectations with respect to prudential supervisory transparency.

¹³ ICAAP: Internal Capital Adequacy Assessment Process; ILAAP: Internal Liquidity Adequacy Assessment Process.

The control programme includes annual meetings with the authorised management and the three internal control functions of all the banks. Moreover, individual meetings regarding banks under enhanced supervision are organised with the *réviseurs d'entreprises agréés* every year.

Number of meetings

	2016	2017	2018
Meetings with the senior management of banks or persons responsible for the internal control functions	273	399	492
Meetings with other stakeholders (including other supervisors or external auditors)	50	78	73

• On-site supervision

The programme of on-site inspections to be carried out by the CSSF agents is drawn up at the beginning of the year. This programme is based on the assessment of the risk areas of the different credit institutions. On-site inspections generally follow standard inspection procedures, in the form of interviews with the people responsible, the assessment of procedures and the verification of files and systems.

For banks under the direct supervision of the ECB, the programme of inspections is drawn up centrally by the ECB which takes into account the opinion of the JSTs (which include CSSF agents). These inspections are carried out according to the SSM methodology, usually by teams composed of agents of several authorities (the ECB and national authorities).

Detailed explanations on on-site inspections are provided in Chapter XVI “Instruments of supervision”.

2.3.2. Summary of the SREP

At least once a year, the analyses, information and insights of the on-site and off-site supervision are gathered and completed by specific analyses in order to reach an overall assessment in line with the relevant guidelines issued by the EBA (EBA/GL/2014/13).

To this end, analyses, information and insights are aligned to the following three dimensions:

- a risk assessment system (RAS);
- an analysis of the credit institutions’ Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP);
- a quantification of own funds and liquidity which corresponds to the banks’ capital and liquidity needs given the results of the RAS, the ICAAP and ILAAP analysis and the stress tests.

The RAS includes the following four elements:

- an assessment of the viability (over 12 months) and sustainability (over three years/over a complete cycle) of the business model by assessing, in particular, the capacity of the business model to generate (risk adjusted) positive net profits;
- an assessment of the quality of the internal governance arrangements, among which the internal control mechanisms, and the compliance of these arrangements with the provisions of the Law of 5 April 1993 on the financial sector, CSSF Regulation N° 15-02 and Circular CSSF 12/552;
- an assessment of the risks to capital which focusses on the inherent risks and on the management and control of these risks;
- an assessment of the liquidity and funding risks which covers the short-term liquidity risks and the long-term funding risks as well as the management and control of these risks.

In accordance with the guidelines EBA/GL/2014/13, the conclusions of the assessments of the different SREP elements are translated into an overall score ranging from 1 (low risk for the viability of the institution) to 4 (high risk for the viability of the institution). Based on this overall assessment, the CSSF decides whether to apply the supervisory measures as laid down in Article 53-1 of the Law of 5 April 1993 on the financial sector.

Since the creation of the SSM, the minimum standards regarding the application of the SREP have been subject to a significant harmonisation work under the initiative of the ECB. In 2018, the resulting common standards¹⁴ were applied to the high-priority LSIs by the CSSF for the first time.

As regards the 2018 SREP, 64% of the less significant institutions remaining under the direct supervision of the CSSF received an overall score of 2 and 36% of them received an overall score of 3. No bank received an overall score of 1 or 4. Based on the outcome of the SREP, the CSSF decided to require additional own funds for almost 2/3 of these banks, deeming that the minimum requirements for own funds according to the CRR did not cover appropriately the risks incurred. These credit institutions were subject to Pillar 2 capital add-ons ranging from 0.5% to 5% of their risk exposure amount. On average, Pillar 1 and Pillar 2 capital requirements, apart from capital buffers under the Law of 5 April 1993 on the financial sector, amounted to 9.2%, as against 9.0% in 2017. Moreover, the CSSF took other supervisory measures to address specific risks and weaknesses, particularly with respect to liquidity and internal governance.

All in all, the CSSF sent 197 observation letters to banks during 2018.

2.4. Supervision on a consolidated basis

As at 31 December 2018, 19 banking groups were supervised on a consolidated basis. The consolidated supervision was carried out based on the consolidated situation of the parent institutions, among which 15 banks incorporated under Luxembourg law (*idem* in 2017), three financial holding companies incorporated under Luxembourg law (*idem* in 2017) and one financial holding company incorporated under foreign law established in another EU Member State (*idem* in 2017).

Ten (*idem* in 2017) of the 15 banks were part of banking groups considered as significant and their supervision, including the consolidated supervision, was exercised by the ECB. The consolidated supervision of the other five banks, considered as less significant according to the criteria laid down in the SSM regulation, was exercised by the CSSF, under the oversight of the ECB.

Likewise, one of the four financial holding companies was subject to the consolidated supervision of the ECB while the other three remained under the consolidated supervision of the CSSF.

The conditions triggering a consolidated supervision as well as the scope, content and means of supervision on a consolidated basis are specified in Chapter 2, Title II of Part I of the CRR.

For those entities that remain subject to its consolidated supervision, the CSSF pays special attention to the “group head” function exercised by the parent institution. It takes a particular interest in the way the parent undertaking communicates its policies and strategies to its subsidiaries as well as in the controls set up at the Luxembourg parent company in order to monitor the organisation and activities of the subsidiaries and their exposures.

The CSSF has not identified financial conglomerates for which it should ensure additional supervision pursuant to Chapter 3b of the Law of 5 April 1993 on the financial sector which is supplemented by Circular CSSF 15/629.

2.5. International cooperation in banking supervision

2.5.1. Supervisory colleges

The cooperation between European competent authorities by way of supervisory colleges, as governed by Articles 112 to 118 of Directive 2013/36/EU, did not become entirely unnecessary with the implementation

¹⁴ https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.srep_methodology_booklet_lsi_2018.en.pdf.

of the SSM. These colleges continue to be in place at national level for less significant banks. This cooperation also extends to non-European authorities. In order to improve the functioning of the colleges of supervisors, the EBA drew up regulatory technical standards on the functioning of colleges of supervisors (Commission Delegated Regulation (EU) 2016/98 and Commission Implementing Regulation (EU) 2016/99).

In 2018, the CSSF organised three supervisory colleges for the supervision of less significant banking groups for which it exercised an ultimate consolidated supervision at European level (Quilvest Wealth Management S.A., EFG Investment (Luxembourg) S.A. and Banque Havilland S.A.).

As a large number of banking groups are present in the Luxembourg financial centre via subsidiaries which, on the one hand, are subject to the supervision of the CSSF on an individual basis and, on the other hand, belong to the scope of consolidated supervision carried out by their home authorities, the CSSF participates, as host supervisor, in many colleges. In 2018, the CSSF participated in 21 meetings of supervisory colleges, among which five supervisory colleges organised by the supervisory authorities from non-EEA countries, which concerned in total 19 banking groups.

The establishment and functioning of the colleges are based on written agreements (Memorandum of Understanding, MoU) and Written Coordination and Cooperation Arrangements (WCCA) signed by the different authorities participating in the colleges. In order to reflect the new organisation of the banking supervision within the euro area, some MoUs have been or will be replaced by MoUs signed by the ECB instead of the CSSF.

The performance of a Joint Risk Assessment is a key objective of the colleges of supervisory authorities. Based on this Joint Risk Assessment, the colleges assess the capital adequacy of the banking groups and their subsidiaries with regard to the incurred risks, as well as their liquidity situation. The colleges then draw up a Joint Decision on Capital and Liquidity which either confirms the adequacy or requires capital surcharges or additional liquidity buffers that the banking groups and/or their subsidiaries must comply with at a consolidated and/or individual level. These Joint Decisions on Capital and Liquidity, which state the motivations underpinning the decision, are formally transmitted to the banking groups and their subsidiaries.

Furthermore, the colleges aim at promoting the exchange of information between authorities, including information on the situation of compliance risks related to money laundering/terrorist financing.

2.5.2. Cooperation with other authorities

Besides the institutionalised cooperation in JSTs and colleges, the CSSF works closely with the foreign supervisory authorities in the framework of consultations provided for by the European directives and in all circumstances in which cooperation is needed. Cooperation generally takes place in the form of calls for advice, information or assistance initiated or received by the CSSF. In this context, the CSSF sent 109 letters to supervisory authorities in 2018.

Annual meetings took place between the CSSF and the Swiss supervisory authority, FINMA, as well as between the CSSF and the Banco Central do Brasil. The CSSF cooperates with the Chinese and American authorities mainly through its participation in colleges of supervisors organised by these authorities.

The CSSF also cooperates with the national judicial and law enforcement authorities in accordance with Article 2 of the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de surveillance du secteur financier) and Article 9-1 of the Law of 12 November 2004 on the fight against money laundering and terrorist financing. Moreover, the CSSF refers to the intelligence service in the context of the procedures for authorisation and qualifying holdings, if it deems it necessary.

2.6. Recovery plans

Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) provides authorities with:

- arrangements to deal with failing banks at national level; and
- cooperation arrangements to tackle cross-border banking failures.

The BRRD, transposed by the Law of 18 December 2015, also requires banks to prepare recovery plans to overcome financial distress.

In 2018, the CSSF received 37 recovery plans (including four group recovery plans) of which it assessed the comprehensiveness, the quality and the general credibility. As host authority, the CSSF participated in eight joint decisions on group recovery plans. It also contributed to the assessment of recovery plans of significant institutions consolidating in Luxembourg. Finally, the CSSF organised eight meetings during which the banks presented their recovery plans.

Furthermore, the CSSF actively participated in different working groups and drafting teams involved in the wider context of the BRRD and the crisis management framework at the EBA and SSM level.

2.7. Supervision of central securities depositories having banking status

Regulation (EU) No 909/2014 of 23 July 2014 (Central Securities Depositories Regulation - CSDR) introduced the licence of central securities depository (CSD) in a harmonised manner at EU level.

In Luxembourg, one bank currently exercises an activity which requires authorisations under the CSDR. In the case at hand, three authorisations are required:

- the authorisation to carry out CSD activities (Article 16 of the CSDR);
- the authorisation to set up an interoperable link (Article 19 of the CSDR);
- the authorisation to provide, under the banking licence, banking-type ancillary services for CSD participants (Article 54 of the CSDR).

With the extent and complexity of the CSDR and the relevant technical standards, drawn up by ESMA and the EBA, the CSSF identified around 1,500 requirements and concrete conditions to be verified and assessed during the handling of the authorisation files. The process started with the submission of the three above-mentioned authorisation files in September 2017. Throughout 2018, the CSSF communicated its observations in relation to the authorisation files to the entity concerned. The authorisation process continues in 2019.



CHAPTER VII

SUPERVISION OF PFS

1. INVESTMENT FIRMS

1.1. Development of investment firms in 2018

1.1.1. Development in the number of investment firms

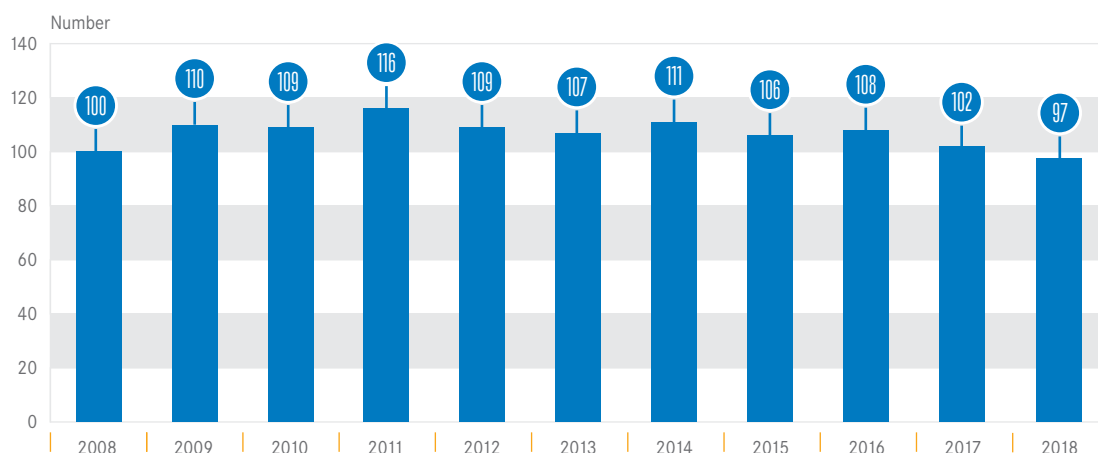
The downward trend in the number of investment firms that started in 2017 continued in 2018. The number of investment firms subject to the supervision of the CSSF fell from 102 entities as at 31 December 2017 to 97 entities at the end of 2018.

Five entities were authorised as investment firms in 2018, against three new entities in 2017.

Ten entities gave up their investment firm status during the year under review, compared to nine in 2017. These 10 entities gave up their investment firm status for the following reasons:

- change or cessation of activities, so that the entity no longer needed an authorisation as investment firm, as it no longer fell within the scope of the Law of 5 April 1993 on the financial sector (five entities);
- merger (three entities);
- change into specialised PFS (one entity);
- closing of EU/EEA investment firm branches established in Luxembourg (one entity).

Development in the number of investment firms



Among the investment firms, the activity of private portfolio manager was the most widespread with 81 entities authorised in this respect as at 31 December 2018. It is worth mentioning that two out of the five new entities registered on the official list adopted the status of private portfolio manager.

1.1.2. CRR investment firms

In the context of Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR), certain categories of investment firms must comply with the requirements on prudential reporting since 1 January 2014. Circular CSSF 15/606 clarifies the categorisation of investment firms and explicitly sets out the criteria which allow determining whether or not an investment firm falls within the scope of the CRR.

The number of CRR investment firms falling within the scope of the CRR amounted to 23 as at 31 December 2018, as against 30 as at 31 December 2017. Among the five investment firms newly authorised in 2018, none fall within the scope of the CRR.

1.1.3. Trends in employment

Following two stable years, the total number of staff for all investment firms decreased by 6.9% in 2018 and amounted to 2,115 people as at 31 December 2018, against 2,271 people at the end of December 2017.

Thus, the growth in staff of a certain number of players observed in 2018 and staff variations related to new authorisations as investment firm could not counteract the downward development of total staff due to the deregistration of 10 investment firms from the official list and the staff reduction recorded in some investment firms.

Employment in investment firms

Year	Number of investment firms	Total staff
2010	109	2,358
2011	116	2,411
2012	109	2,662
2013	107	2,560
2014	111	2,390
2015	106	2,278
2016	108	2,285
2017	102	2,271
2018	97	2,115

It should be noted that the status cessations that took place in 2018, in particular the change of an investment firm into a specialised PFS, did not necessarily reflect a loss of jobs in the financial sector. These transfers of activities did not impact employment in the financial sector as a whole, but only affected the breakdown between the different categories of financial players.

Please note also that, as at 31 December 2018, about half the investment firms had eight or fewer employees.

1.1.4. Development of balance sheets and profit and loss accounts

The provisional balance sheet total of all investment firms established in Luxembourg amounted to EUR 875 million¹ as at 31 December 2018, against EUR 1,973 million as at 31 December 2017, i.e. a substantial decrease of 55.66%. This fall is mainly attributable to one investment firm with a very high balance sheet total which gave up its investment firm status in 2018.

Investment firms also recorded a negative development in their net results. Indeed, provisional net results amounted to EUR 70.5 million² as at 31 December 2018, against EUR 138 million as at 31 December 2017, representing a substantial 48.89% loss. This decrease is mainly explained by investment firm statuses being abandoned, including two important players in terms of net result and, to a lesser extent, by a decrease in net result of certain actors year-on-year.

It should also be noted that a little more than one third of the investment firms, including notably several entities authorised during the last three years, registered negative results as at 31 December 2018.

Development of the balance sheet total and of the net results of investment firms

<i>(in million EUR)</i>	2017	2018	Variation in %
Balance sheet total	1,973	875	-55.66%
Net results	138.0	70.5	-48.89%

1.1.5. International expansion of investment firms**• Subsidiaries created and acquired abroad in 2018**

In 2018, one Luxembourg investment firm acquired a Swiss subsidiary in the context of a group merger.

• Freedom of establishment

In 2018, two branches were established in other EU/EEA countries by Luxembourg investment firms. Five branches have been taken over by a Luxembourg investment firm in the context of a merger with another

¹ The branches established in Luxembourg by investment firms originating from another EU/EEA Member State and included, since 2009, in the total number of investment firms are not included in these figures.

² Cf. footnote 1 above.

foreign entity of the group and three branches have been closed. Moreover, following the deregistration from the official list of two investment firms, their branches are no longer registered on the list of investment firm branches established in other EU/EEA countries at the end of 2018. The total number of branches of Luxembourg investment firms in other EU/EEA Member States amounted to 33 entities as at 31 December 2018, compared to 31 entities as at 31 December 2017. The number of branches established in a non-EU/EEA country did not change and still amounted to one entity as at 31 December 2018.

Following the closure of a branch originating from Germany, the number of branches established in Luxembourg by investment firms originating from other EU/EEA Member States totalled five entities as at 31 December 2018.

• Freedom to provide services

In 2018, seven investment firms incorporated under Luxembourg law applied to pursue business in one or several EU/EEA Member States by way of free provision of services. The total number of investment firms which were active in one or more EU/EEA countries following a notification amounted to 79 entities as at 31 December 2018 (82 in 2017). The majority of the investment firms concerned carried out their activities in several EU/EEA countries by way of free provision of services.

1.2. Prudential supervisory practice

1.2.1. Compliance with the quantitative standards by investment firms

• Capital base

In accordance with Articles 24 to 24-10 of the Law of 5 April 1993 on the financial sector, the authorisation of investment firms is subject to the production of evidence showing the existence of minimum capital base. This capital base consisting of subscribed and paid-up share capital, relevant share premiums, legally formed reserves and profits brought forward, after deduction of possible losses for the current financial year, must be permanently available to the investment firm and invested in its own interest.

It should be borne in mind that the subordinated loans or the profits for the current financial year must not be taken into account for the determination of the minimum capital base of a professional of the financial sector³.

Based on the financial data that investment firms must provide to the CSSF on a monthly basis in accordance with Circular CSSF 05/187 (completed by Circular CSSF 10/433), the CSSF verifies, in particular, the ongoing compliance of investment firms with the minimum capital base conditions. In 2018, the CSSF intervened at four investment firms for non-compliance with the legal provisions relating to capital base. The CSSF issued an injunction and imposed an administrative fine on one investment firm, pursuant to Articles 59 and 63 of the Law of 5 April 1993 on the financial sector.

• Capital ratios

Investment firms falling within the scope of Circular CSSF 07/290 (as amended by Circulars CSSF 10/451, 10/483, 10/497 and 13/568) defining the capital ratios pursuant to Article 56 of the Law of 5 April 1993 on the financial sector and investment firms falling within the scope of the CRR⁴ must permanently fulfil the capital ratio requirements.

In 2018, the CSSF intervened at six investment firms for non-compliance with the capital adequacy ratio. Meanwhile, most investment firms concerned regularised or are in the process of regularising the situation of non-compliance. The CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector and imposed an administrative fine on one investment firm, pursuant to Article 63 of that law. The CSSF attaches utmost importance to permanent compliance with the structural

³ Pursuant to Article 20(5) of the Law of 5 April 1993 on the financial sector.

⁴ CRR investment firms (cf. point 1.1.2. of this chapter) no longer fall within the scope of Circular CSSF 07/290 but must comply with the requirements of Directive 2013/36/EU of 26 June 2013 (CRD IV) and Regulation (EU) No 575/2013 of 26 June 2013 (CRR) as regards capital ratios and large exposure limits.

ratios that investment firms are required to observe and closely monitors the regularisation processes implemented by investment firms in case of capital adequacy ratio deficiency.

- **Large exposure limits**

In the context of the supervision of compliance with large exposure limits⁵, in 2018, the CSSF authorised one investment firm, in accordance with Article 396 of the CRR, to exceed the large exposure limit laid down in Article 395(1) of the CRR until the withdrawal of its authorisation by the Minister of Finance, the entity having taken the decision to cease all financial sector business.

1.2.2. Specific controls

Article 54(2) of the Law of 5 April 1993 on the financial sector entitles the CSSF to require a *réviseur d'entreprises agréé* (approved statutory auditor) to carry out a specific audit at a financial professional, covering one or several specific aspects of the business or operation of the entity concerned. The ensuing costs are to be borne by the professional concerned. The CSSF did not use this right in 2018.

1.2.3. Supervision on a consolidated basis

Following the Law of 23 July 2015 repealing Chapter 3a of Part III of the Law of 5 April 1993 on the financial sector and introducing a common chapter governing the supervision of CRR institutions on a consolidated basis (Chapter 3 of Part III), only investment firms subject to Regulation (EU) No 575/2013 fall within the scope of supervision on a consolidated basis⁶. The relevant articles define the scope and parameters of the supervision on a consolidated basis. The content and means of consolidated supervision as well as cooperation with other supervisory authorities with respect to consolidated supervision are also defined therein.

As at 31 December 2018, the following three investment firms were submitted to the supervision on a consolidated basis by the CSSF:

- CapitalatWork Foyer Group S.A.
- FIL (Luxembourg) S.A.⁷
- Fund Channel S.A.

1.2.4. Introductory visits

Introductory visits are made at the premises of investment firms that recently received their authorisation and, where appropriate, of existing players that received an authorisation to carry out a new activity in addition to the existing authorisations. The purpose of these missions is to verify that the contemplated business plan is being followed and that the systems and infrastructures are correctly implemented. In 2018, the CSSF visited six investment firms.

⁵ Large exposure limits are governed by the CRR (Part Four relating to large exposures) and are not applicable to investment firms complying with the criteria set out in Article 95(1) or Article 96(1) of the CRR. The investment firms authorised to provide investment services 3 and/or 6 fall within the scope of the laws and regulations on large exposures.

⁶ The investment firms which do not fall within the scope of the CRR are no longer subject to consolidated supervision carried out by the CSSF.

⁷ Consolidated supervision by the CSSF of the parent financial holding company in Luxembourg, i.e. FIL Holdings (Luxembourg) S.A.

2. SPECIALISED PFS

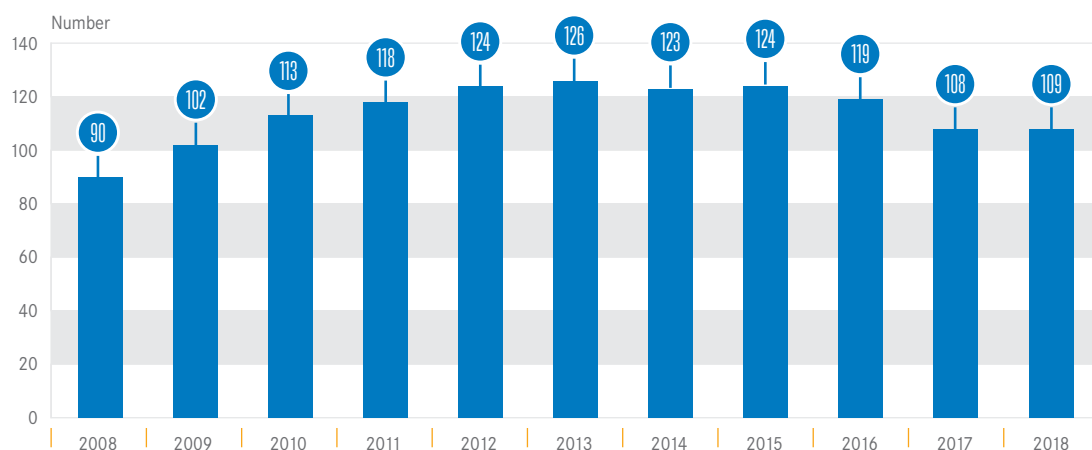
2.1. Development of specialised PFS in 2018

2.1.1. Development in the number of specialised PFS

During the year 2018, the number of specialised PFS stabilised and reached 109 entities as at 31 December 2018 (against 108 entities at the end of 2017).

In 2018, six entities (two in 2017) have been authorised as specialised PFS, including two entities that had already been authorised, either as credit institution or as investment firm. However, five entities gave up their specialised PFS status during the year (13 in 2017), one of them having been absorbed by another specialised PFS in the context of a merger.

Development in the number of specialised PFS



Among the specialised PFS, the statuses of corporate domiciliation agent and professional providing company incorporation and management services are the most prevalent with 86 and 92 entities, respectively, authorised under these statuses as at 31 December 2018 (idem in 2017), followed by the status of registrar agent with 61 entities authorised at the same date (2017: 58 entities).

Breakdown of specialised PFS according to status

Status	Number
Professionals providing company incorporation and management services	92
Corporate domiciliation agents	86
Registrar agents	61
Family Offices ⁸	30
Professional depositaries of assets other than financial instruments	15
Professionals performing lending operations	6
Professional depositaries of financial instruments	3
Debt recovery	2
Mutual savings fund administrators	1
Operators of a regulated market authorised in Luxembourg	1
Financial postal services	1

⁸ The section "Family Offices" only includes the entities authorised and carrying out this activity.

Five of the six entities that have been registered on the official list of specialised PFS in 2018 have been authorised as professional providing company incorporation and management services and corporate domiciliation agent, two of them having in addition been authorised as registrar agent. One entity has been authorised as professional performing lending operations.

2.1.2. Trends in employment

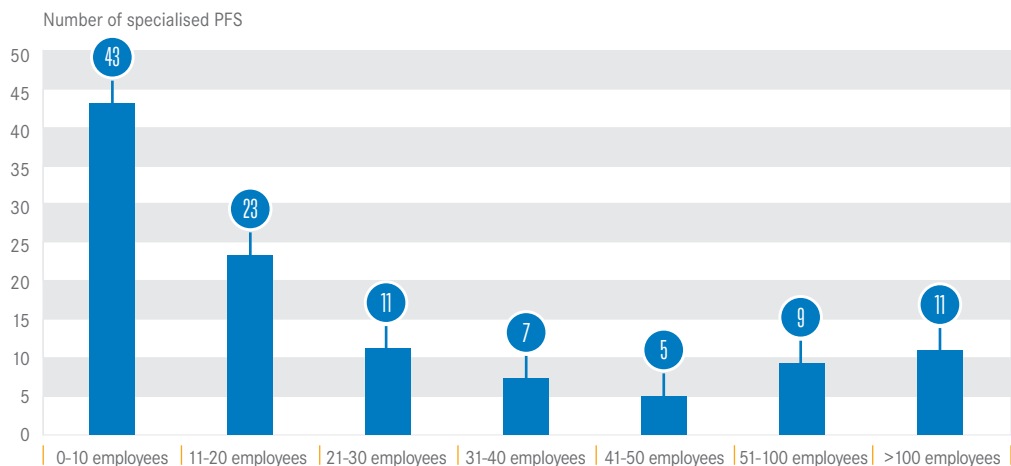
During 2018, the number of staff employed by all specialised PFS rose by 472 people, representing an 11.7% increase as compared to the end of 2017.

Development in employment of specialised PFS

Year	Number of specialised PFS	Total staff
2010	113	3,552
2011	118	3,127
2012	124	3,046
2013	126	3,201
2014	123	3,431
2015	124	3,787
2016	119	3,972
2017	108	4,008
2018	109	4,480

As at 31 December 2018, 11 specialised PFS employed more than 100 people (idem in 2017) and 43 specialised PFS employed 10 or fewer people (against 47 at the end of 2017).

Number of employees per specialised PFS



2.1.3. Development of balance sheets and profit and loss accounts

The rise in the provisional balance sheet total of all the specialised PFS by EUR 1,575.15 million compared to 2017 (+30.5%) is mainly attributable to three entities, one of which being a former credit institution that has reduced its activities to specialised PFS and which accounted for two thirds of this growth.

Over a one-year period, overall net results of specialised PFS rose by EUR 33.65 million (+9.4%).

Development of the balance sheet total and of the net results of specialised PFS

<i>(in million EUR)</i>	2017	2018	Variation in %
Balance sheet total	5,170.35	6,745.50	+30.5%
Net results	357.61	391.26	+9.4%

2.1.4. International expansion of specialised PFS

In 2018, no specialised PFS opened or closed a branch. Thus, as at 31 December 2018, two specialised PFS (idem in 2017) were represented by means of branches abroad, one in Malta and one in Denmark.

2.2. Prudential supervisory practice

Within the context of the prudential supervision exercised on specialised PFS, the CSSF verifies compliance with the quantitative and qualitative standards by specialised PFS.

2.2.1. Capital base

In accordance with Article 20 and Articles 25 to 28-10 of the Law of 5 April 1993 on the financial sector, the authorisation of specialised PFS is subject to the production of evidence showing the existence of minimum capital base for a PFS authorised as a legal person, or own assets for a PFS authorised as a natural person.

In 2018, the CSSF registered cases of non-compliance with the legal provisions in this respect by six entities (five in 2017). Their situation was regularised in a satisfactory manner within the months following the non-compliance.

2.2.2. Compliance of the day-to-day management and Corporate Governance

In 2018, the CSSF intervened four times (twice in 2017) by way of deficiency letters due to a situation of non-compliance in the day-to-day management of specialised PFS, mainly linked to insufficient presence and/or lack of effective involvement of one of the two managers (*dirigeants*) in charge of the entity's day-to-day management or to the need for reorganisation of the entity's administrative or management body composition.

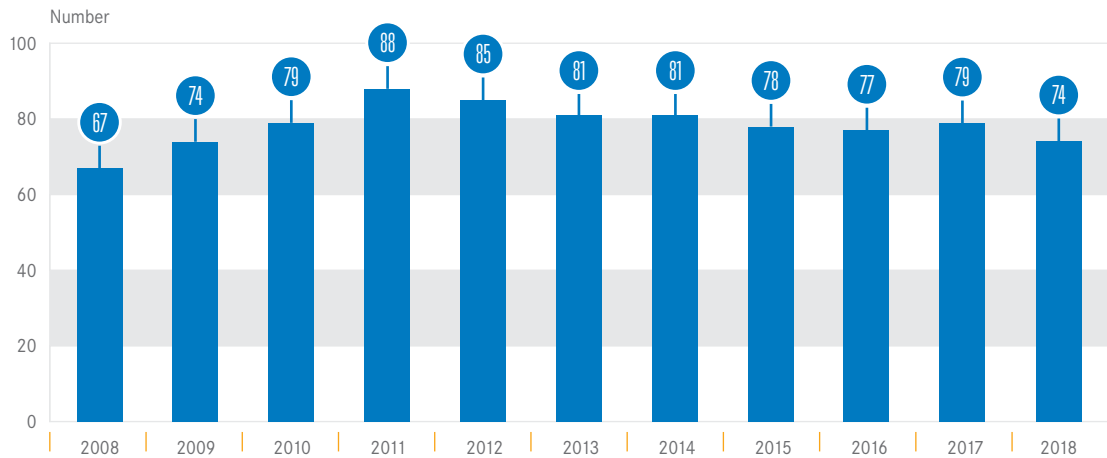
3. SUPPORT PFS

3.1. Development of support PFS in 2018

3.1.1. Development in the number of support PFS

In 2018, the number of support PFS fell by five entities to 74 entities as at 31 December 2018, against 79 entities at the end of 2017.

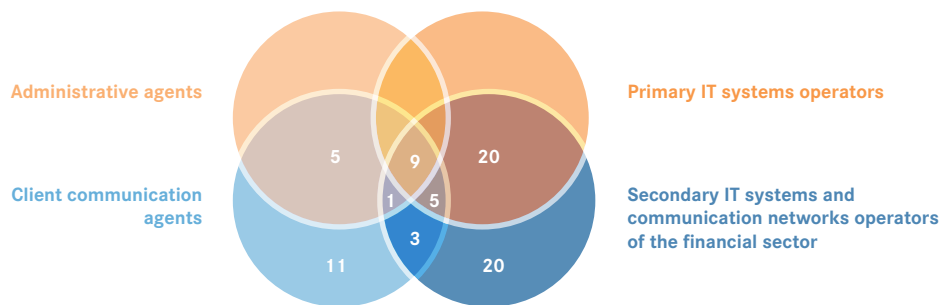
Development in the number of support PFS



Two support PFS have been authorised as secondary IT systems and communication networks operator of the financial sector (OSIS) in 2018.

Three support PFS were deregistered from the official list following a merger and four support PFS gave up their authorisation.

Breakdown of support PFS according to status



It should be noted that administrative agents are *ipso jure* authorised to exercise the activities of client communication agents. As a result, no entity has only the status of administrative agent. The same applies to primary IT systems operators which are *ipso jure* authorised to carry out the activities of secondary IT systems and communication networks operators of the financial sector.

3.1.2. Trends in employment

The number of staff of support PFS rose from 9,656 people as at 31 December 2017 (79 active entities) to 9,931 people as at 31 December 2018 (74 active entities), representing an annual increase of 275 positions (+2.85%).

Development in support PFS employment

Year	Number of support PFS	Total staff
2010	79	8,249
2011	88	8,679
2012	85	9,016
2013	81	8,971
2014	81	9,043
2015	78	9,218
2016	77	9,185
2017	79	9,656
2018	74	9,931

3.1.3. Development of balance sheets and profit and loss accounts

The balance sheet total of all support PFS established in Luxembourg reached EUR 1,344.1 million as at 31 December 2018, against EUR 1,234.3 million as at 31 December 2017, i.e. an increase of 8.90%.

Net results of support PFS grew from EUR 80.4 million as at 31 December 2017 to EUR 82.7 million as at 31 December 2018 (+2.94%).

3.2. Prudential supervisory practice

The CSSF exercises its prudential supervision based on several instruments, mainly financial and ad hoc information, documents to be submitted in the context of the Risk Assessment Report (RAR) and the Descriptive Report (DR), introductory visits and on-site inspections (cf. Chapter XVI “Instruments of supervision”). This supervision also involves sending deficiency letters.

The CSSF’s work in order to better align its supervisory approach with the continuously evolving specificities of the activities of the various categories of support PFS continued in 2018. Taking into account the weaknesses identified over the last years, both in terms of quality and consistency of the Risk Assessment Reports (RAR), plays a major role in this context.



Agents hired in 2018 and 2019: Departments “Supervision of banks” and “Supervision of investment firms”

From left to right: Rafael DOS SANTOS, Liz MEYER, Sébastien SAMMUT, Amandine CHITEL, Gerty SONG, Julienne KOIVULAMPI, Helen SEIB, Bruno TINOCO, Bob MORBACH, Sophia ROUBROEKS, Nora JUCHEM

Absent: Florent MOSCHEL



Agents hired in 2018 and 2019: Legal Department and Departments “Supervision of specialised PFS”, “Lean Management” and “Single Supervisory Mechanism”

From left to right: Lotfi SOUILAH, Xavier SANS SANS, Heleen DE GEEST, Sophie GIALLOMBARDO, Simon DAGRAIN, Priscille HOARAU, Sylvie DREZE, Edward LARIJANI

Absent: Jasmin JAHIC



CHAPTER VIII

SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

1. REGULATORY FRAMEWORK

The Law of 10 November 2009 on payment services (hereinafter LPS), which transposed Directive 2007/64/EC of 13 November 2007 on payment services in the internal market into national law, has been amended by the Law of 20 July 2018 transposing Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (hereinafter PSD2) and repealing Directive 2007/64/EC. The LPS imposes authorisation, exercise and supervisory conditions on the payment institutions and electronic money institutions that provide payment services or that issue electronic money.

The rapid growth in electronic and mobile payments led to significant technical innovation in the retail payments market. As a consequence, the payment services, which are specifically listed in the annex to the LPS, have been amended by the Law of 20 July 2018 to include two new payment services: the payment initiation services and the account information services.

The emergence of these new types of payment services implied the arrival of new players, which are subject to authorisation or registration: the payment initiation service providers and the account information service providers. While payment initiation service providers are payment institutions, the account information service providers are subject to a lighter registration regime.

Many innovative payment products or services remain however excluded, entirely or in part, from the scope of Directive (EU) 2015/2366.

2. PAYMENT INSTITUTIONS

Following the authorisation of one new payment institution, 10 Luxembourg payment institutions were listed in the public register of payment institutions established in Luxembourg as at 31 December 2018. Moreover, there were 10 branches established in other EU Member States by two of these 10 institutions.

The balance sheet total of payment institutions amounted to EUR 819 million as at 31 December 2018, representing a 37.65% increase compared to the end of 2017 when the balance sheet total reached EUR 595 million.

3. ELECTRONIC MONEY INSTITUTIONS

Following the authorisation of one new electronic money institution, six electronic money institutions were listed in the public register of electronic money institutions authorised in Luxembourg as at 31 December 2018. Moreover, one branch of an institution authorised in Luxembourg has to be added to this figure.

The balance sheet total of electronic money institutions amounted to EUR 1.8 billion as at 31 December 2018, representing a 40.65% increase compared to the end of 2017 when the balance sheet total reached EUR 1.3 billion.



CHAPTER IX

SUPERVISION OF INVESTMENT FUND MANAGERS AND UCIS

1. AUTHORISED INVESTMENT FUND MANAGERS

Authorised investment fund managers (authorised IFMs)¹ comprise the following types of fund managers:

- management companies subject to Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment (hereinafter 2010 Law); and
- authorised alternative investment fund managers (AIFMs) subject to the Law of 12 July 2013 on alternative investment fund managers (hereinafter 2013 Law).

These managers vary greatly in Luxembourg, in terms of size and investment strategies as well as in terms of exercised activities.

1.1. Development in numbers

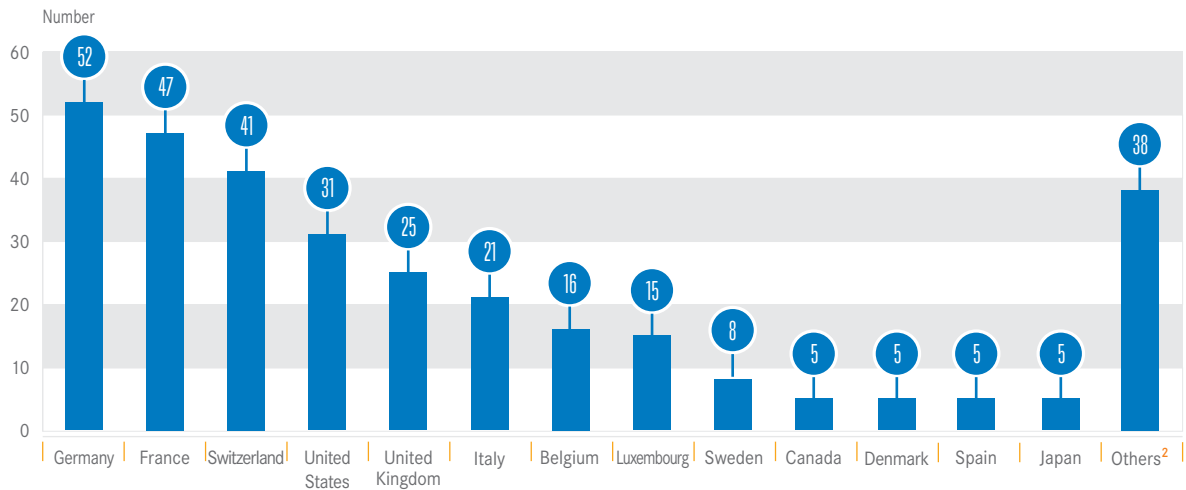
The total number of authorised IFMs amounted to 314 as at 31 December 2018, compared to 306 as at 31 December 2017. This net increase of eight entities is the result of 20 registrations and 12 withdrawals in 2018. Among the new registrations, three entities exercise activities in the investment fund sector in Luxembourg for the first time.

¹ It should be noted that this section's statistics do not include the 26 internally authorised managers, namely 16 SICAVs which did not designate a management company under Article 27(1) of the 2010 Law and 10 internally managed alternative investment funds (AIFs), as laid down in Article 4(1)(b) of the 2013 Law. Moreover, the 75 management companies subject to Article 125-1 of Chapter 16 of the 2010 Law managing UCIs which do not qualify as AIFs or UCITS or which fall within the scope of the exemption or transitional provisions of the 2013 Law are not counted in the statistics of this section as their activity is considered as not statistically significant. These management companies are hence included in Section 2 on other investment fund managers.

1.2. Geographical origin

As in previous years, the main countries of origin of authorised IFMs are Germany, France, Switzerland and the United States of America. It should be pointed out that most investment fund managers registered in 2018 are of US or French origin.

Geographical origin of authorised IFMs



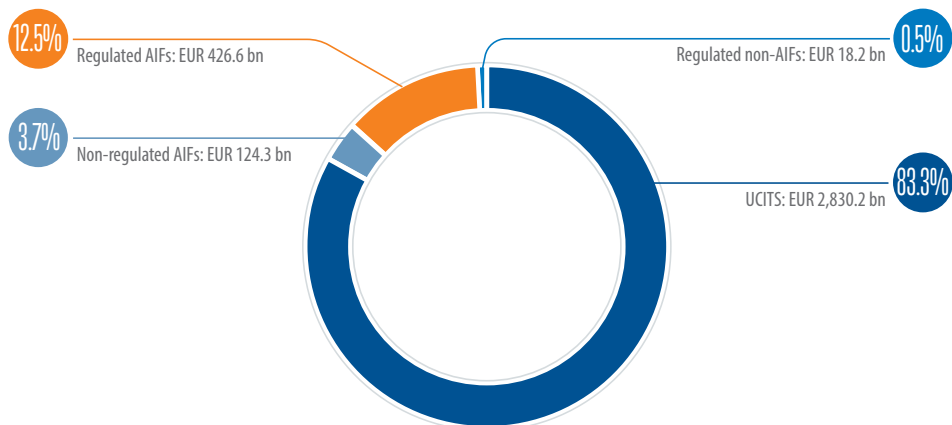
1.3. Development in employment

As at 31 December 2018, total staff of authorised IFMs³ amounted to 5,705 employees, against 4,969 employees as at 31 December 2017, i.e. an increase of 736 employees. This rise results, on the one hand, from a general increase of the number of employees within the existing authorised IFMs and, on the other hand, from the arrival of new entities in 2018.

1.4. Assets under management

As at 31 December 2018, authorised IFMs managed assets of EUR 3,399.3 billion.

Breakdown of assets under management according to type of product



² Others: Andorra (2), Australia (3), Austria (2), Bermuda (1), BVI (1), Chile (1), Finland (2), Greece (3), Guernsey (1), Ireland (1), Jersey (3), Liechtenstein (2), Malta (2), Mauritius (1), the Netherlands (3), Norway (1), Poland (1), Portugal (2), Qatar (2), Russia (2), South Africa (1), the United Arab Emirates (1).

³ The total staff figures of authorised IFMs do not include staff of these IFMs' branches.

The category of “Regulated non-AIFs” is composed of specialised investment funds (SIFs) governed by the Law of 13 February 2007 and investment companies in risk capital (SICARs) governed by the Law of 15 June 2004 which do not qualify as AIFs.

It is worth mentioning that the 50 most significant authorised IFMs in terms of assets under management manage 81% of the assets.

1.5. Investment strategies

The following table shows the breakdown of the investment strategies pursued by authorised IFMs according to the categorisations laid down in Commission Delegated Regulation (EU) No 231/2013.

Breakdown of investment strategies

Investment strategies	UCITS	Regulated AIFs and non-AIFs	Non-regulated AIFs	Total
Fixed-income transferable securities	35.6%	2.4%	0.0%	38.0%
Variable-yield transferable securities	27.2%	1.2%	0.0%	28.4%
Mixed transferable securities	17.6%	3.1%	0.0%	20.7%
Funds of funds	2.6%	2.2%	0.5%	5.3%
Real estate funds	0.0%	1.8%	0.5%	2.3%
Capital investment funds	0.0%	1.4%	0.8%	2.2%
Hedge funds	0.0%	0.0%	0.1%	0.1%
Others	0.3%	1.1%	1.6%	3.0%
Total	83.3%	13.2%	3.5%	100.0%

With respect to all the funds managed by these authorised IFMs, a concentration of investment strategies relating to fixed-income transferable securities and variable-yield transferable securities (mixed transferable securities also consisting of these two types of assets) is to be noted.

1.6. Discretionary management

The 2010 Law and the 2013 Law allow authorised IFMs to benefit from an extended scope of activity, in particular for the provision of discretionary management services. As at 31 December 2018, 59 authorised IFMs (46 in 2017) provided this service for a total of EUR 45.9 billion of assets under management (compared to EUR 59.9 billion in 2017).

1.7. Financial situation

The provisional balance sheet total of all authorised IFMs, including their branches, reached EUR 14.5 billion as at 31 December 2018, as against EUR 14.7 billion as at 31 December 2017, i.e. a slight decrease of 1.4%. This negative trend can be explained by the decrease of the item “Result of the financial year” linked to a decline in the assets under management and an increase in fees.

Provisional net results amounted to EUR 2.9 billion as at 31 December 2018, as against EUR 3.1 billion as at 31 December 2017, representing a decrease of 6.5%. Finally, out of the 314 authorised IFMs, 259 recorded a net profit and 55 a net loss. Among the authorised IFMs that recorded a loss, 11 are newly created authorised IFMs.

Development of the balance sheet total and of the net results of authorised IFMs

<i>(in bn EUR)</i>	2017	2018	Variation in %
Balance sheet total	14.7	14.5	-1.4%
Net results	3.1	2.9	-6.5%

The financial data of authorised IFMs also shows that:

- liquidities held by the authorised IFMs cover 96% of their own funds, evidencing a sound and prudent management;
- staff costs increased by 9.32%, due mainly to the strengthening of the substance of authorised IFMs.

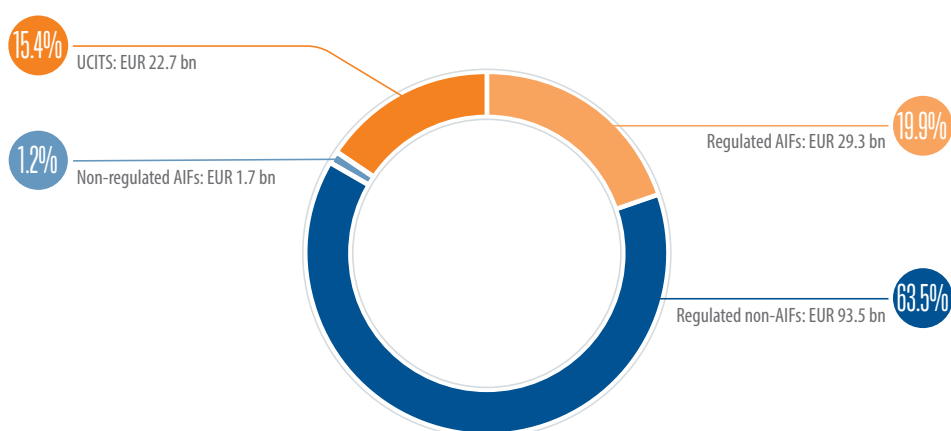
2. OTHER INVESTMENT FUND MANAGERS

The following other investment fund managers (other IFMs) are present in Luxembourg:

- 565 registered investment fund managers (registered IFMs);
- 75 management companies subject to Article 125-1 of Chapter 16 of the 2010 Law: these management companies manage UCIs which do not qualify as AIFs or UCITS or which fall within the scope of the exemption or transitional provisions of the 2013 Law;
- 16 self-managed UCITS investment companies (SIAGs);
- 10 internally managed alternative investment fund managers;
- one management company set up under Chapter 18 of the 2010 Law.

At EUR 66.4 billion, the share of the assets under management of these other IFMs remains moderate compared to the authorised IFMs. It should also be noted that EUR 80.8 billion are held in regulated AIFs and regulated non-AIFs which fall within the scope of the transitional provisions as defined in Article 58 of the 2013 Law and which are consequently not linked to an authorised or registered IFM set up under the 2013 Law.

Breakdown of assets under management of other IFMs according to type of product



The following table shows the main investment strategies pursued by the other IFMs.

Breakdown of investment strategies

Investment strategies	UCITS	Regulated AIFs and non-AIFs	Non-regulated AIFs	Total
Fixed-income transferable securities	4.4%	10.0%	0.0%	14.4%
Variable-yield transferable securities	3.9%	9.7%	0.0%	13.6%
Mixed transferable securities	7.1%	23.1%	0.0%	30.2%
Funds of funds	0.0%	16.2%	0.1%	16.3%
Real estate funds	0.0%	4.7%	0.0%	4.7%
Capital investment funds	0.0%	16.0%	0.5%	16.5%
Hedge funds	0.0%	0.1%	0.0%	0.1%
Others	0.0%	3.6%	0.6%	4.2%
Total	15.4%	83.4%	1.2%	100.0%

With respect to all the funds managed by the other IFMs and similarly to authorised IFMs, the most representative UCITS investment strategies are strategies relating to fixed-income transferable securities and variable-yield transferable securities (mixed transferable securities also consisting of these two types of assets).

The trend slightly differs with respect to AIFs for which funds of funds and capital investment funds strategies represent a significant proportion along with the above-mentioned strategies.

• EuVECA and EuSEF

In 2018, no new EuVECA manager registration request under Regulation (EU) No 345/2013 of 17 April 2013 on European venture capital funds was submitted to the CSSF. The total number of registered EuVECAs was nine as at 31 December 2018.

As concerns EuSEFs, no registration request for an EuSEF manager (in accordance with Article 15 of Regulation (EU) No 346/2013 of 17 April 2013 on European social entrepreneurship funds) was submitted to the CSSF. By contrast, an application for the registration of an EuSEF fund which will be managed by an authorised Luxembourg manager has been made in accordance with Article 15a of the above-mentioned regulation.

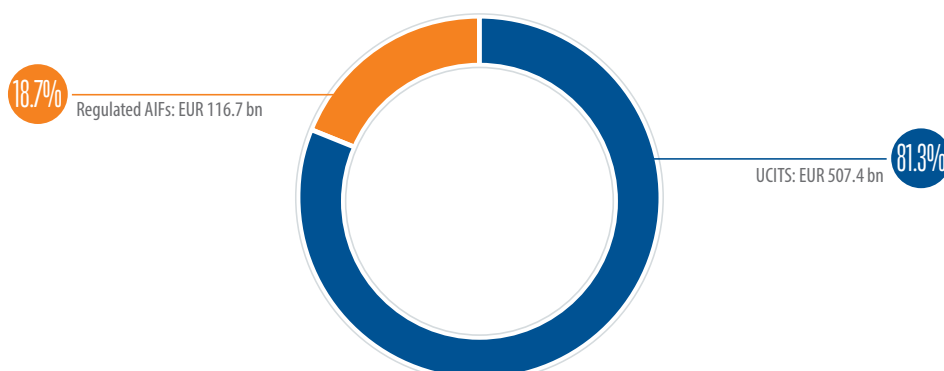
As at 31 December 2018, 113 EuVECAs and four EuSEFs managed by a manager registered in another EU country were distributed in Luxembourg.

3. CROSS-BORDER ACTIVITIES⁴

3.1. IFMs established in another EU Member State

IFMs established in another EU Member State and carrying out the management of Luxembourg-based UCITS or AIFs under Article 119 of the 2010 Law and/or Article 33 of the 2013 Law manage EUR 624.1 billion of assets.

⁴ The IFMs established in third countries, carrying out the management of Luxembourg regulated and non-regulated AIFs according to Article 44 of the 2013 Law and managing EUR 20.2 billion of assets, are excluded.

Breakdown of products managed on a cross-border basis⁵

IFMs established in another EU Member State and exercising cross-border activities in Luxembourg break down as follows:

- 77 managers manage UCITS;
- 132 managers manage regulated AIFs;
- nine managers manage both UCITS and regulated AIFs.

Among these 218 IFMs, 15 managers originating from Germany, France, Ireland, Italy, Malta and Sweden provided management services for UCITS and AIFs via a branch in Luxembourg as at 31 December 2018.

3.2. IFMs established in Luxembourg

3.2.1. Freedom to provide services under the UCITS Directive

In 2018, 11 authorised IFMs (compared to nine in 2017) notified their intention to carry out the functions included in the collective management activities in another EU Member State in the framework of freedom to provide services. The host Member States are Belgium, Ireland, Malta and Portugal.

3.2.2. Freedom to provide services under the AIFMD

In 2018, 10 authorised IFMs (compared to 15 in 2017) notified their intention to manage AIFs under the freedom to provide services in one or several other EU Member States. The host Member States are the 28 EU countries, with the exception of the United Kingdom and Luxembourg.

3.2.3. Free establishment of branches under the UCITS Directive and the AIFMD

As at 31 December 2018, 42 authorised IFMs (compared to 39 in 2017) were represented by a branch in one or several EU Member States under the UCITS Directive or the AIFMD. This corresponds to a total of 86 branches (compared to 76 in 2017).

As at 31 December 2018, total staff within these branches amounted to 813 employees, compared to 838 employees as at 31 December 2017.

⁵ Data not available for non-regulated AIFs.

4. EVOLUTION OF THE UCI SECTOR IN 2018

As at 31 December 2018, 3,908 UCIs were registered on the official list, compared to 4,044 at the end of the previous year (-3.4%). This decrease is linked to a consolidation trend in the UCI sector, combined with a preference to create umbrella structures.

Out of the 3,908 UCIs, 2,536 had adopted an umbrella structure, representing a decline of 67 entities compared to the previous year. Single-compartment UCIs decreased by 69 entities.

The total number of fund units rose from 14,728 as at 31 December 2017 to 14,898 as at 31 December 2018. This rise results from the net creation of 239 sub-funds within UCIs with an umbrella structure, which compensates the decrease in number of single-compartment UCIs (-69 entities).

As the inflow of new capital (EUR 92.4 billion) could not compensate the negative developments in the financial markets (- EUR 187.4 billion), total net assets of Luxembourg UCIs decreased by EUR 95.0 billion over one year to reach EUR 4,064.6 billion as at 31 December 2018 (-2.3%).

Evolution of the total number, number of fund units and net assets of UCIs

Year	Total number of UCIs	Number of fund units	Net assets (in bn EUR)
2008	3,592	12,546	1,576.5
2009	3,699	12,472	1,858.4
2010	3,914	13,203	2,220.4
2011	4,121	13,595	2,120.0
2012	4,117	13,757	2,413.7
2013	4,181	14,048	2,645.7
2014	4,193	14,237	3,127.7
2015	4,160	14,496	3,543.6
2016	4,144	14,595	3,741.3
2017	4,044	14,728	4,159.6
2018	3,908	14,898	4,064.6

Similarly to preceding years, the Luxembourg UCITS sector benefited from a positive balance between mergers in which the receiving UCITS is domiciled in Luxembourg (130 projects) and those in which the receiving UCITS is domiciled in another EU Member State (35 projects).

5. PRUDENTIAL SUPERVISORY PRACTICE

5.1. Prudential supervision

The CSSF's prudential supervision aims to verify that IFMs and UCIs subject to its supervision continuously observe all legal, regulatory and contractual provisions relating to their organisation and operation, with the objective to ensure investor protection and stability of the financial system.

Prudential supervision is exercised via:

- off-site supervision based on the analysis of the periodic financial information, annual reports, other reports (including the reports of the *réviseurs d'entreprises agréés* (approved statutory auditors)) and regular or ad hoc information received by the CSSF;
- on-site supervision, i.e. on-site inspections carried out by the CSSF agents at the offices of supervised entities.

5.2. Off-site supervision

5.2.1. Review of monthly, half-yearly and annual financial information

Circular CSSF 15/627 requires that all Luxembourg UCIs (UCITS, UCIs subject to Part II of the 2010 Law, SIFs and SICARs) provide, on a monthly basis, functional information and financial information on the activities of authorised funds and sub-funds (prudential report U1.1.).

Circulars IML 97/136, CSSF 07/310, CSSF 08/348 and CSSF 08/376 apply to half-yearly (prudential report K3.1.) and annual (prudential reports O4.1. and O4.2.) financial information.

The deadline to transmit the monthly financial information is 10 days following the reference date, which is in principle the last day of each month. The deadline for communicating the half-yearly information is 45 days after the reference date. As regards annual financial information, the reference date depends on the closing date of the financial year and of the legal deadline for filing the annual accounts. Consequently, the deadline for transmitting the information is four months for UCITS governed by Part I of the 2010 Law and six months for UCIs governed by Part II of the 2010 Law and SIFs.

Luxembourg UCIs must transmit the financial information electronically to the CSSF and, where applicable, through a duly appointed provider. The CSSF expects that the UCIs rigorously comply with the deadlines for the communication of the financial information to the CSSF. The CSSF also points out the importance of preparing the prudential reports with due care so that they are accurate in form and content.

The CSSF carries out quality and coherence controls on the data received and, where necessary, takes sanction measures where the reporting entities do not comply with their obligations. In this context, the CSSF highlights that it publishes, on its website, several documents such as guidelines, control rules, examples and FAQs in order to clarify a certain number of recurring questions in relation to prudential reporting. Data collected in the framework of prudential supervision are shared with the BCL and STATEC for statistical purposes.

5.2.2. Supervision of the UCI activity based on annual and half-yearly reports, management letters and long form reports

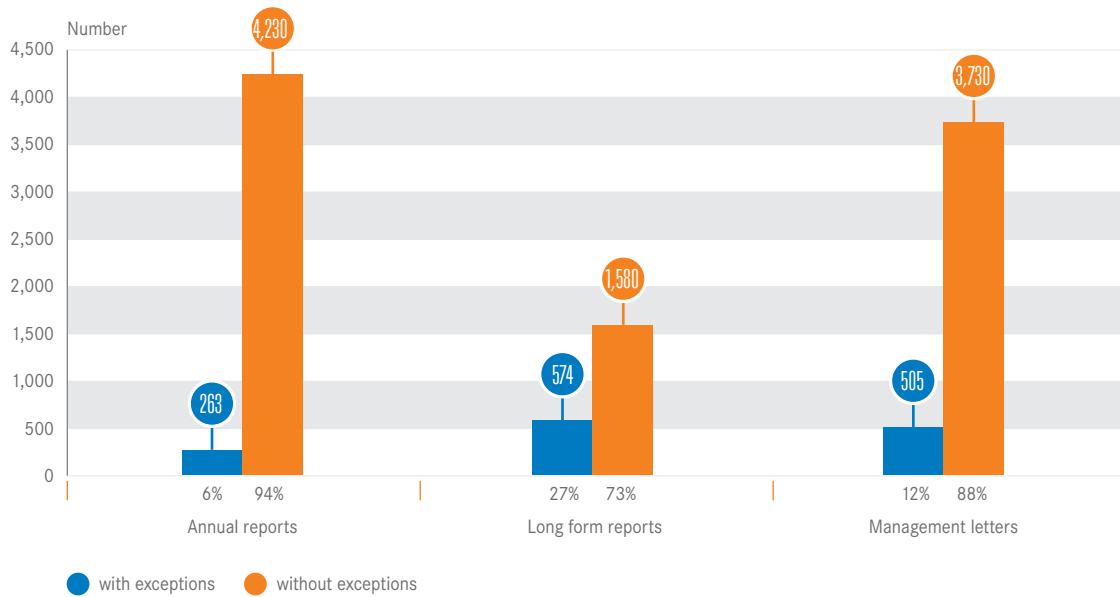
In the framework of the review of annual and half-yearly reports, management letters and long form reports⁶, the CSSF had to take decisions in the form of injunctions, formal requests and recommendations regarding the *dirigeants* (managing directors) of some UCIs. These decisions aimed at addressing the organisational deficiencies raised by the *réviseurs d'entreprises agréés* in their reports or management letters.

In 2018, the CSSF sent 140 letters to require corrective measures in order to remedy more serious deficiencies identified during the review of the above-mentioned documents. Besides the formal interventions and pursuant to a risk-based supervision, the CSSF also intervened via telephone or email to clarify or deal with less critical deficiencies.

The following chart highlights, per type of report, the number and proportion of reports in which one or several exceptions were noted by the *réviseur d'entreprises agréé* and which were subject to a review by the CSSF.

⁶ While the annual reports and management letters concern UCI(TS), SIFs and SICARs, the long form reports only concern UCIs subject to the 2010 Law, i.e. UCITS Part I and UCIs Part II.

Number and proportion of reports with or without exceptions noted



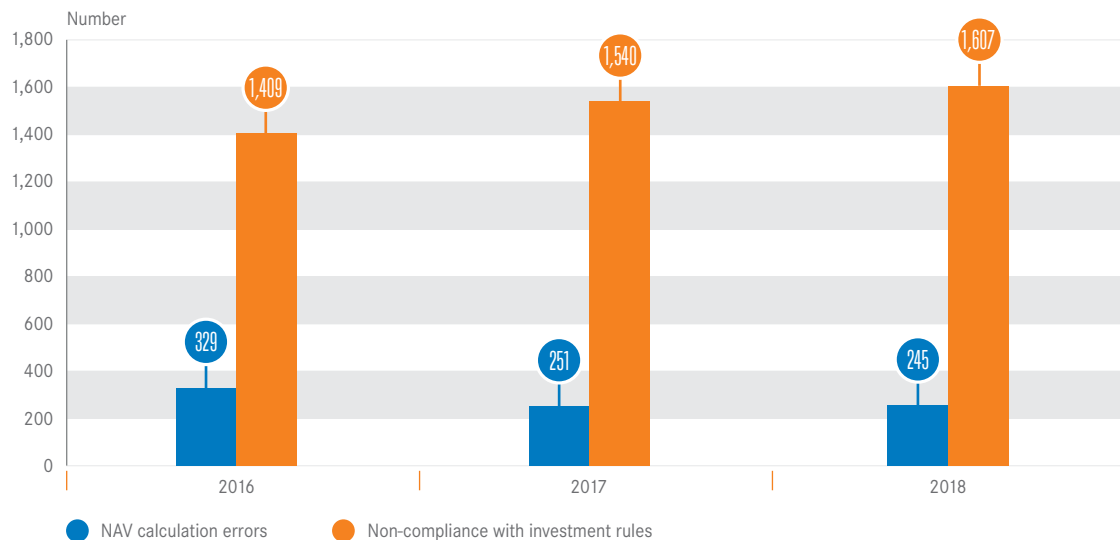
In 2018, the CSSF’s interventions via letter, addressed mostly to UCITS, mainly concerned the fight against money laundering and terrorist financing (AML/CTF). The exceptions noted in relation to AML/CTF concerned, in particular, incomplete customer/investor documentation or internal procedures and processes not fulfilling the regulatory requirements.

5.2.3. NAV calculation errors and non-compliance with investment rules

• **Declarations made in 2018**

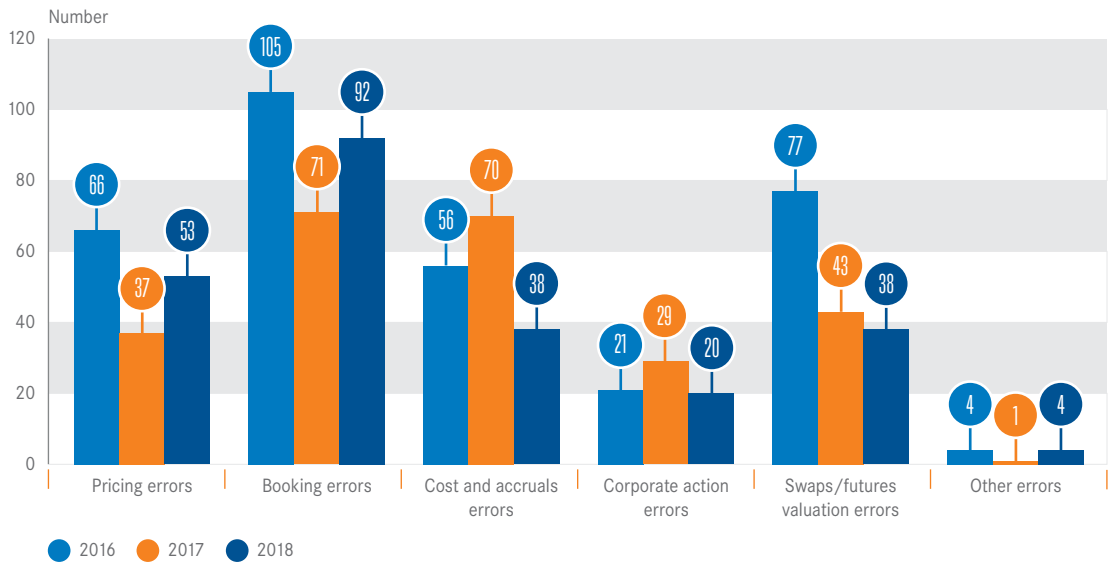
In 2018, the CSSF received 1,852 declarations on the basis of Circular CSSF 02/77, compared to 1,791 declarations in 2017, representing an increase of 3.41% that is entirely attributable to non-compliance with investment rules (+4.35%).

Evolution of the number of NAV calculation errors and instances of non-compliance with investment rules reported to the CSSF over the last three years



As in previous years, the simplified procedure, as described in Circular CSSF 02/77, could be applied in most cases of NAV calculation errors and non-compliance with investment rules.

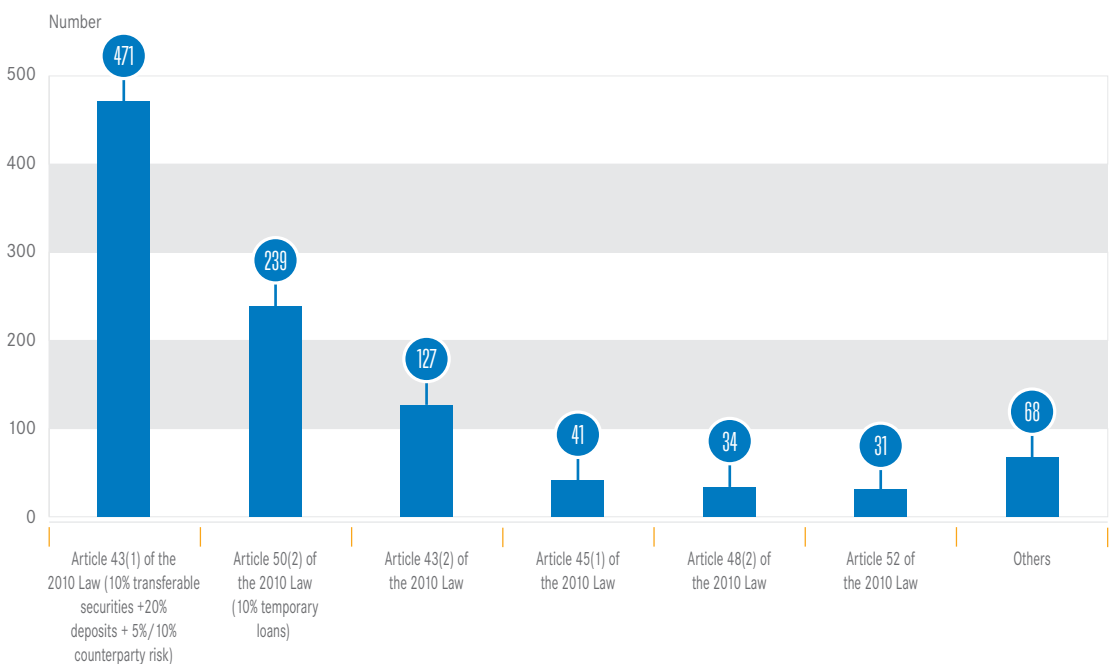
Evolution of the origin of NAV calculation errors over the last three years



Booking errors remained the main cause of NAV calculation errors.

Failure to observe legal limits of diversification, holding and borrowing was the main source of non-compliance with investment rules with 1,011 cases (1,074 cases in 2017, i.e. -5.87%). This was followed by 406 cases of exceeding internal limits defined in sales documents (306 cases in 2017, i.e. +32.68%) and 190 cases of legal constraints breaches as regards asset eligibility (160 cases in 2017, i.e. +18.75%).

Breakdown of the instances of non-compliance with the legal limits of diversification, holding and borrowing



- Compensation in relation to correction of NAV calculation errors or instances of non-compliance with investment rules

Compensation in 2017 and 2018

	Investors			UCI/Sub-fund		
	2017	2018	Variation in %	2017	2018	Variation in %
Total amount of compensation following NAV calculation errors	8,522,213.29	40,167,579.94	+371.33%	2,571,664.39	16,153,598.63	+528.14%
Total amount of compensation following non-compliance with investment rules	2,067.46	0.00	-100.00%	1,630,269.21	7,650,066.85	+369.25%

In 2018, the amount of compensation paid out increased due to a higher number of cases requiring significant compensation. Overall, the total amount of compensation remained moderate as compared to the total amount of assets under management.

5.3. On-site supervision

The “UCI on-site inspection” department continued to increase its staff, with 17 agents as at 1 April 2019, against 13 as at 1 April 2018. The team carries out on-site inspections consisting of an in-depth review of the IFMs’ business models and governance as well as thematic on-site inspections covering, among others, the fight against money laundering and terrorist financing.

The “Prudential supervision and risk management” department performs thematic on-site inspections on risk management, procedures related to Circular CSSF 02/77 and money market funds.

Moreover, the “On-site inspection” department of the CSSF performs thematic inspections in relation to central administration and MiFID regulations at IFMs.

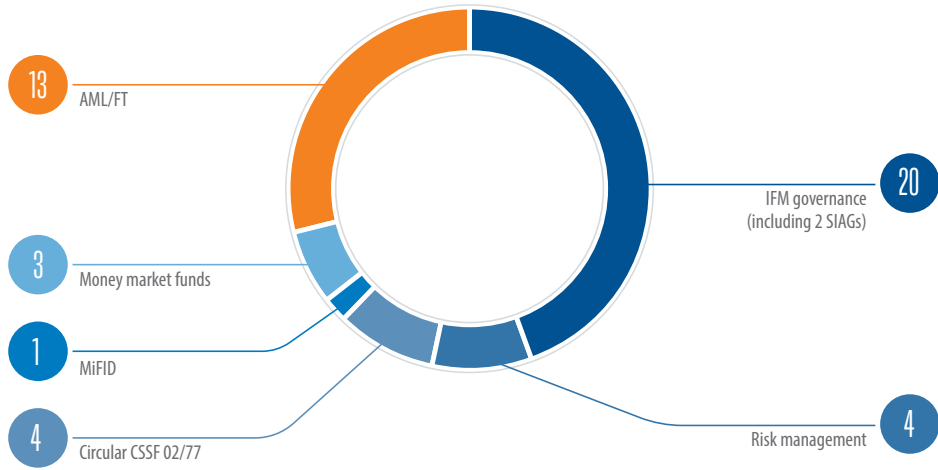
5.3.1. Statistics

In 2018, the CSSF carried out 45 on-site inspections at IFMs⁷ based on a long-term inspection plan using a risk-based approach.

The authorised IFMs inspected represented about 19% in terms of assets under management of these IFMs. Moreover, the inspections concerned 12 authorised IFMs whose assets under management exceeded EUR 10 billion.

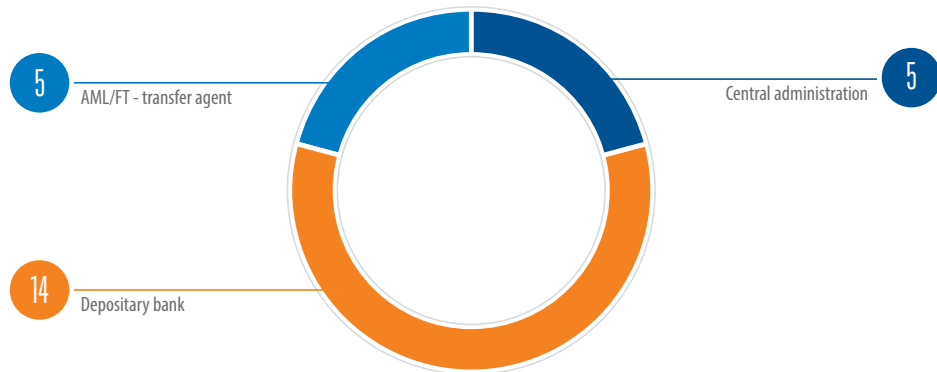
⁷ Including two self-managed SICAVs.

Thematic on-site inspections performed in 2018 at IFMs (including self-managed SICAVs)



The CSSF also performed 24 on-site inspections at depositary banks and central administrations.

Thematic on-site inspections performed in 2018 at UCI service providers⁸



5.3.2. Main findings

In the context of the on-site inspections relating to governance of IFMs, the CSSF identified shortcomings in the follow-up of delegated activities, a topic that had already been addressed in the previous annual reports of the CSSF due to the recurrence of such observations and the importance of this subject. Deficiencies have also been identified in the due diligence process, at the entry into business relationship and on a continuous basis. Due diligence appears to be sometimes incomplete, or even missing. Moreover, in certain cases, due diligence processes do not include assessments of the outcome of the controls performed.

Where activities are delegated to entities belonging to the same group, the CSSF observed a lack of involvement of the IFM in the continuous monitoring of the delegates. The CSSF would therefore like to remind IFMs that, in the context of delegation management and monitoring, regulations make no distinction between a delegate being part or not of the same group to which the IFM belongs. Moreover, the frequency and information gathered by the key performance indicators are often not adapted to the delegated activities.

As far as the internal audit function is concerned, the CSSF observed that the audit plan does not always cover all the functions of the IFMs, and their subsidiaries and branches. Finally, the recommendations made by the internal audit are not consistently addressed with an appropriate monitoring.

⁸ These on-site inspections were carried out at credit institutions, investment firms and specialised PFS.

The CSSF also noted that the update of the IFMs' procedures manuals is not always adapted to the development of their activities and the regulations in force. Moreover, the senior management of certain IFMs does not have management information allowing it to adequately conduct business and it does not write down the decision taken in this context.

Finally, as concerns the use of information technologies, the CSSF identified weaknesses in the management of access rights and in the creation and implementation of business continuity plans, despite the fact that the latter contribute to the reduction of the entities' vulnerability in case of incidents or external IT attacks.

6. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

6.1. Circular CSSF 18/696

Circular CSSF 18/696, published on 20 July 2018, aims at implementing, into the Luxembourg regulation applicable to money market funds subject to the supervision of the CSSF and to Luxembourg managers of money market funds, the Guidelines on stress tests scenarios under Article 28 of the MMF Regulation (Ref. ESMA/34-49-115) published on 21 March 2018 by ESMA.

6.2. Circular CSSF 18/697

On 23 August 2018, the CSSF published Circular CSSF 18/697, whose purpose is, in particular, to lay down the principles of sound governance and to specify the CSSF requirements on internal organisation and good practice of AIF depositaries. This circular does not cover AIFs having designated a registered AIFM, nor UCIs subject to Part II of the 2010 Law and for which marketing with retail investors established in Luxembourg is possible. As regards SIFs and SICARs that do not qualify as AIFs, or that qualify as AIFs and that have designated a registered IFM, they are now covered by Chapter 5 of Part I of the circular. Chapter E of Circular IML 91/75 has been repealed. It should be noted that the circular amended and replaced Annex 1 of Circular CSSF 16/644 and entered into force on 1 January 2019.

6.3. Circular CSSF 18/698

Circular CSSF 18/698, published on 23 August 2018, aims at aligning the requirements relating to the authorisation and organisation of investment fund managers in the area of UCITS and AIFs. It addresses thus Luxembourg IFMs in general, i.e. management companies of UCIs authorised under Chapter 15 or 16 of the 2010 Law and AIFMs authorised under the 2013 Law. The Luxembourg branches of IFMs referred to in Chapter 17 of the 2010 Law as well as the self-managed investment companies (SIAGs) and the internally managed alternative investment funds (FIAAGs) are also included in its scope. The circular provides additional clarifications on certain conditions for the authorisation of IFMs, more particularly the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework. It also includes specific provisions on AML/CFT applicable to IFMs and to entities carrying out the activity of registrar agent. This circular repealed Circular CSSF 12/546 on the authorisation and organisation of Luxembourg management companies and entered into force with immediate effect.



Agents hired in 2018 and 2019: Departments “Operations and coordination of the UCI departments’ specific IT tools”, “Authorisation and supervision of UCITS and pension funds” and “International, regulation and enforcement”

From left to right: Simon HASNE, Nicolas WAECKERLÉ, Sophie DE SANCTIS, Véronique SCHNEIDER, Lucien CLEMENT, Diana ALBINOVIC, Rosella PASSUCCI, Lynn FELTEN, Alessandro PAOLUCCI

Absent: Luigi MASTROSERIO, Christophe PIETQUIN, Anita TIGANJ



Agents hired in 2018 and 2019: Departments “Authorisation and supervision of alternative investment funds” and “UCI on-site inspections”

From left to right: Antoine NORO, Stéphanie DUVIVIER, Rainer LAND, Anamarija BABIC, Marc LEEMANS, Cristina DOS SANTOS, Baraa OUNISSI

Absent: Geoffrey BARRÉ, Odile SUERGIU



CHAPTER X

SUPERVISION OF SECURITISATION UNDERTAKINGS

1. DEVELOPMENTS OF AUTHORISED SECURITISATION UNDERTAKINGS

During 2018, the CSSF received two applications for registration on the official list of authorised securitisation undertakings subject to the Law of 22 March 2004 on securitisation.

Following the deregistration of three securitisation undertakings and the registration of one securitisation undertaking during the year, 31 securitisation companies were registered on the official list of authorised securitisation undertakings as at 31 December 2018, against 33 entities at the end of 2017. The balance sheet total of authorised securitisation undertakings amounted to EUR 44.5 billion at the end of 2018, representing an increase of EUR 2.1 billion against 2017.

The submitted application files reveal that securitisation transactions mainly consist in repackaging transactions in the form of structured products issues linked to various financial assets, notably equity indices, baskets of shares or units of UCIs, as well as in securitisation of debt, loans and other comparable assets. The repackaging transactions are mainly synthetic securitisation transactions in respect of the risk transfer technique.

In general, the securities issued by securitisation undertakings are bonds and subject to foreign law. It is also possible for some securitisation undertakings to issue warrants. As at 31 December 2018, 10 of the 31 authorised securitisation undertakings issued securities admitted to trading on a regulated market.

To date, no application file for a securitisation fund has been submitted to the CSSF. Neither has the CSSF received any application file for a fiduciary-representative under Luxembourg law, even though the Law of 22 March 2004 on securitisation has established a specific legal framework for these independent professionals in charge of representing investors' interests.

2. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

Regulation (EU) 2017/2402 of 12 December 2017, published in the Official Journal of the EU of 28 December 2017, lays down a general framework for securitisation with appropriate due-diligence, risk-retention and transparency requirements for securitising parties, and creates a specific framework for simple, transparent and standardised (STS) securitisation (Securitisation Regulation). This regulation, which applies to institutional investors, originators, sponsors, original lenders and securitisation special purpose entities, entered into force on 17 January 2018 and is applicable as from 1 January 2019.

In the context of the implementation of this regulation, ESMA published the final reports relating to the draft regulatory and/or implementing standards concerning:

- the content and format of the STS notification under Regulation (EU) 2017/2402 (ref.: ESMA33-128-477);
- the requirements relating to third-party firms providing STS verification services (ref.: ESMA33-128-473);
- the disclosure requirements under Regulation (EU) 2017/2402 (ref.: ESMA33-128-474). On 31 January 2019, ESMA also published an opinion concerning amendments to the draft technical standards on disclosure requirements (ref.: ESMA33-128-600) following the request of the European Commission after the submission in August 2018 of the first version of the draft standards;
- the information and format to be provided as part of an application by firms seeking to register with ESMA as securitisation repositories as well as operational standards and access conditions to the information collected and maintained by securitisation repositories (ref.: ESMA33-128-488). In this context, ESMA also published a final technical advice on fees to be charged by ESMA for registering and supervising securitisation repositories;
- the cooperation, exchange of information and notification between national competent authorities and the European Supervisory Authorities (ref.: ESMA33-128-557).

ESMA also published further guidance to market participants on ESMA's arrangements for being notified of a securitisation's STS status (ref.: ESMA33-128-585). This guidance also includes an STS notification template (ref.: ESMA33-128-585a).

Moreover, ESMA also issued a statement addressing various topics related to its near-term implementation activities under Regulation (EU) 2017/2402. This statement aims to provide additional information to facilitate market participants' understanding regarding the next steps of this implementation (ref.: ESMA33-128-577).

Finally, on 31 January 2019, ESMA published Q&As relating to the application of Regulation (EU) 2017/2402 (ref.: ESMA33-128-563) and which provide technical clarifications to help the entities concerned to fill in the templates to be used.

The EBA published final reports containing draft technical standards that cover:

- the homogeneity of underlying exposures in securitisation (ref.: EBA/RTS/2018/02);
- risk retention for securitisation transactions (ref.: EBA/RTS/2018/01).

The EBA also published a final report on the guidelines on the STS criteria for ABCP securitisation (ref.: EBA/GL/2018/08) and on STS criteria for non-ABCP securitisation (ref.: EBA/GL/2018/09).

These final reports have been submitted for approval to the European Commission.



CHAPTER XI

SUPERVISION OF PENSION FUNDS

1. DEVELOPMENT OF PENSION FUNDS IN 2018

1.1. Major events and trends observed in 2018

As at 31 December 2018, 12 pension funds subject to the Law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (SEPCAVs) and pension savings associations (ASSEPs) were registered on the CSSF's official list of pension funds.

The year 2018 was mainly marked by the development of new cross-border pension schemes within existing pension funds. Within the framework of the Budapest Protocol, which organises the practical implementation of the relations between authorities for cross-border activities, the CSSF sent four notifications to the competent authorities acting as host Member State and approved two pension schemes in 2018.

The sector of pension funds supervised by the CSSF will be impacted by the transposition into Luxembourg law of Directive (EU) 2016/2341 of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) which will amend the Law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (SEPCAVs) and pension savings associations (ASSEPs). The new legal provisions will cover, among other things, the governance system, the creation of new key functions such as risk management, internal audit and the actuarial function and the establishment of a pension benefit statement containing key information for every member. These changes will require upgrades to the existing structures.

The opening-up of the institutions for occupational retirement provision following the entry into force, on 1 January 2019, of the Law of 1 August 2018 amending the Law of 8 June 1999 relating to supplementary pension schemes and the recent initiatives at European level to implement a pan-European personal pension product (PEPP) offer new perspectives in the field of pensions and opportunities to increasingly stimulate and globalise the sector.

1.2. Pension funds activities

The pension funds supervised by the CSSF manage one or several pension schemes set up by Luxembourg or foreign companies for their employees.

As at 31 December 2018, three pension funds managed cross-border pension schemes. These pension funds provide their services to sponsoring undertakings established in Ireland, the Netherlands, the United Kingdom, Germany, Italy, Belgium, Portugal and Spain as well as to non-EU sponsoring undertakings.

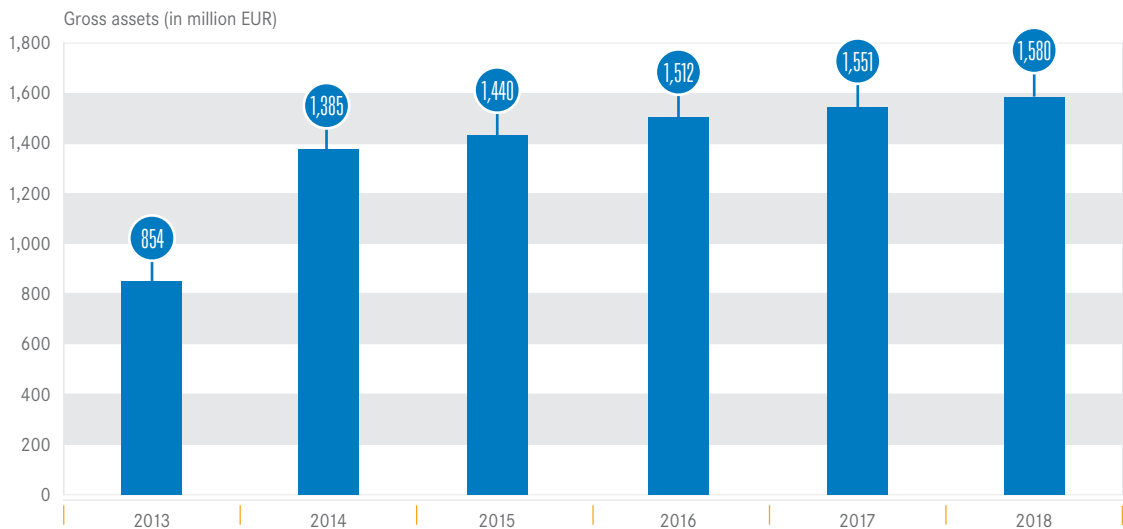
Ten out of the 12 pension funds registered on the official list have adopted the legal form of a pension savings association and two have adopted the legal form of a pension savings company with variable capital.

1.3. Development of pension fund assets

At the end of 2018, gross assets of pension funds amounted to EUR 1,580 million against EUR 1,551 million as at 31 December 2017, representing a 2% growth.

The assets of cross-border pension schemes amounted to EUR 560 million as at 31 December 2018 against EUR 473 million at the end of the previous year.

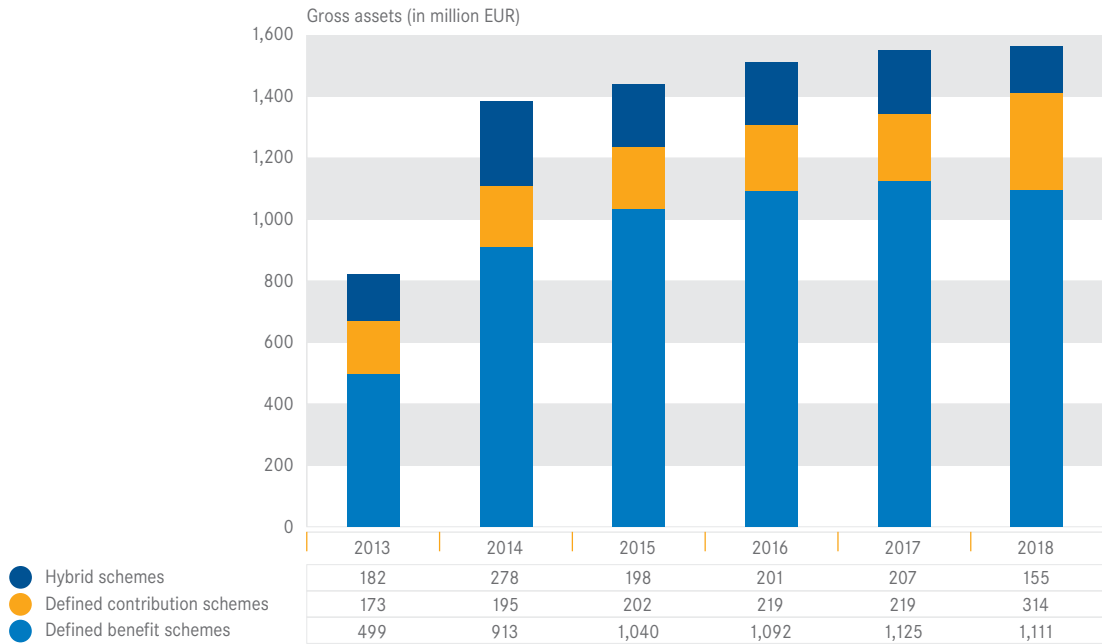
Development of pension fund assets



1.4. Development of assets according to the type of pension scheme

At the end of 2018, gross assets of the defined benefit schemes amounted to EUR 1,111 million and represented 70% of overall gross assets of pension funds. The assets of defined contribution schemes amounted to EUR 314 million as at 31 December 2018.

Development of assets according to the type of pension scheme

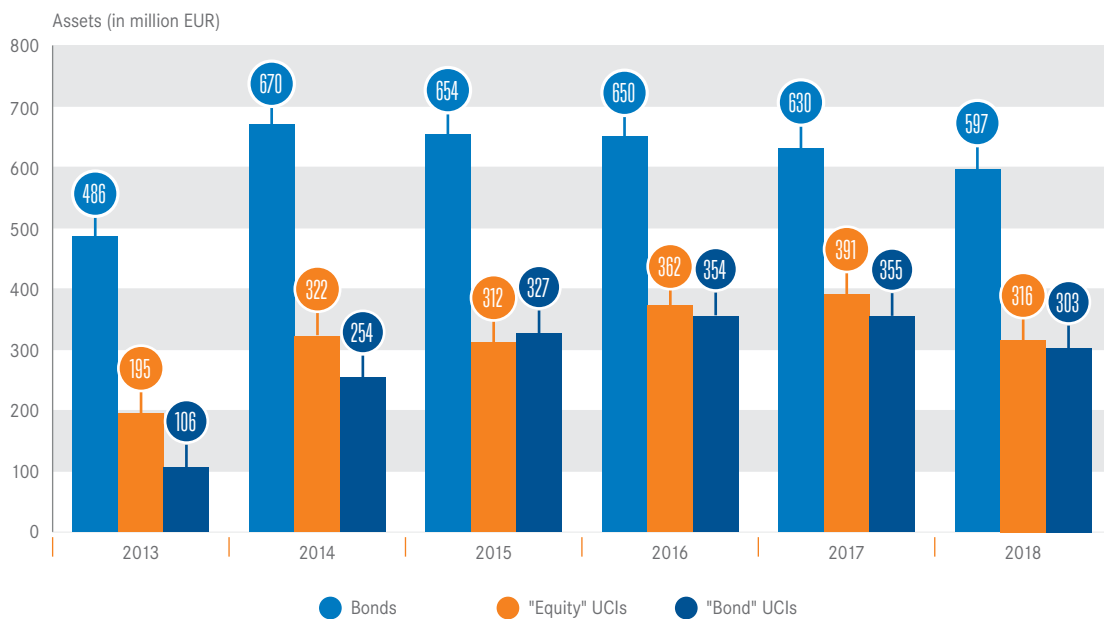


1.5. Allocation of pension fund assets

In 2018, pension funds invested mainly in investment funds (i.e. EUR 659 million), 48% (EUR 316 million) of which were exposed to the equity market, 46% (EUR 303 million) to the bond market and 6% (EUR 41 million) were invested in mixed funds, money market funds and AIFs.

Total investment of pension funds in bonds represented EUR 597 million, i.e. 39% of total gross assets of pension funds.

Allocation of pension fund assets

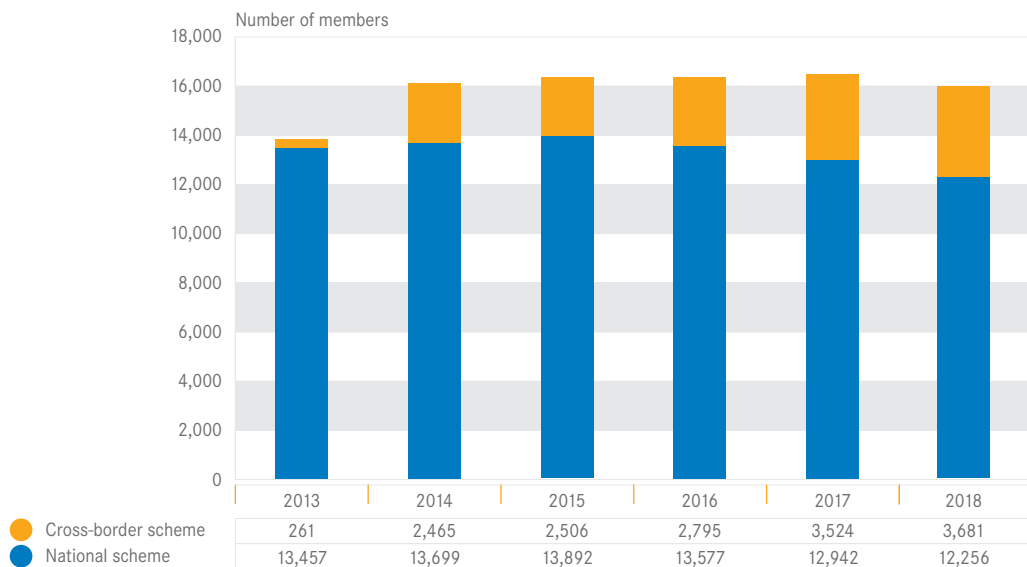


1.6. Development in the number of pension fund members

At the end of 2018, the pension funds had 15,937 members against 16,466 members as at 31 December 2017. This fall is notably due to the withdrawal of one ASSEP, at the end of the year, whose liabilities have been transferred to insurance contracts.

An analysis of the population of the members of pension funds supervised by the CSSF shows that the proportion of international members (3,681 members as at 31 December 2018) is rising compared to the previous years, as a result of a growing globalisation of certain pension funds via schemes offered in multiple host countries. Four new pension schemes with foreign sponsoring undertakings (including non-EU Member States) were approved in 2018.

Development in the number of pension fund members



2. DEVELOPMENT OF LIABILITY MANAGERS IN 2018

In 2018, no new liability manager has been registered on the official list of professionals authorised to act as liability managers for pension funds subject to the Law of 13 July 2005.

The number of liability managers for pension funds authorised by the CSSF amounted to 18 as at 31 December 2018.



CHAPTER XII

SUPERVISION OF SECURITIES MARKETS

1. APPROVAL OF PROSPECTUSES FOR SECURITIES RELATING TO OFFERS TO THE PUBLIC OR ADMISSIONS TO TRADING ON A REGULATED MARKET

1.1. Application of the laws and regulations on prospectuses for securities

Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (New Regulation) applies as from 21 July 2019, except for some provisions applicable as from 21 July 2017 or 21 July 2018.

Through different working groups established within ESMA, the CSSF is actively involved in the drawing-up of implementing measures for the New Regulation and in the discussions on issues requiring the adoption of common positions via the publication of FAQs or guidelines by ESMA.

At national level, the CSSF continues to provide its agents in charge of the review of the files of securities prospectuses with the means necessary to familiarise themselves with the innovations introduced by this regulation, the following being noteworthy:

- the ability of the Member States to exempt, under certain conditions, the offers to the public not exceeding EUR 8,000,000 from the obligation to publish a prospectus;
- the introduction of two alleviated disclosure regimes, namely the regime for secondary issuances and the EU Growth prospectus regime that, under certain conditions, allow frequent issuers and small and medium-sized enterprises to access capital markets more easily and at lower cost;
- a summary with a maximum length limited, in most cases, to seven pages and which allows the reuse of the contents of the key information document required under Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (a summary of the base prospectus is no longer required);

- the possibility to notify the registration document to the competent authority of the home Member State for the prospectus approval;
- the possibility to draw up a base prospectus as several separate documents;
- new requirements relating to the inclusion and presentation of risk factors in a prospectus;
- a limited list of documents which can be incorporated by reference in the prospectus;
- an assistance by the financial intermediary in the exercise of the investor's right of withdrawal following the publication of a supplement to the prospectus.

The New Regulation impacts the manner of working and communicating with the CSSF. In that respect, the CSSF's IT systems will be adapted to facilitate the transmission of documents and the related metadata. In fact, as from 19 July 2019, the CSSF collects, on behalf of ESMA, a list of metadata related to securities subject to an approved document and related to the document in question.

The CSSF teams remain more than ever attentive and at the disposal of issuers to assist and accompany them in the transition to the new regulation.

As in the past, the CSSF strongly recommends that the filing entities use, where necessary, the address prospectus.help@cssf.lu before the official filing. Indeed, the analyses carried out prior to the official processing of a file often allow raising or clarifying issues which would have delayed the review process if these issues were identified only during this process. In many cases, this saves valuable time subsequently.

It should be noted that the number of requests for advice slightly rose in 2018 against 2017, i.e. 134 requests dealt with in 2018. The most frequent topics which were treated during these upstream reflections concerned the very structure of the prospectus, the financial statements of issuers or guarantors and the interactions between the prospectus regulations and other regulations.

In 2018, 4.90 business days were in average necessary to send the final comments and 22.19 business days to review a file.

In 2018, the CSSF approved three prospectuses each with an omission of information due to non-pertinence in accordance with Article 23(4) of the Prospectus Regulation.

Two out of the three substantiated requests for omission of information pursuant to Article 10 of the Prospectus Law which were submitted to the CSSF, were accepted during the year under review.

1.2. Approvals and notifications in 2018

1.2.1. Documents approved by the CSSF in 2018

In 2018, the number of documents approved by the CSSF decreased compared to 2017, with a total of 1,364 approved documents (246 prospectuses, 298 base prospectuses, nine registration documents and 811 supplements) against 1,508 in the previous year (-9.55%). The number of base prospectuses approved in 2018 slightly dropped compared to the preceding year, whereas the number of approved prospectuses significantly decreased by 24.07%. A decrease of 6.35% of approved supplements could be noted.

1.2.2. Documents drawn up under the European passport regime in 2018

In 2018, the CSSF received 1,065 notifications (relating to 250 prospectuses and base prospectuses and to 815 supplements) from the competent authorities of several EEA Member States, against 1,124 notifications (relating to 267 prospectuses and base prospectuses and to 857 supplements) in 2017 (-5.25%). Between 2017 and 2018, there has been a 6.37% decrease in the number of received notifications relating to prospectuses and base prospectuses. The number of notifications relating to supplements dropped by 4.90% over this period.

In 2018, the CSSF sent notifications for 814 CSSF-approved documents (248 prospectuses and base prospectuses and 566 supplements) to the competent authorities of the EEA Member States, against 935 documents (318 prospectuses and base prospectuses and 617 supplements) in 2017 (-12.94%). Thus,

there has been an important fall of 22.01% over the year for prospectuses and base prospectuses while a more moderate decline for supplements (-8.27%) has been noted.

1.2.3. Approvals

2018 has been a roller coaster year with respect to approvals. Indeed, some months were much busier than the previous year and others were calmer. Thus, discrepancies were noted with a rise of almost 28% in January and a fall by over 30% in May. Consequently, it was very difficult to predict, from one month to the next, the flow of prospectuses to be approved. Despite this fact, the CSSF teams always remained responsive to issuers; even when large amounts of documents had to be approved, they not only complied with the deadlines set by the CSSF but also met the time constraints of issuers.

As previously explained, the number of approvals of base prospectuses slightly decreased compared to 2017. Indeed, 298 base prospectuses have been approved in 2018, against 310 in 2017. It should be noted that 26 issuers decided not to have their base prospectuses approved by the CSSF any more, whereas 14 new issuers chose the CSSF for the approval of their base prospectuses. It appears that four of the aforementioned 26 issuers filed their base prospectuses for approval with another authority.

Moreover, 73 prospectuses were approved in the framework of issues of asset-backed securities, which is a slight decrease against 2017 with 83 prospectuses of this category.

This year again, the CSSF observed great diversity in the geographical origin of the issuers. The top three geographical origins are still Germany (20.65%), Luxembourg (13.33%) and the United Kingdom (11.38%). As far as the other issuers are concerned, 10.24% come from other EEA Member States, representing a significant decrease compared to 2017. 8.46% come from third countries.

Finally, the CSSF approved 208 files relating to Luxembourg issuers, including 43 prospectuses, 39 base prospectuses, two registration documents and 124 supplements.

1.3. ESMA statistics for 2017

On 15 October 2018, ESMA published its statistics relating to the prospectus activity in 2017. These statistics reveal that Luxembourg ranks second behind Ireland with respect to the number of approved documents by the competent authorities of the EEA Member States. The CSSF approved 17.8% of the approved documents in the EEA, i.e. 634 prospectuses and base prospectuses.

2. TAKEOVER BIDS

The CSSF is the competent authority to ensure compliance with the Law of 19 May 2006 transposing Directive 2004/25/EC of 21 April 2004 on takeover bids (Law on Takeover Bids). The Law on Takeover Bids provides for several cases in which the CSSF is the competent authority, notably depending on whether the company concerned by the takeover bid has its registered office in Luxembourg or in another Member State and whether its securities are admitted to trading on a regulated market located in Luxembourg or in another Member State.

In 2018, the CSSF did not have to deal with any case on takeover bids.

As far as the mandatory bid on the shares of Orco Property Group S.A. is concerned, as announced by CPI Property Group S.A. on behalf of its subsidiary Nukasso Holdings Limited in 2016, the action before the Luxembourg administrative courts against the CSSF's decision not to approve the offer document in the context of the above-mentioned mandatory bid is still ongoing. In that context, please refer to the CSSF Press release 18/13 published on 15 March 2018.

2.1. Derogations granted by the CSSF under Article 4(5) of the Law on Takeover Bids

In 2018, the CSSF did not grant any derogation under Article 4(5) of the Law on Takeover Bids.

2.2. Takeover bids not falling within the scope of the Law on Takeover Bids

In 2018, the CSSF did not have to deal with any such case.

2.3. Questions regarding the Law on Takeover Bids raised in 2018

In 2018, several requests for advice concerned the practical application of the notion of change of control, linked to operations of restructuring, reorganisation or indirect acquisition of holdings affecting the shareholding structure of companies falling within the scope of the Law on Takeover Bids, in the framework of the application of Article 5(1) of this law (mandatory takeover bid). In its answers, the CSSF took into account the nature of the change, i.e. whether it is a material change in the control over a given company or a simple formal change in the shareholding structure not affecting the minority shareholders.

In this context, the CSSF reiterates that the two conditions of Article 5(1) of the Law on Takeover Bids, namely acquiring securities and gaining control over a target company falling within the scope of the Law on Takeover Bids, must, in principle, be cumulatively fulfilled in order to trigger its application and cover situations in which securities are acquired and control is gained over these companies either directly or indirectly.

3. MANDATORY SQUEEZE-OUT AND SELL-OUT OF SECURITIES

As competent authority under the Law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public (Squeeze-Out/Sell-Out Law), the CSSF monitors the mandatory squeeze-out and sell-out procedures which are governed by this law. The CSSF also receives majority shareholder notifications as laid down in Article 3 of the Squeeze-Out/Sell-Out Law and publishes a list of companies for which it received such notifications on its website.

In 2018, the CSSF dealt with a mandatory squeeze-out procedure on the shares of QUILVEST (ISIN LU0011790804) under the provisions of Article 4 of the Squeeze-Out/Sell-Out Law. This procedure was initiated on 20 August 2018 by the shareholders of QUILVEST acting in concert in their capacity as majority shareholder of this company within the meaning of Article 1(1) of the Squeeze-Out/Sell-Out Law.

The majority shareholder then made public the proposed price of USD 171.20 per share of QUILVEST in the context of this procedure of mandatory squeeze-out as well as a valuation report relating to these securities drawn up by PricewaterhouseCoopers, a société coopérative incorporated under Luxembourg law which acted as an independent expert pursuant to the provisions of Article 4(5) of the Squeeze-Out/Sell-Out Law.

In the absence of opposition to the mandatory squeeze-out project, the CSSF accepted and published, on 2 November 2018, the price of USD 171.20 per share of QUILVEST as fair price in accordance with the provisions of Article 4(6) of the Squeeze-Out/Sell-Out Law. The majority shareholder of QUILVEST informed then the shareholders of QUILVEST of the date and arrangements for the final payment of the price of the shares subject to the mandatory squeeze-out.

Apart from the notification prior to the mandatory squeeze-out procedure in respect of the shares of QUILVEST, no other notification from a majority shareholder has been made to the CSSF in 2018.

4. SUPERVISION OF ISSUERS OF SECURITIES OF WHICH THE CSSF IS THE COMPETENT AUTHORITY

4.1. Issuers subject to supervision

Pursuant to the Law of 11 January 2008 on transparency requirements for issuers (Transparency Law), the CSSF is in charge of the supervision of issuers falling within the scope of this law. As at 25 February 2019, 496 issuers were subject to the supervision of the CSSF as Luxembourg was their home Member State within the meaning of this law. This number has decreased as compared to February 2018, notably due to the fact that most of the remaining issuers on which Luxembourg had been imposed as home Member State in 2016 no longer fall within the scope of the Transparency Law.

Overall, during 2018, Luxembourg was confirmed as the home Member State of 27 issuers, whereas 99 issuers no longer fell within the scope of the Transparency Law. The list of issuers supervised by the CSSF and the list of issuers on which the home Member State has been imposed by the CSSF is available on the CSSF's website (Supervision > Securities markets > Transparency > Information on the population of issuers).

Out of the 496 issuers supervised by the CSSF, 151 are Luxembourg issuers, of which 47 are issuers of shares and two issuers whose shares are represented by depositary receipts in respect of shares admitted to trading on a regulated market. Among these Luxembourg issuers, eight are banks, 10 are securitisation undertakings authorised pursuant to the Law of 22 March 2004 on securitisation and three are UCIs.

173 issuers have their registered office in another EU Member State and 172 issuers are established in a third country (outside the EU).

The statistics related to the issuers of securities whose home Member State is Luxembourg are regularly updated on the CSSF's website (Supervision > Securities markets > Transparency > Statistics).

4.2. Reviews in relation to the Transparency legislation

4.2.1. Periodic information

The reviews of the periodic information to be drawn up by issuers of securities of which Luxembourg is the home Member State pursuant to the Transparency Law continued during the 2018 review campaign. The CSSF sent 30 reminders and imposed six administrative fines pursuant to Article 25 of the Transparency Law related to annual and half-yearly financial reports. The work carried out shows that, overall, the issuers were aware of their obligations in relation to the Transparency legislation and maintained their level of compliance in this regard.

The CSSF published the names of the issuers subject to the Transparency Law which failed to publish their annual and half-yearly financial reports as required by Articles 3 and 4 of the Transparency Law. The administrative sanctions imposed under Article 25 of this law are also being published since the entry into force of the Law of 10 May 2016 amending the Transparency Law. This information is available on the CSSF's website (Supervision > Securities markets > Transparency > Information on the population of issuers > Sanctions).

4.2.2. Ongoing information

In 2018, the CSSF continued its reviews of notifications relating to the acquisition or disposal of major holdings. In total, the CSSF received about 210 notifications relating to major holdings. The review of these notifications led the CSSF to issue three warnings and to impose one sanction.

The main infringements observed during the reviews consisted of late notifications or disclosure. The warnings, issued notably for late notifications, imply that the holder or issuer concerned will be monitored more strictly in relation to its notifications of major holdings for a period of 18 months.

5. ENFORCEMENT OF FINANCIAL INFORMATION

Within the context of its mission of supervising securities markets, the CSSF is in charge of examining the financial information published by issuers of securities. Through this activity, generally known as enforcement, the CSSF ensures that the financial information complies with the relevant reporting framework, i.e. the applicable accounting standards.

Beyond the legal and regulatory requirements, the examination of the financial information contributes to the investors' protection and confidence in the financial markets.

5.1. General framework of consistent enforcement of accounting standards

5.1.1. Legal and regulatory framework

• Transparency Law

The CSSF accomplishes its enforcement mission pursuant to the Transparency Law which empowers it to examine the financial information published by issuers of securities falling within the scope of application of that law.

The powers and penalties available to the CSSF as regards enforcement are set out in Articles 22 and 25 of the Transparency Law.

• ESMA Guidelines on enforcement of financial information

The CSSF complies with the ESMA Guidelines issued in 2014 on enforcement of financial information. These guidelines are based on principles that describe, among others, the selection techniques to be followed, the types of enforcement decisions and actions that enforcers may use and explain how enforcement activities are coordinated within ESMA. These guidelines are available on the CSSF's website (Supervision > Securities markets > Enforcement of financial information > ESMA guidelines).

5.1.2. Population of issuers subject to enforcement

Under the Transparency Law and taking into account the exemptions provided for in Article 7 of this law, the population of issuers falling within the scope of enforcement as at 1 January 2018 amounted to 208 entities (1 January 2017: 219 entities).

Information on the characteristics of these issuers (registered office, types of securities issued and accounting standards used) is available on the CSSF's website (Supervision > Securities markets > Enforcement of financial information > Statistics).

5.1.3. European cooperation

ESMA's work in the field of accounting, auditing, periodic information and storage of regulated information is led by the Corporate Reporting Standing Committee. Enforcement-specific topics are mainly discussed within the European Enforcers Coordination Sessions (EECS) forum. The CSSF actively contributes to the work of this working group whose purpose is to ensure, through a convergent approach of the supervision implemented by the national competent authorities, the consistent enforcement of the IFRS by the issuers whose securities are admitted to trading on European regulated markets.

5.2. Enforcement process

The enforcement process set up by the CSSF and which complies with ESMA guidelines specifies the implemented selection methods and examination types as well as the characteristics of the decisions available to the CSSF.

5.2.1. Selection method

The enforcement process begins with the selection of the issuers which will be examined in the context of enforcement. The selection model applied is based on a mixed model whereby a risk-based approach is combined with a sampling and rotation approach. The risk-based approach adopted by the CSSF considers the risk of misstatements and the possible impact of such a misstatement on the financial markets.

5.2.2. Types of examinations

In the context of its examination process, the CSSF identifies the most efficient way to enforce financial information. The examination programme, defined every year for the selected issuers, includes:

- unlimited scope examinations: evaluation of the entire content of the financial information of an issuer in order to identify issues/areas that need further analysis and to assess whether the financial information is compliant with the relevant financial reporting framework;
- focussed scope examinations: evaluation of pre-defined issues in the financial information of an issuer and the assessment of whether the financial information is compliant with the relevant financial reporting framework in respect of those issues. This type of examination covers, in particular, thematic examinations during which the CSSF reviews the practices followed by a sample of issuers concerning specific issues;
- follow-up examinations during which the CSSF ensures that the decisions taken in relation to the different misstatements identified during the previous examinations were taken into account by the issuers concerned.

These examinations include direct and repeated contacts (meetings, exchange of mails and conference calls) with representatives of the issuer and/or its external auditor in order to analyse the most sensitive problems and issues and obtain information, documents and other objective evidence required to perform the examination. Some examinations may also lead to on-site inspections at the issuers concerned.

5.2.3. Types of decisions

Following the examinations described above, the CSSF may conclude that a specific accounting treatment does not comply with the relevant financial reporting framework. The CSSF must then determine whether the misstatement is a material or immaterial departure from the financial reporting framework and if any relevant enforcement decisions should be taken accordingly. In case of a material misstatement, the CSSF may take one of the following measures, as laid down in Article 22 of the Transparency Law:

- require a reissuance of the financial statements;
- require a corrective note; or
- require a correction in future financial statements with restatement of the comparatives, where relevant.

The CSSF notifies its decisions to the issuer appropriately, namely in the form of injunctions, recommendations and follow-up measures of the corrections or improvements of financial information proposed by the issuer itself.

5.3. Activities and results in 2018

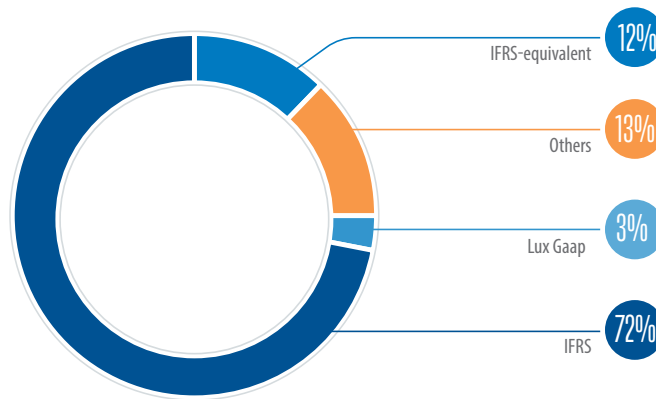
5.3.1. Summary of the enforcement activities in 2018

The examinations performed in 2018 covered 32% of the issuers falling within the scope of enforcement.

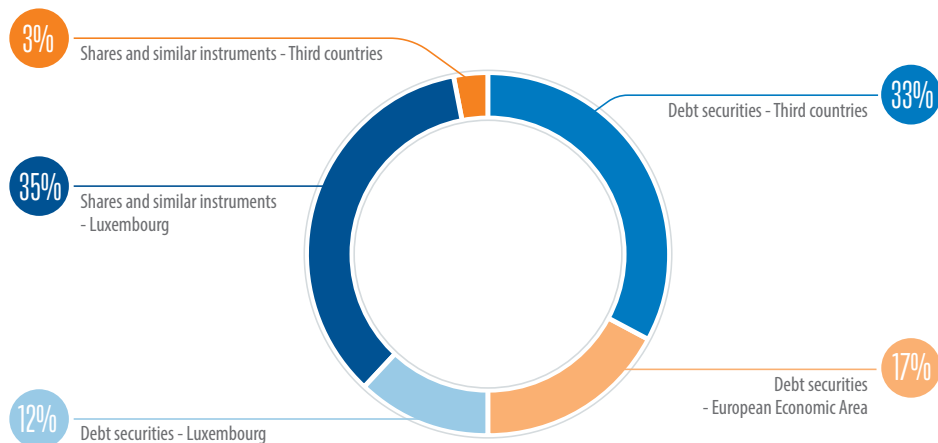
• Unlimited scope examinations

In 2018, the unlimited scope examinations covered 19% of the issuers (against 17% in 2017). As the tables below show, the unlimited scope examinations covered different categories of issuers and accounting standards, and thus a significant sample of the population of issuers supervised by the CSSF.

Breakdown of unlimited scope examinations of financial information according to the accounting standards used by the issuers



Breakdown of unlimited scope examinations of financial information by issuer type (according to the type of securities admitted to trading and the registered office)



Following these unlimited scope examinations, the CSSF concluded that certain specific accounting treatments were non-compliant with the relevant reporting framework and had to take decisions vis-à-vis certain issuers, aiming to either correct the identified errors or amend and improve the subsequent published financial statements.

During the 2018 enforcement campaign, the CSSF notified on average 3.4 misstatements/irregularities per issuer (compared to 4.7 in 2017).

Breakdown by topic of notifications issued to issuers by the CSSF following the examinations carried out during the last two years

Topic	2017	2018
Disclosure of financial statements (IAS 1, IAS 34, IAS 7)	20%	27%
Alternative performance measures	20%	25%
Fair value measurement (IFRS 13, IAS 40)	11%	7%
Financial instruments (IAS 32, IAS 39, IFRS 7)	11%	5%
Impairment of assets (IAS 36)	6%	5%
New standards (IFRS 9, IFRS 15, IFRS 16)	0%	5%
Income taxes (IAS 12)	3%	4%
Business combinations (IFRS 3)	1%	4%
Consolidation standards (IFRS 10, IFRS 12)	1%	3%
Other accounting standards and issues	27%	15%

• Focussed scope examinations

Two focussed scope examinations were carried out on different samples of issuers during the 2018 campaign. The purpose of the first examination was to ensure that the selected issuers comply with the main requirements of IFRS 8 “Operating Segments”. During a second focussed scope examination, the CSSF reviewed the non-financial and diversity information published by issuers in accordance with the Law of 23 July 2016 on the disclosure of non-financial and diversity information by certain large undertakings and groups. A report dated 10 January 2019 setting out the main conclusions of this review was published by the CSSF and is available on its website (Supervision > Securities markets > Enforcement of financial information).

• Follow-up of the 2017 examinations

Issuers subject to an examination during the 2017 campaign and which the CSSF requested to modify or improve their future financial statements, were subject to a follow-up examination in order to ensure compliance with the decisions taken by the CSSF.

• Examinations within the context of the issue of prospectuses

As in the previous years, enforcement examinations were carried out in 2018 within the context of the prospectus approval process, and in particular in the event of an application for the admission to trading on a regulated market. Besides the aspects directly related to accounting standards, the topics covered concerned notably compliance with the ESMA Guidelines on Alternative Performance Measures.

5.3.2. Main observations and recommendations issued in 2018

The observations presented below concern in particular the priorities identified during the 2018 campaign and described in Press release 17/43 published by the CSSF on 15 December 2017.

These observations and recommendations should not be considered as interpretations of the international accounting standards for which only the IASB and its interpretation committee, the IFRS IC, are competent.

• Amendments to IAS 7 “Statement of cash flows”

On 29 January 2016, the IASB published amendments to IAS 7 which aimed to improve information provided to users of financial statements about an entity’s financing activities. These amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted.

The effect of these amendments was a particular point of attention during the 2018 unlimited scope examinations. To fulfil the new requirements, issuers are required to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities including both changes arising from cash and non-cash transactions.

Overall, the CSSF observed that issuers usually satisfyingly complied with the new requirements in a specific note. This information generally takes the form of a reconciliation between the opening and closing balances for liabilities arising from financing activities. Such reconciliations comprise cash flow transactions such as issuances/subscriptions or debt repayments, as well as non-cash items such as changes in fair values or the effects of changes in foreign exchange rates.

The CSSF also noted that some issuers do not disclose these changes where a reconciliation to the information presented elsewhere in the financial statements is apparent and that the financing structure is not very complex. However, the CSSF recommends an explicit presentation of this information.

It should also be pointed out that some issuers present, due to their business model, their financing transactions as operating activities. Although the amendments to IAS 7 do not apply to operating activities, some issuers disclose a reconciliation of these transactions spontaneously. The CSSF encourages this practice.

The CSSF reiterates the usefulness of the statement of cash flows which allows users of financial statements to assess the ability of an entity to generate cash and the needs to utilise those cash flows. In this context, the amendments to IAS 7 aim to increase the understanding of the financing arrangements and transactions of an entity. They allow presenting the information on financing sources and the use of these sources, as well as the risks associated with financing activities. The presentation of this information also enables users of financial information to improve their confidence in an entity’s cash flow projections.

• Alternative performance measures

Since the effective date of application in July 2016 of the ESMA Guidelines on Alternative Performance Measures (APMs), the CSSF has noted a significant improvement in the compliance of the information disclosed by issuers. However, the CSSF noted during the 2018 campaign no less than 30 deficiencies which notably relate to the absence of definitions of APMs, of explanations as to their use and of reconciliations of APMs to the figure(s) from the financial statements.

The CSSF also participates in the Narrative Reporting Working Group coordinated by ESMA. Besides the work on non-financial information, the group’s aim in 2019 is to publish a report on the application of the Guidelines on APMs within the European single market and a related set of frequently asked questions (FAQs) as it has been previously done by the Taskforce on Alternative Performance Measures.

• IAS 34 “Interim Financial Reporting”

The interim financial statements prepared in accordance with IAS 34 are subject to regular monitoring by the CSSF, particularly in view of the absence of obligation to audit these financial statements by an external auditor. During the previous campaigns, specific reviews were carried out in order to ensure compliance of the published information. In 2018, the CSSF took about 10 actions directly related to IAS 34 and which mainly related to the following infringements:

- wrong comparative period presented;
- absence of information in relation to operating segments;
- absence of explanations relating to significant events and transactions.

• **Segment information**

As announced in its Press release 17/43, the CSSF carried out a focussed scope examination regarding segment information included in the notes to the financial statements of a sample of issuers. During its preceding campaigns, the CSSF often noticed diverse approaches with respect to segment information communicated by issuers stemming from the same industry, particularly in relation to the number of operating segments identified, the factors used to identify them and the aggregation of the segments. Differences were also observed with respect to information relating to products and services, geographical areas and main customers.

On the basis of these findings, the CSSF wanted to ensure the proper application of IFRS 8 “Operating segments”. During the focussed scope examination, the CSSF examined the manner in which around 30 issuers from different industries took into account the main requirements of the standard. The observations and recommendations presented below include the main findings of the CSSF.

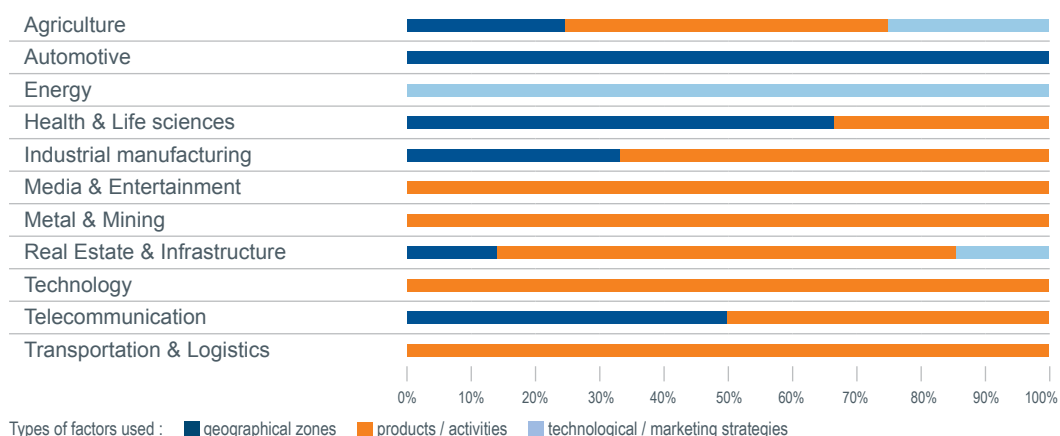
- *General information*

The CSSF noted a total of 123 operating segments identified and presented in the last financial report available by the 34 issuers concerned. The following tables show that there are sometimes discrepancies between the issuers from the same industry with respect to the identified operating segments and the factors used to identify them.

Number of operating segments presented by the 34 issuers

Industry	Number of issuers reviewed	Number of operating segments identified		
		Mean	from	to
Agriculture	4	7	3	12
Automotive	2	3	-	-
Energy	1	3	-	-
Health & Life sciences	3	4	2	7
Industrial manufacturing	3	3	1	5
Media & Entertainment	2	4	2	5
Metal & Mining	4	3	2	5
Real Estate & Infrastructure	7	4	1	11
Technology	4	2	1	2
Telecommunication	2	2	1	2
Transportation & Logistics	2	2	1	3

Main factors used to identify the sectors to be presented by the 34 issuers



Types of factors used : ■ geographical zones ■ products / activities ■ technological / marketing strategies

Even though no material irregularity has been noted during the focussed scope examination, the CSSF deems appropriate to reiterate the importance of the information required under paragraph 22 of IFRS 8 for the users of financial statements, namely the factors used to identify the operating segments as well as the judgements made by management in applying the aggregation criteria where operating segments have been aggregated. This information enhances comparability of segment information presented by different issuers.

Moreover, the CSSF noted that for almost a third of the sample of issuers, information allowing the identification of the chief operating decision maker was missing. Although IFRS 8 does not explicitly require to disclose this information, the CSSF deems the latter to be important to understand which function or which group of individuals is in charge of making decisions with respect to resources to be allocated and of assessing the entity's performance.

- Measurement

Amongst the required information under IFRS 8 regarding measurement, the CSSF noted in particular that for almost one third of the reviewed issuers the basis of accounting for transactions between reportable segments has not been provided. The CSSF reminds issuers that, if applicable, they must ensure to provide this specific information required under paragraph 27.a of IFRS 8 in the note on segment information of their financial statements.

- Reconciliations

Paragraph 28 of IFRS 8 sets some requirements to be complied with regarding reconciliations of quantitative data specific to the reportable segments to quantitative data on the entity's revenue arising from ordinary activities, profit or loss before taxes, total assets and total liabilities. Overall, the CSSF noted that issuers satisfyingly presented these reconciliations.

- Entity-wide disclosures

According to paragraphs 31 to 34 of IFRS 8, information about products and services, geographical areas and major customers must be provided, irrespective of the operating segments identified. Although findings show that for a limited number of issuers, sometimes information about geographical areas was incomplete or even missing, in general, this information has been presented satisfyingly.

For its next enforcement campaigns, the CSSF will continue to exchange with issuers for which irregularities have been observed during the focussed scope examination. Given the importance of this information for the understanding of the issuers' activities and financial performance, the CSSF expects that the issuers' management, their board of directors and audit committee continue to assess and carefully consider the disclosure requirements under IFRS 8 and that they ensure that all information deemed relevant is presented in their financial statements.

5.4. Prospects for the 2019 campaign

The enforcement campaign for the financial year 2019 will follow an approach similar to the one of the preceding financial year. The selected issuers will be subject to unlimited and focussed scope examinations. In addition, within the context of the 2018 closing of financial statements, the CSSF announced in Press release 19/02, published on 10 January 2019, a certain number of topics and issues that will be specifically monitored during the 2019 campaign of enforcement examination of issuers preparing their financial statements in accordance with the IFRS.

6. SUPERVISION OF MARKETS AND MARKET OPERATORS

6.1. Obligation to report transactions in financial instruments

Credit institutions and investment firms must report to the CSSF all transactions in financial instruments they have executed. The reporting regime in respect of transactions in financial instruments, in force since 3 January 2018, is mainly set down in Article 26 of Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments (MiFIR).

6.2. Development in the number of transaction reports in financial instruments

In 2018, the number of transaction reports sent by the entities and accepted by the CSSF reached 10,846,899. The number of transaction reports has been multiplied by 16.24 compared to the number of transaction reports received in 2017 under MiFID I (667,911).

Monthly breakdown of transactions by type of instrument in 2018

	Shares	Forwards	UCIs	Bonds	Futures	Options	Others	Monthly total
CFI Code	(Exxxxx)	(Jxxxxx)	(Cxxxxx)	(Dxxxxx)	(Fxxxxx)	(Oxxxxx)		
January	570,251	136,596	75,129	34,564	14,109	6,531	23,919	861,099
February	713,807	174,975	74,110	33,507	30,503	8,242	25,146	1,060,290
March	599,225	170,140	81,821	56,788	45,424	7,406	30,402	991,206
April	448,894	113,273	118,093	33,757	29,873	5,385	70,716	819,991
May	572,619	137,707	84,896	100,678	34,770	6,080	34,042	970,792
June	544,540	114,264	63,519	41,986	34,541	6,609	22,308	827,767
July	656,466	122,982	111,814	36,242	29,598	5,425	9,347	971,874
August	462,755	111,041	58,957	56,832	35,010	5,265	4,009	733,869
September	470,943	99,974	68,088	121,888	39,805	5,884	3,198	809,780
October	844,309	145,704	93,533	55,852	64,022	7,663	5,566	1,216,649
November	529,555	125,121	80,731	34,246	45,199	6,272	3,154	824,278
December	458,875	127,551	81,430	34,508	45,388	7,058	4,494	759,304
Annual total	6,872,239	1,579,328	992,121	640,848	448,242	77,820	236,301	10,846,899

These data as well as the evaluation of the information received via TREM (Transaction Reporting Exchange Mechanism), set up between competent authorities for their respective supervisory missions, reveal the trends on European markets and, particularly, on the Luxembourg market. The main purpose of the supervision of the markets is to prevent and detect infringements of financial and stock market laws and regulations. In this context, monthly internal reports as well as specific internal reports are drawn up on the basis of the received reports. These ex post analyses of transactions in financial instruments can be used as a starting point for the CSSF's inquiries.

7. INVESTIGATIONS AND COOPERATION

The mission of the CSSF is to combat insider dealing and market manipulation in order to ensure the integrity of financial markets, to enhance investor confidence in those markets and thereby ensure a level playing field for all market participants.

In the context of its supervision of securities markets, the CSSF either opens investigations on its own initiative or conducts them following a request for assistance from a foreign administrative authority in the context of international cooperation.

Based on Article 23(2) of the Code of Criminal Procedure, some facts which may constitute a breach of the Luxembourg criminal provisions and which were noted during the aforementioned investigations are also brought to the attention of the State Prosecutor.

7.1. Investigations initiated by the CSSF

In 2018, the CSSF did not open any market abuse investigation.

In 2018, an investigation on market manipulation in the form of wash trades (buy/sell transactions in financial instruments with no economic substance) led the CSSF to impose administrative fines on two investors, natural persons, the highest fine amounting to EUR 250,000.

Moreover, two investigations (one into insider dealing and the other into market manipulation) have been closed without administrative fines or other administrative sanctions being imposed.

7.2. Investigations conducted by the CSSF upon request of a foreign authority

In 2018, the CSSF received 64 cooperation requests from foreign authorities (74 in 2017) in relation to the following subjects.

Cooperation requests by subject¹

Subject		2017	2018
Market abuse	Insider dealing	48	31
	Market manipulation	11	6
	Others	-	1
Law of 5 April 1993 on the financial sector		4	18
MiFID II/MiFIR (markets in financial instruments)		3	3
Takeover bids		1	1
Transparency		2	2
Short selling		-	1
Others		6	5

Six of these requests came from administrative authorities of non-EEA States.

The CSSF processed all the requests with the necessary diligence befitting cooperation between authorities.

7.3. Suspicious transaction and order reports

Based on Article 16 of Regulation (EU) No 596/2014 of 16 April 2014 on market abuse (MAR), the CSSF received 47 suspicious transaction and order reports in 2018 (41 in 2017).

In accordance with its cooperation obligations provided for by the regulations on market abuse and the relevant multilateral cooperation agreements, the CSSF transmitted the reports received to the relevant foreign competent authorities, notably if the underlying financial instruments are admitted to trading on foreign trading venues or markets. The transmitted reports can lead these authorities to open investigations.

In 2018, the CSSF also received 26 reports transmitted by foreign authorities (28 in 2017).

The CSSF analysed all of these reports with the necessary diligence.

¹ Please note that a request may concern one or several of these subjects.

8. INDICES USED AS BENCHMARKS

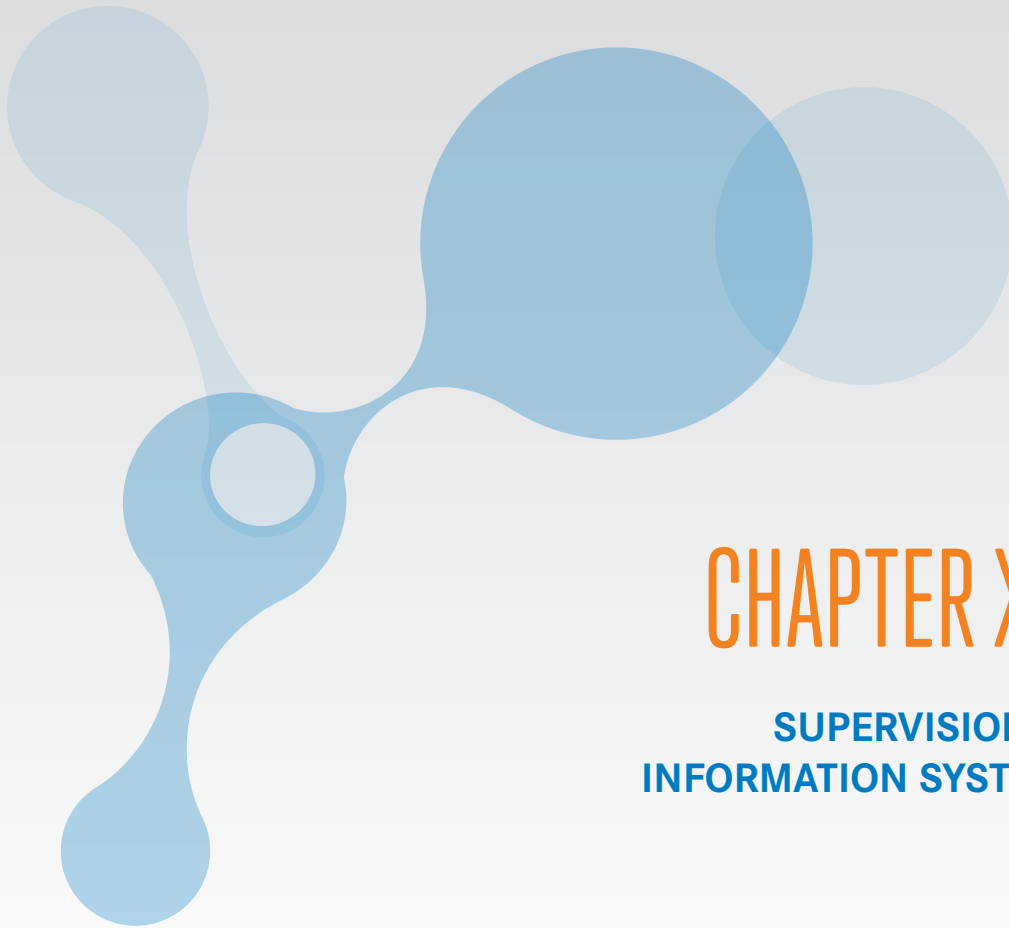
Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (Benchmark Regulation) applies since 1 January 2018, except for the provisions applicable since 30 June 2016.

The last delegated and implementing acts provided for by the Benchmark Regulation and supplementing this regulation were adopted in 2018.

In Luxembourg, the Law of 17 April 2018 implementing the Benchmark Regulation designates the CSSF as the competent authority for the benchmark administrators and as the default competent authority to ensure compliance with this regulation by the supervised entities governed by the regulation. An exception applies however to this default competence for entities subject to the supervision of the Commissariat aux Assurances which is designated as competent authority to ensure compliance with the regulation by these entities.

As regards the regulatory developments regarding benchmarks, it is worth mentioning the proposal for an EU regulation amending Regulation (EU) 2016/1011 as regards the EU climate transition benchmarks and the EU Paris-aligned benchmarks which aims to amend the Benchmark Regulation by introducing new generations of low carbon benchmarks in order to facilitate investments in sustainable assets and projects. This proposal for a regulation also lays down that providers of critical benchmarks and entities established in third countries providing benchmarks used in the EU within the meaning of the Benchmark Regulation will have two further years, i.e. until 31 December 2021, in order to comply with the requirements of the Benchmark Regulation as amended by this new EU regulation.

Any questions concerning the application of the Benchmark Regulation may be addressed to the CSSF by e-mail to benchmarks@cssf.lu. The CSSF also created a section dedicated to benchmarks on its website (Supervision > Benchmarks).



CHAPTER XIII

SUPERVISION OF INFORMATION SYSTEMS

This chapter deals with the supervision of information systems of financial professionals, including mainly credit institutions, investment firms, specialised PFS, payment institutions and electronic money institutions. As regards the specific supervision of support PFS, please refer to point 3. of Chapter VII “Supervision of PFS”.

1. ACTIVITIES IN 2018

1.1. Assessment of the application of Circular CSSF 17/654 on cloud computing

The regulatory framework governing IT outsourcing was substantially modified in May 2017, in particular with the introduction of Circular CSSF 17/654 on IT outsourcing relying on a cloud computing infrastructure.

Mid-2018, after one year of implementation of Circular CSSF 17/654, the CSSF took stock. The main findings are the following:

- Since the entry into force of Circular CSSF 17/654, many applications for authorisation or notifications were submitted to the CSSF for the use of cloud computing solutions. This allowed the CSSF to reassess the authorisation/notification process and to become aware of the difficulties encountered by the supervised entities. The CSSF concluded that the authorisation/notification process was too burdensome and that the circular lacked flexibility for non-material activities.
- Through the numerous questions addressed to the CSSF, the supervised entities expressed their need for more guidance from the CSSF, in particular with respect to the materiality assessment of outsourced activities.
- In December 2017, the EBA published its Recommendations on outsourcing to cloud service providers (EBA/REC/2017/03). The CSSF considered that Circular CSSF 17/654 covered the requirements laid down in the European text and was stricter and less flexible in some aspects.

- In August 2018, the CSSF considered that it was necessary for investment fund managers to comply with Circular CSSF 17/654 when outsourcing to a cloud computing infrastructure. This regulatory change has been introduced by Circular CSSF 18/698 and needed also to be reflected in Circular CSSF 17/654.

Based on these observations, the CSSF amended Circular CSSF 17/654 as follows:

- addition of investment fund managers in the scope of application (in line with Circular CSSF 18/698);
- introduction of the principle of proportionality for non-material activities only;
- publication of guidance assisting the entities in assessing the materiality of the activities;
- introduction of a register of cloud computing outsourcings, to be maintained by the supervised entities, for material and non-material activities;
- cancellation of the necessity to submit a notification for cloud computing outsourcing of non-material activities, in favour of maintaining the register;
- replacement of the “compliance table” by more specific and leaner forms;
- rewording and/or reorganisation of some paragraphs for more clarity (minor changes);
- update of the FAQ to assist the entities in their analyses and approaches.

The revised version of Circular CSSF 17/654 was published on 27 March 2019. It should be noted that this revised version remains in line with the EBA Recommendations on outsourcing to cloud service providers (EBA/REC/2017/03).

1.2. Publication of a white paper on Artificial Intelligence

Artificial Intelligence (AI) is one of the most promising technologies, and different kinds of practical applications, especially in the financial sector, are emerging. The potential benefits that AI can bring are enormous, but these can only be achieved if the fundamentals of this technology and its underlying risks are well understood and an adequate control framework is put in place.

In this context, the CSSF performed a research study in order to better understand what AI and the related risks are. The result is a document which intends to provide some basic knowledge about Artificial Intelligence and which describes the different types of AI and some practical use cases for the financial sector. Furthermore, the study covers the analysis of the main risks associated with AI technology and provides some key recommendations to take into account when implementing AI inside a business process. Given the increasing adoption of AI in the financial sector and the relative lack of practical guidance from a risk perspective, the CSSF decided to share the results, especially with the financial sector, by publishing them.

The document was published in December 2018 on the CSSF website in the form of a “white paper” and has no binding value vis-à-vis the supervised institutions. Nevertheless, it provides the foundations for a constructive dialogue with all the stakeholders of the financial sector for a deeper understanding of the practical implementations of AI technology and its implications.

1.3. National cooperation: working groups and conferences

In 2018, the CSSF worked, in particular, on the following topics:

- security and evolution of payment means: the CSSF took part as observer in the ABBL Payment Committee and in ALMUS (Association Luxembourgeoise des Membres et Utilisateurs SWIFT).
- FinTech: the CSSF established and chairs a working group gathering market participants in order to evaluate the need to regulate certain activities. A sub-working group was created to analyse the potential risks and challenges of the blockchain technology or DLT and to publish a white paper without binding value for supervised entities. This white paper will also highlight the elements to be taken into account in the due diligence process by a financial professional that envisages to use such technology, regardless of the applications concerned. Thus, the paper will not address the use made of blockchains or DLT from the point of view of the services, but will only cover general technical aspects of these platforms which are often improperly managed by the financial professionals.

- cybersecurity: the CSSF participates as observer in the ABBL Trust & Cybersecurity Committee.

Conferences and events concerning new technologies or new IT service offers represent interesting information and exchange platforms in order to stay aware of the evolution of these technologies and services. In this regard, the CSSF took part in many events organised in Luxembourg on topics such as e-payments, cybersecurity, blockchain, cloud or artificial intelligence.

1.4. International collaboration with other authorities

Given the fast and continuous evolution of technologies, bringing about new forms of financial services or more complex operational models that are exposed to new threats, it is in the interest of any supervisory authority to take part in working groups allowing it to discuss various topics with its peers and benefit from each other's experience.

In this context, the CSSF has been for many years a member of the international working group IT Supervisors Group (ITSG) composed of IT supervisors from various countries of the European, Asian, American and African continents.

In 2018, the annual meeting was held in Seoul under the umbrella of the Financial Services Commission (FSC), the financial sector supervisory authority of South Korea. The discussions concerned (1) FinTech (in particular, the impact of new technologies such as DLT, Robo Advisor, Biometrics, open banking developments and the way to handle actors and projects by the different authorities, on the business models and experience of the regulatory sandboxes), (2) cybersecurity (exchange of information between supervisors and need in terms of training of supervisors), and (3) IT continuity and disaster recovery plans (exchange on regulatory requirements in the various countries and on the technical and procedural solutions observed). The different round tables also allowed to exchange on the developments in risks, regulations and practices in relation to IT supervision in each of the represented countries.

Moreover, the CSSF continues to participate in the following working groups which are in charge of issues relating to IT supervision within the European institutions:

- the European Forum on the Security of Retail Payments (SecuRe Pay Forum), co-chaired by the EBA and the ECB. The SecuRe Pay Forum is composed of national EU/EEA supervisory authorities and central banks. The work of this forum focusses on the security of electronic payment instruments, services and schemes available in the EU/EEA Member States. Its aim is to facilitate common knowledge and understanding of the challenges in this matter between the authorities and to enhance their cooperation. It can submit its analyses and recommendations to the ECB and the EBA which adopt them, where appropriate, in the form of an oversight framework, guidelines or technical standards.
- the Task Force on IT Risk Supervision (TFIT) of the EBA: the Standing Committee on Oversight and Practices (SCOP) assists and advises the EBA as regards the ongoing risk assessment in the banking system, the promotion of cooperation between authorities and the enhanced convergence of supervisory practices. The SCOP draws on the work of this working group dedicated to IT risk supervision, thus taking into account the increasing importance of IT and the resulting operational risks for the financial sector.
- the SSM IT Expert Group (SSM ITEG): this group gathers IT supervisors from each country participating in the Single Supervisory Mechanism (SSM) of the ECB. In plenary sessions or through its different working groups, it deals with all matters relating to IT supervision within the SSM (priorities to be addressed, off-site and on-site supervision methodologies).

In 2018, the three aforementioned working groups devoted most of their efforts on the following topics.

1.4.1. Security of retail payments (PSD2)

Published in December 2015, the revised Payment Services Directive (PSD2) entrusted the preparation of guidelines and technical standards on the security of retail payments to the EBA in close cooperation with the ECB. In 2018, the SecuRe Pay Forum continued its preparation or finalisation of the regulatory texts.

• **Regulatory technical standards (RTS) on strong authentication and communication**

The final version of these technical standards was published in the Official Journal of the EU on 13 March 2018. The standards will enter into force 18 months after their adoption by the European Commission, i.e. on 14 September 2019.

These standards define:

- the requirements of a strong customer authentication and the authorised exemptions from their application based on the risk level associated with the action carried out;
- the requirements aiming to protect the confidentiality and the integrity of the payment service users' personalised security credentials;
- the requirements applicable to the communication standards between all payment service participants (providers or users), in particular between the banks managing a payment account and two new types of payment service providers now subject to PSD2, i.e. account information service providers and payment initiation service providers.

One of the main challenges in drafting these standards was to define balanced requirements which guarantee both an appropriate level of security, without prohibiting the development of user-friendly and innovative means of payment, and a level playing field for all payment service providers.

• **EBA Guidelines on the conditions to be met to benefit from an exemption from the fallback mechanism under Article 33(6) of the RTS**

The CSSF contributed to the drawing-up of the guidelines that specify the conditions that account servicing payment service providers (ASPSPs) must meet to be exempted from the obligation to set up the contingency mechanism described in Article 33(4) of the RTS, where these ASPSPs have opted for a dedicated interface for the communication with the account information service providers and payment initiation service providers.

The consultation took place during summer 2018 over a two-month period. The final text was published on 4 December 2018. The guidelines are applicable since 1 January 2019.

• **EBA Opinion on the use of eIDAS certificates under the RTS**

The CSSF contributed to the drawing-up of this Opinion, which clarifies specific aspects on the use of qualified certificates for electronic seals (QSealCs) and qualified certificates for website authentication (QWACs) under the RTS. The document was published on 13 June 2018 and is applicable as from 14 September 2019 jointly with the RTS.

• **EBA Guidelines on the management of operational and security risks**

The CSSF contributed to the drawing-up of the EBA guidelines for establishing, implementing and monitoring the measures taken by payment service providers in order to manage operational and security risks associated with the services they provide. The EBA Guidelines, applicable since 13 January 2018, are covered by Circular CSSF 19/713.

• **EBA Guidelines on reporting requirements on statistical data on fraud**

The CSSF participated in the drawing-up of these guidelines which aim at ensuring that the reporting requirements regarding fraudulent transactions, relating to Article 96-6 of PSD2, are implemented consistently. The EBA Guidelines, applicable since 18 July 2018, are covered by Circular CSSF 19/712.

• **Q&A PSD2 EBA network**

The CSSF participates in preparing the answers to the questions raised via the EBA's Q&A tool. The overall objective of the Q&A tool is to ensure consistent and effective application of the new regulatory framework across the Single Market. The process entails close and ongoing interaction between the EBA and the European Commission to ensure that the responses to the questions submitted remain consistent with the legislative texts. In 2018, 172 questions were asked, 35 rejected and 27 published.

1.4.2. Assessment of IT risks in the banking supervisory process

- **Continuous improvement of the SSM on-site inspection methodology**

Upon the IT risk assessment of a significant bank, supervisors may take different actions and, in particular, plan an IT on-site inspection at the supervised entity. In the ECB SSM context, the DTIT (a sub-group of SSM IT Expert Group) works on the continuous improvement of the on-site inspection methodology based on feedback and the evolution of IT risk. In 2018, following the publication by the EBA of its Guidelines on the assessment of the Information and Communication Technology (ICT) risk in the context of the Supervisory Review and Evaluation Process (SREP), addressed to the competent authorities, as well as its recommendations on outsourcing to cloud service providers, this working group focused on the integration of these new texts into the methodology of on-site inspection and made the necessary adaptations.

- **Guidelines on ICT Risk Assessment for supervised entities**

Following the publication of the guidelines addressed to the competent authorities on the ICT risk assessment within the context of SREP, the EBA TFIT started drawing up, at the end of 2017, guidelines addressed to the supervised entities and aimed at promoting good practices in the field of IT risk management.

The publication of these guidelines fell behind in 2018 as it had been decided to extend the scope of the entities concerned to payment institutions and electronic money institutions, while initially the text only addressed banks and investment firms. This has notably resulted in the decision to integrate the Guidelines on the management of operational and security risks of PSD2 into the new guidelines, the former needing to be repealed upon the entry into force of the latter. Finally, draft guidelines were published for market consultation on 13 December 2018. Publication of the final guidelines is expected for summer 2019.

1.4.3. Financial innovation

Within the scope of the EBA's FinTech working programme, the EBA TFIT has been entrusted with the task of identifying the prudential risks and opportunities that FinTech may bring to credit institutions. To this end, the TFIT has set up a sub-working group dedicated to FinTech in which the CSSF participated. After consultation of the national supervisors and some entities particularly active in the field of FinTech, the group decided to concentrate its work on seven specific use cases. The group's report was validated by the Board of Supervisors of the EBA on 12 June 2018 and published on 3 July 2018.

2. SUPERVISION OF INFORMATION SYSTEMS IN PRACTICE

Supervision includes verifying that supervised entities comply with the legal and regulatory framework, focussing, in particular, on the technologies implemented as part of the information systems with a view to maintaining or improving the services offered. This also takes into account the specific nature of the outsourcing of these services to support PFS or third parties, within or outside the group.

In the context of the off-site supervision of the information systems, the CSSF processed 260 requests in 2018, i.e.:

- 83 applications for authorisation (IT-related part) for different types of entities (credit institutions, electronic money institutions, payment institutions, PFS);
- 177 requests for advice or for authorisation concerning IT projects submitted by supervised entities (most of them concerned outsourcing, remote access, security of online services or major system changes) and responses to specific IT issues (for example critical items of a management letter from a *réviseur d'entreprises agréé* (approved statutory auditor)).

It should be noted that about 40% of the requests for advice or for authorisation originate from credit institutions.

As regards the on-site supervision of the information systems, the on-site inspections covering the IT risk are described in more detail in point 1.11. of Chapter XVI “Instruments of supervision”.



CHAPTER XIV

SUPERVISION OF THE REMUNERATION POLICIES

The CSSF ensures compliance with the requirements regarding governance and remuneration in the financial sector. The procedures and arrangements implemented by the entities with respect to remuneration form an integral element of robust internal governance arrangements which allow ensuring that risks are managed in an efficient and lasting manner. The remuneration structure, its determination processes and the policies implemented by the entities in this area are part of the sound administrative and accounting organisation of the financial sector entities, the aim of which is to avoid excessive risk-taking.

In 2018, the CSSF continued to carry out examinations in order to ensure compliance with the legal and regulatory requirements applicable to remuneration policies and practices.

Moreover, for the third consecutive year, the CSSF conducted a comparative evaluation exercise of the remuneration policies and practices at national level. In this context, the CSSF noted, in particular, that credit institutions distributed variable remunerations which amounted, on average, to 37% of the fixed component of the remuneration (against 31% in 2017 and 35% in 2016), that the proportion of the variable remuneration paid out in financial instruments amounted to 34% on average (against 30% in 2017 and 32% in 2016) and that the deferred component of variable remuneration amounted, on average, to 28% of the granted variable remuneration (against 29% in 2017 and 27% in 2016).

In 2018, the CSSF continued receiving the notifications of higher remuneration ratios made by entities in order to pay out a variable remuneration exceeding 100% of the fixed component. The CSSF thereby ensures that the procedure and requirements for paying out variable remuneration exceeding 100% of the fixed remuneration, without exceeding 200%, are complied with by the entities concerned. To this end, the CSSF reiterates the need to comply with the notification procedure defined in Article 38-6(g) of the Law of 5 April 1993 on the financial sector and described in Circular CSSF 15/622. Over the last four years, the CSSF identified major weaknesses with regards to compliance with the notification procedures and found that the documents provided often lacked quality. As a consequence, particular attention is paid to the analysis of the notifications received and the payment of a variable remuneration exceeding 100% cannot be made should the procedure

not be fully respected and as long as the CSSF has not received the correctly filled-out forms with their required appendices. Thus, a duly filled-in form A must be sent to the CSSF together with the recommendation to the shareholders explaining the approval sought and detailing its scope, as well as the consequences of the payment of this variable remuneration on maintaining a sound capital base for the entity. A duly filled-in form B must be sent once the general shareholder meeting adopted the approval sought and must include the minutes thereof as an appendix.

Finally, the CSSF is strengthening the analysis of the identification of material risk takers in accordance with Delegated Regulation (EU) No 604/2014, notably in the context of the above-mentioned assessment of the remuneration policies.



CHAPTER XV

PUBLIC OVERSIGHT OF THE AUDIT PROFESSION

1. LEGAL, REGULATORY AND NORMATIVE FRAMEWORK OF THE AUDIT PROFESSION

1.1. Development of the legal and regulatory framework

The Grand-ducal Regulation of 9 July 2013 determining the requirements for the professional qualification of *réviseurs d'entreprises* (statutory auditors) and *réviseurs d'entreprises agréés* (approved statutory auditors) was repealed and replaced by the Grand-ducal Regulation of 14 December 2018 in the context of the reform of the examination of professional competence.

The major amendments introduced by the new grand-ducal regulation are the following:

- the conditions with respect to theoretical qualification were adapted in order to take into account the development of the certificate of complementary training and to avoid any redundancy with the structure of Master studies or equivalent training;
- the reintroduction of compulsory presence in courses for the certificate of complementary training;
- the introduction of a modular approach for the examination of professional competence allowing the candidates to take their written and oral exams in the order they choose.

After the adoption of this grand-ducal regulation, CSSF Regulations N° 16-09 on the establishment of a consultative commission and N° 16-11 on the establishment of a list of diplomas and approvals have been repealed and replaced by CSSF Regulations N° 19-03 and N° 19-04. Circular CSSF 17/662, adopted in July 2017, has been repealed and replaced by Circular CSSF 19/717 to reflect these developments.

1.2. Developments in audit standards

CSSF Regulation N° 19-02 which repeals and replaces CSSF Regulation N° 18-02 adopts:

- the international auditing standards and the International Standard on Quality Control as drawn up by the International Auditing and Assurance Standards Board (IAASB) in the “Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements - 2018 Edition” published by the International Federation of Accountants (IFAC);
- the code of ethics for the audit profession in Luxembourg which corresponds to the 2018 version of the code of ethics issued by the International Ethics Standards Board for Accountants (IESBA), as amended and published on 14 August 2018.

The main changes introduced by this CSSF regulation concern:

- the revised ISA 540 on auditing accounting estimates;
- the code of ethics which was completely restructured;
- some amendments to these standards in order to comply with Regulation (EU) No 537/2014 of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities (PIEs).

These requirements are applicable as from the day of publication of the CSSF regulation except for the revised ISA 540 which will apply for the financial years starting from 15 December 2019.

Circular CSSF 17/662 which adopts the parts “Application and Other explanatory material” and, where appropriate, the Appendices to the international standards on auditing and the International Standard on Quality Control, accompanied by the Luxembourg supplements which include the provisions introduced by the Law of 23 July 2016 concerning the audit profession (Audit Law) and the above-mentioned Regulation (EU) No 537/2014, has been repealed and replaced by Circular CSSF 19/717 to take into account the amendments made by CSSF Regulation N° 19-02.

1.3. Activities of the CEAOB (Committee of European Auditing Oversight Bodies)

A comment letter was issued in 2018 for the attention of the IAASB as regards the exposure draft on proposed ISA 315 on identifying and assessing the risks of material misstatement through knowledge of the entity and its environment.

In the same year, the CEAOB also adopted guidelines on monitoring the fee cap of non-audit services.

Article 27 of Regulation (EU) No 537/2014 of 16 April 2014 on specific requirements regarding statutory audit of PIEs confers on the CSSF the obligation to monitor the developments in the audit market for PIEs and, in particular, to assess the performance of audit committees. Based on this assessment, the CEAOB validated, in 2018, the principle of consulting a sample of audit committees by way of a questionnaire. The CSSF contacted some chairmen of audit committees in Luxembourg to fill in the questionnaire which is also available for information purposes on the CSSF’s website. It can be used as a tool for audit committees to ensure their compliance with the new legal and regulatory requirements, their functioning and their efficiency and to identify, where appropriate, items for improvement.

2. QUALITY ASSURANCE REVIEW

2.1. Scope

By virtue of the Audit Law, *réviseurs d’entreprises agréés* and *cabinets de révision agréés* (approved audit firms) are subject to a quality assurance review of the audit engagements, organised according to the terms laid down by the CSSF in its capacity as oversight authority of the audit profession.

The population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* that carry out statutory audits and other assignments entrusted exclusively to them by law is as follows (as at 31 December 2018):

- number of *cabinets de révision agréés*: 59, including 11 that audit PIEs;
- number of approved independent *réviseurs* (auditors): two, none of whom audits PIEs.

Based on the data collected through the “Annual Annexes” for the year 2018, the audit engagements break down as follows between *cabinets de révision agréés* and independent *réviseurs d'entreprises agréés*:

- 82% of the audit engagements are carried out by the “Big 4”¹;
- 10% of the audit engagements are carried out by medium-sized audit firms²;
- 8% of the audit engagements are carried out by the other audit firms and independent *réviseurs*.

2.2. Activity programme for 2018

The CSSF set down a multiannual programme for the control of *cabinets de révision agréés/réviseurs d'entreprises agréés* which aims at observing the legal quality assurance review cycle, this cycle being three years for firms that audit PIEs and six years for the other ones. This programme was based on the information transmitted by audit firms and *réviseurs d'entreprises agréés* through the “Annual Annexes” relating to their activity.

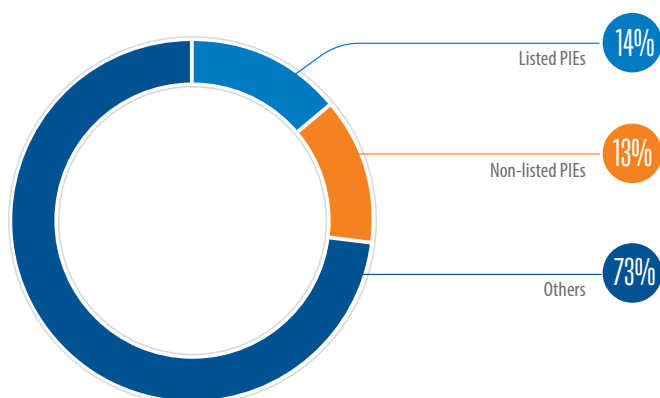
Under the 2018 programme, 15 firms were reviewed, eight of which audit PIEs and nine are members of an international network. The quality assurance reviews concerned:

- the understanding and documentation of the organisation, policies and procedures established by the reviewed audit firms in order to assess compliance with the International Standard on Quality Control (ISQC1);
- the review of a sample of audit files relating to audit engagements of the financial years 2018 (five reviewed files) and 2017 (or 2016, 2015, 2014, where appropriate);
- the setting-up of a specific follow-up for professionals for which material weaknesses were noted in the previous financial years.

The 15 reviewed audit firms reported³ a total of 8,690 audit engagements, including 491 in relation to PIEs. Under the 2018 review programme, 198 mandates were reviewed, 53 of which concerned PIEs.

The quality assurance reviews started in January 2018 and were carried out by nine CSSF inspectors with professional audit experience and expert knowledge in the business areas of the financial centre. These reviews represented a total of 9,256 hours.

Breakdown of audit files reviewed by the CSSF in 2018 per entity type

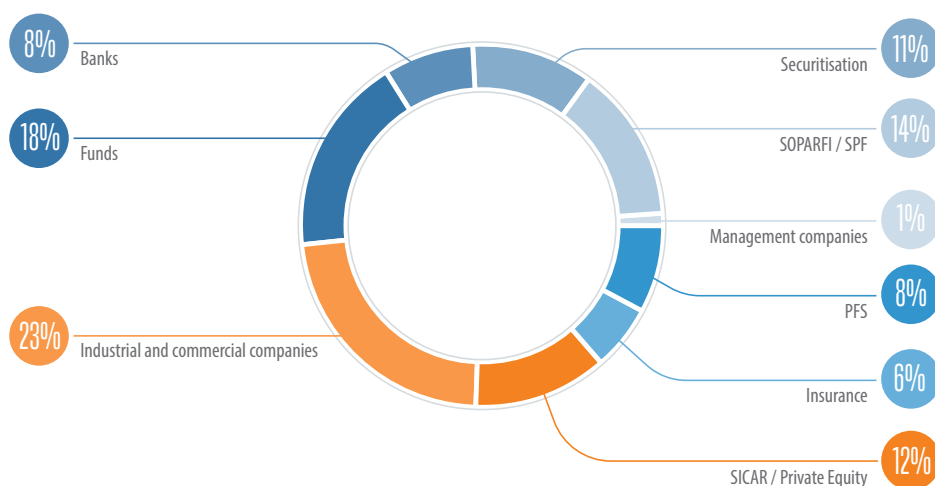


¹ PwC, KPMG, Deloitte, EY.

² Firms that carry out over 100 audit engagements (as at 31 December 2018, three firms are concerned).

³ Based on the statements of *cabinets de révision agréés* as at 31 December 2017.

Breakdown of audit files reviewed by the CSSF in 2018 per sector



2.3. Conclusions of the 2018 campaign of quality assurance reviews

The 15 reviews carried out in 2018 were subject to an inspection report.

In particular, out of these 15 reviews, the CSSF carried out a specific follow-up of one *cabinet de révision agréé* and three *réviseurs d'entreprises agréés* due to previous campaign conclusions. The measure was terminated for the audit firm. The specific follow-up was maintained for two of the three *réviseurs d'entreprises agréés*.

Apart from the specific follow-up, the following conclusions were transmitted to *réviseurs d'entreprises agréés* in relation to the 2018 campaign:

- a training plan was given to one *réviseur d'entreprises agréé*;
- the audit files of one *réviseur d'entreprises agréé* must be subject, prior to the signature of any report, to an engagement quality control review by a second *réviseur d'entreprises agréé* who has not participated in carrying out the reviewed statutory audit;
- 10 *réviseurs d'entreprises agréés* were subject to a specific follow-up.

2.4. Major issues identified during the quality assurance reviews of 2018

2.4.1. Review of the quality control systems of *cabinets de révision agréés*

The main observations brought out by the 2018 quality control review in relation to the quality assurance systems of the *cabinets de révision agréés* concerned:

- the lack of details in the description and analysis of the non-audit services reported in some audit files of PIEs;
- the shortcomings regarding the documentation of work in the PIEs' audit files aiming to ensure that no prohibited non-audit service, referred to in Article 5 of Regulation (EU) No 537/2014, was provided by the *cabinet de révision agréé* or by any member of its network to the audited entity, to its parent undertaking or to undertakings it controls in the EU;
- the perfectible aspect of the update and maintenance of the family tree and data of the audited entities in the systems of some firms, especially with respect to PIEs, in accordance with the provisions of Article 5 of Regulation (EU) No 537/2014;
- the interpretation errors when determining the external rotation time frame of the statutory auditor in the context of audit engagements of PIEs and in accordance with Article 17 of Regulation (EU) No 537/2014.

The CSSF invites the *cabinets de révision agréés* concerned to take corrective actions in order to address these points.

Moreover, some irregularities identified during the 2017 inspections were noted again during the 2018 quality assurance reviews. These irregularities concern:

- the completeness of the list of mandates communicated to the CSSF;
- the perfectible aspect of Engagement Quality Control Reviews (EQCR), the implementation of which did not allow identifying significant irregularities in the legal and regulatory framework, whereas the CSSF noted the irregularities in these same audit files during its inspections.

On these last two points, the CSSF reiterates its call on the *cabinets de révision agréés* to consolidate their procedures in order to ensure the communication of comprehensive information during the next quality assurance reviews and to implement appropriate corrective measures in order to enhance the engagement quality control reviews.

2.4.2. Audit files

The findings of the 2018 quality assurance reviews show that the *cabinets de révision agréés* continue their efforts to carry out quality statutory audits. However, the controls of the CSSF highlighted that the audit diligence with respect to the following points could be perfected:

- the relevance and sufficiency of the audit diligence implemented for the audit of financial assets valued at fair value;
- the valuation of carried interest and its presentation in the financial statements;
- the identification and description of key audit matters in the audit report of PIEs;
- the compliance of the additional report intended for the audit committee with Article 11 of Regulation (EU) No 537/2014 in the framework of the statutory audit of PIEs;
- the adequacy of the presentation of the financial statements, including the information disclosed.

• Relevance and sufficiency of the audit diligence implemented for the audit of financial assets valued at fair value

The CSSF recommends the *cabinets de révision agréés* to use more professional scepticism in the review:

- of the appropriateness of the chosen valuation methods;
- of the reasonableness of the key assumptions used (e.g. the EBITDA, the growth rate, baskets of selected comparable companies, percentages of haircuts applied) in the valuation methods;
- of the relevance and reliability of the information on which the accounting estimates are based.

• Valuation of carried interest and presentation in the financial statements

During the 2018 quality control review, recurring irregularities were identified with respect to the accounting treatment and information provided in the notes to the financial statements regarding carried interest, namely the performance-based incentive scheme for the management teams of some investment funds, and in particular:

- the absence of information on carried interest in the notes to the financial statements; or
- the absence of quantified estimates of carried interest in the notes to the financial statements. The notes to the financial statements describe only the applicable calculation method.

Irrespective of the valuation method chosen by the entity to value its assets, the amount of all financial commitments or contingencies which are not included in the balance sheet must be indicated in the notes to the accounts in accordance with the Law of 19 December 2002 on the trade and companies register

and the accounting practices and annual accounts of undertakings. Moreover, the auditor must implement the audit diligence necessary to understand the accounting treatment of carried interest and to ensure the reasonableness of his/her estimate.

• Identification and description of key audit matters in the audit report of PIEs

The 2018 inspections of the PIEs' audit files allowed assessing the first application of the extended audit report. The review of the key audit matters revealed some weaknesses.

Thus, the CSSF encourages the *cabinets de révision agréés* to describe in detail the identified risks and to report, where appropriate, the audit assertions concerned in the key audit matters.

Moreover, the description of the audit diligence implemented is often too general. For instance, the sentence "an appropriate combination of tests of procedures and substantive controls" is not precise enough to assess how the auditor addresses the identified risks. In addition, in some cases, the diligence described is not always performed.

The CSSF also noted that the terms used are sometimes too technical or vague and that they should be clarified in order to facilitate the reading of the audit report.

• Compliance of the additional report intended for the audit committee with Article 11 of Regulation (EU) No 537/2014 in the framework of the statutory audit of PIEs

In several audit files of PIEs, the CSSF observed an incomplete recording of the communication to the audit committee in accordance with the provisions of Article 11 of Regulation (EU) No 537/2014.

The CSSF calls on firms to be more vigilant when verifying that the content of the additional report complies with the audit opinion. Conflicting information was identified in this matter, particularly with respect to the non-audit services provided.

Finally, some audit files do not include a dated and signed version of the additional report which would prove that this report had indeed been submitted to the audit committee at the latest on the presentation date of the audit report.

• Adequacy of the presentation of the financial statements, including the information disclosed

As during the inspections of the two preceding years, the CSSF has yet identified irregularities relating to the presentation of and information provided in the financial statements in the controlled audit files. The verification of the adequacy of the presentation and provided information with the legal and regulatory framework in force, particularly in relation to the accounting estimates or significant risks, continues all too often to be subject to a lack of diligence by the auditor.

Consequently, the CSSF reiterates its recommendation to the firms to ensure that the diligence performed is adapted to the circumstances and, at the very least, that the content of the audit files shows that the identified irregularities, misstatements or shortfalls which are not insignificant are communicated at the appropriate management level of the audited entity.

3. OVERVIEW OF THE POPULATION OF *RÉVISEURS D'ENTREPRISES* IN LUXEMBOURG

3.1. Access to the profession

3.1.1. Activities of the Consultative Commission for the Access to the Audit Profession

The Consultative Commission's task is, among others, to verify the theoretical and professional qualification of the candidates for the access to the audit profession in Luxembourg, as well as that of the service providers from other Member States wishing to exercise by way of free provision of services.

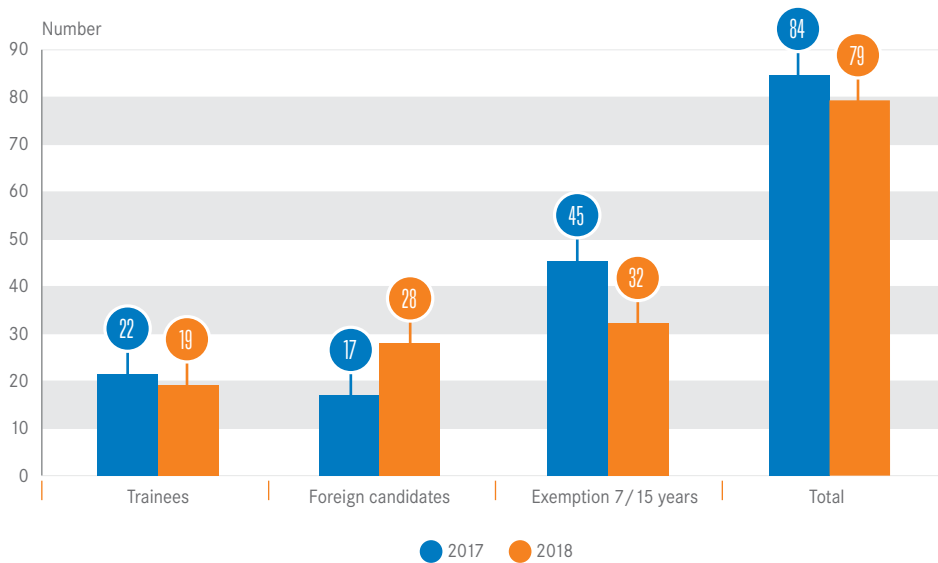
The Commission met seven times in 2018 and analysed the files of 79 candidates, against 84 in 2017, representing a drop of 6%.

In 2018, the access to training was refused to three candidates (4%) as the number of subjects to be completed based on their administrative certificate was greater than five.

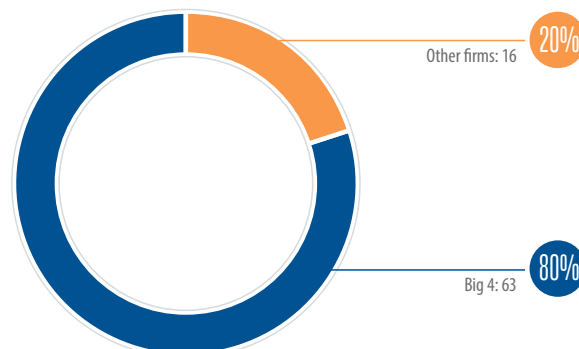
There are three categories of candidates:

- trainee *réviseurs d'entreprises*;
- foreign candidates;
- candidates applying for an exemption based on their professional experience of either 7 or 15 years.

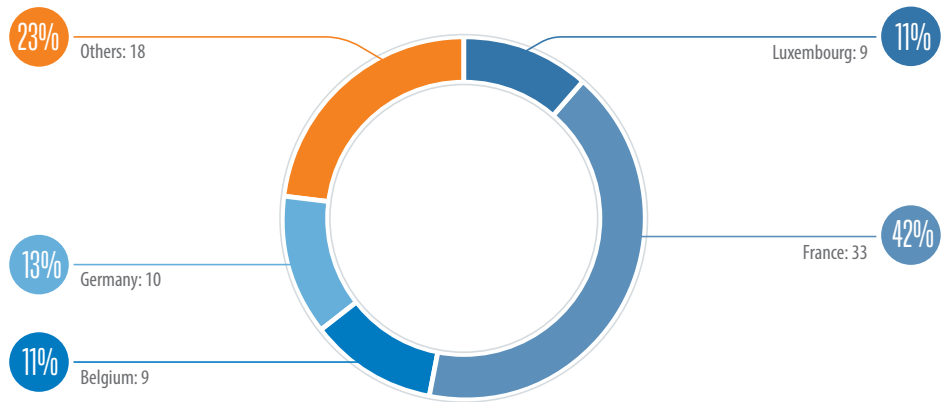
Development in the number of application files submitted to the Consultative Commission



Breakdown of candidates per firm



Breakdown of candidates per nationality



3.1.2. Examination of professional competence in 2018

The CSSF administrated the examination of professional competence in accordance with Articles 5 and 6 of the Grand-ducal Regulation of 9 July 2013 determining the requirements for the professional qualification of *réviseurs d'entreprises*.

In this context, the examination jury communicated the following results with respect to 26 candidates registered for the 2018 examination of professional competence to the CSSF:

- Ordinary session: 26 candidates took the written exam, 15 of whom were admitted to the oral exam. In total, 13 passed the exam and two were subject to partial referral.
- Extraordinary session: two candidates took the written exam, one of whom was admitted to the oral exam. In total, one passed the exam of the extraordinary session.

Thus, all sessions included, 14 candidates passed the examination of professional competence in 2018 successfully.

Having passed this examination, candidates may request the CSSF to be granted the title of “*réviseur d'entreprises*”.

The graduation ceremony was held on 25 February 2019 in the presence of the Minister of Finance Mr Pierre Gramegna.



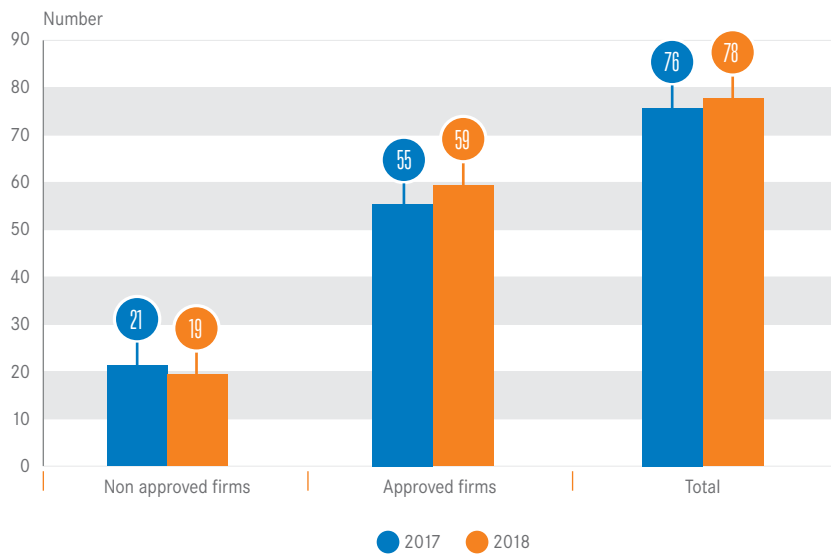
3.2. Public register

The public register of *réviseurs d'entreprises agréés*, *cabinets de révision agréés* and third-country auditors and audit entities is available on the CSSF's website (Supervision > Audit profession > Public register).

3.2.1. National population as at 31 December 2018

• Development in the number of *cabinets de révision* and *cabinets de révision agréés*

The total number of *cabinets de révision* and *cabinets de révision agréés* amounted to 78 as at 31 December 2018, against 76 as at 31 December 2017.



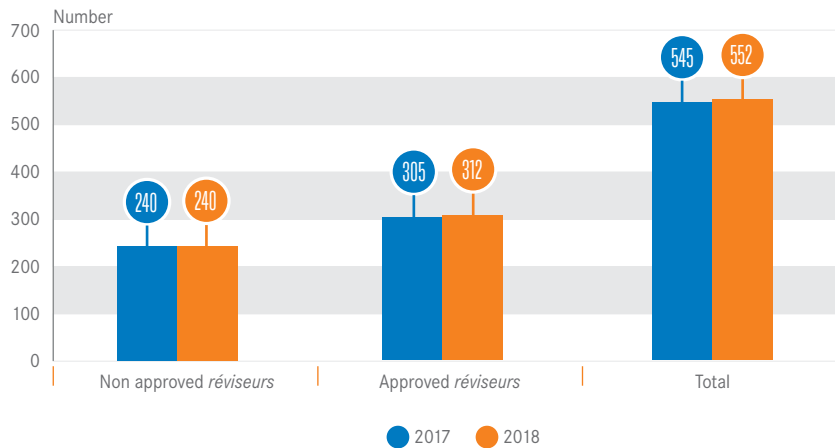
The following firms were approved in 2018:

- FIDUCIAIRE DE LA GRANDE REGION S.A.,
- TKS Luxembourg,
- ELERIUS,
- PKF Audit & Conseil.

In 2018, two firms gave up the title of “*cabinet de révision*”.

• Development in the number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés*

The total number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés* amounted to 552 as at 31 December 2018, against 545 as at 31 December 2017, representing a 1.3% increase.



In 2018, the CSSF granted the title of “*réviseur d'entreprises*” to 20 persons and approved 17 *réviseurs d'entreprises*.

During the year under review, 10 *réviseurs d'entreprises* gave up their approval.

The population consists of 68% men and 32% women. The average age of the *réviseurs* is 43.07 years for women and 46.20 years for men.

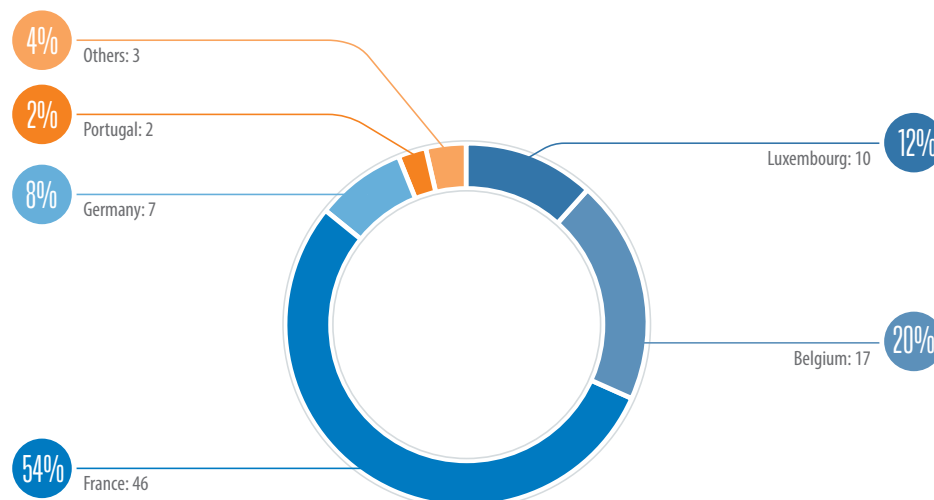
• Development in the number of trainee *réviseurs d'entreprises*

The total number of trainee *réviseurs d'entreprises* amounted to 85 as at 31 December 2018, against 113 as at 31 December 2017, which represents a 33% decrease.

The population consists of 68% men and 32% women. The average age of trainees is 31.13 years for women and 31.49 years for men.

It should be pointed out that 84% of the population of trainees comes from the “Big 4” firms.

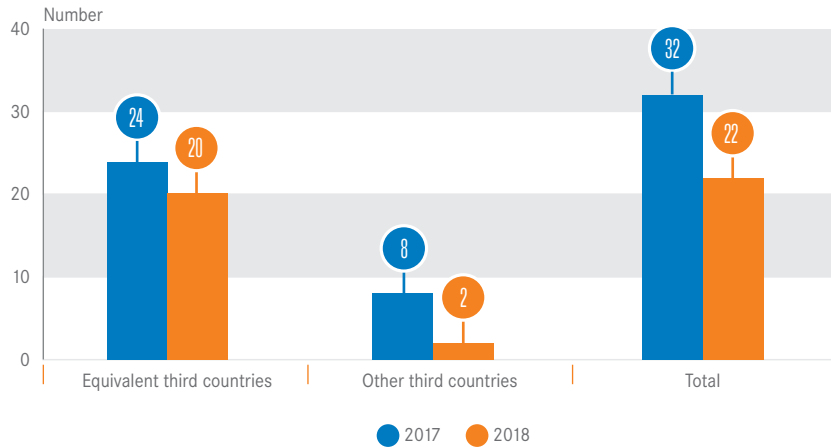
Breakdown of trainees per nationality



3.2.2. Third-country auditors and audit firms

The number of third-country auditors and audit entities that provide an auditor’s report on the annual or consolidated financial statements of a company incorporated outside EU Member States, whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange decreased by 10 entities in 2018. Their activities no longer falling within the scope of the amended Directive 2006/43/EC, they did not renew their registration with the CSSF.

Breakdown of registered third-country auditors



The public register listing all registered third-country auditors is available on the CSSF’s website.

4. COOPERATION AGREEMENTS

The CSSF did not sign any new cooperation agreements in 2018.

The agreements previously concluded are available on the CSSF’s website.



Agents hired in 2018 and 2019: Department "Information systems of the CSSF"

From left to right: Tamian NINGAYO, Sven WAEYENBERGH, Philippe BERNARD, Nicolas GEYER, Jean-Yves HENDRIX, Pascal PIRIH, Antoine TOMBINI, Martin GRANDCOLAS, Sergio NEVES

Absent: Elisabeth SILVA



Agents hired in 2018 and 2019: Department "Personnel, administration and finance"

From left to right: Marine REPELOWICZ, David MONTEIRO, Nathalie FUSULIER, Jennifer KANDEL, Sandra MIOTTO, Daniel VIEIRA DA SILVA, Marc MISCHO, Daniel SCHWIENKE, Pedro DUARTE

Absent: Andy LEONARD, David ZIESER



CHAPTER XVI

INSTRUMENTS OF SUPERVISION

1. ON-SITE INSPECTIONS

The “On-site inspection” (OSI) department is in charge of coordinating all on-site inspections conducted by the CSSF with regard to banks¹, payment institutions, electronic money institutions, UCIs as well as their management companies, investment firms, specialised PFS, support PFS, pension funds, securitisation undertakings and financial market participants. Moreover, the OSI department coordinates on-site inspections of Luxembourg significant banks with the “Centralised On-site Inspection” department of the ECB. It should be noted that, beside the OSI department, other CSSF departments also carry out targeted on-site inspections.

In addition to on-site inspections of professionals under Luxembourg law, the OSI department also participated, in the context of the mixed teams/cross-border missions concept implemented by the ECB, in two on-site inspections of a European significant bank abroad.

The OSI department’s staff increased to 76 people as at 31 December 2018 in order to fulfil all its tasks.

On-site inspections are in-depth investigations which provide a better understanding of the functioning and activities of the supervised entities and allow the evaluation of the risks to which these entities are exposed and their compliance with the laws and regulations. In general, on-site inspections are proposed by the supervisory departments on an annual basis. To do so, the departments developed a risk-based approach enabling them to determine which professionals are to be controlled by means of an on-site inspection. Subsequently, an annual planning is established and validated by the Executive Board of the CSSF. Any change, insertion or deletion in this annual planning must be subject to a formal validation.

The teams in charge of on-site inspections² are set up according to the nature, scale and scope of the missions and generally include agents from the OSI department and the off-site supervisory departments.

¹ This includes less significant banks which are not subject to the SSM as well as “AML/CFT”, “MiFID”, “Depositary bank” and “Central administration of UCIs” on-site inspections of significant and less significant banks as these topics are not directly covered by the SSM.

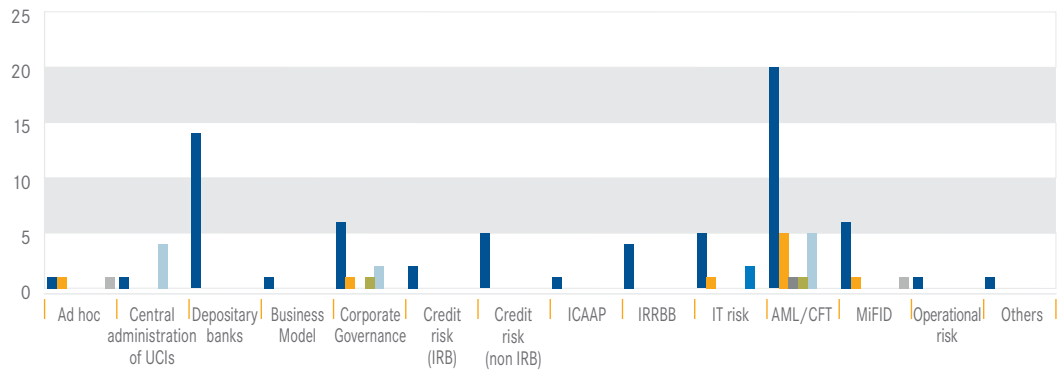
² With the exception of the missions performed at significant banks which are organised according to the methodology of the ECB.

The observations made during the on-site inspection are validated during a fact validation meeting with the professional. Thereafter, the teams in charge of the mission draw up an internal report for each on-site inspection highlighting the potential flaws and weaknesses identified during the mission. Generally, on-site inspections are followed by an observation letter that is sent to the inspected professional. In the event of more serious failures, the CSSF analyses whether an injunction procedure or a non-litigious administrative procedure is required in order to impose an administrative sanction pursuant to the sectoral laws in force. The sanctions and means of administrative police are described in detail in point 2. of this chapter.

Since the entry into force of the Grand-ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF, a lump sum has been billed for every on-site inspection relating to a specific topic. This lump sum amounts to EUR 25,000 for banks and EUR 10,000 for the other entities.

The 95 missions (excluding the UCI departments)³ carried out in 2018 covered the following topics.

Breakdown of the on-site inspections carried out in 2018 by topic and type of entity (excluding UCI departments)



- Banks
- Investment firms
- Electronic money institutions
- Payment institutions
- Specialised PFS
- Support PFS
- Investment fund managers

1	1	14	1	6	2	5	1	4	5	20	6	1	1
1				1					1	5	1		
										1			
				1						1			
	4			2						5			
									2				
1												1	

1.1. Ad hoc on-site inspections

Ad hoc on-site inspections are intended for the investigation of a specific or even worrying situation or problem related to the professional. Often, this particular situation of the professional has already been observed in the context of the off-site prudential supervision. Such missions may either be planned in advance or be carried out without prior warning. The nature and scale of ad hoc on-site inspections may vary significantly and, consequently, determine the composition and size of the on-site teams.

In 2018, three ad hoc on-site inspections were performed, two of which continued in 2019. They concerned, in particular, governance and anti-money laundering and counter-terrorist financing (AML/CFT). The findings with respect to AML/CFT are detailed in Chapter XIX “Financial crime”.

1.2. “Interest rate risk” on-site inspections

“Interest rate risk” or “Interest rate risk in the banking book (IRRBB)” on-site inspections aim to assess the management of the interest rate risk arising from non-trading activities and the stress test results. They are performed based on the methodology prepared by the ECB.

³ Forty-three additional missions were performed by the UCI departments and are set out in point 5.3. of Chapter IX “Supervision of investment fund managers and UCIs”.

In 2018, the CSSF carried out four IRRBB on-site inspections, including two at significant banks in the framework of the SSM. One on-site inspection was carried out by a mixed team with a head of mission from another European country.

As regards these missions, deficiencies relating to governance, exhaustive risk identification, interest rate risk quantification and stress testing were identified.

1.3. “Operational risk” on-site inspections

“Operational risk” on-site inspections, excluding internal models, aim to verify the manner in which operational risk is identified, controlled, managed and measured. They are performed based on the methodology prepared by the ECB.

In 2018, the CSSF carried out this type of mission at one significant bank in the framework of the SSM. The purpose of this mission, which started at the end of 2018, is to assess the operational risk management processes at the level of governance, Risk Control and Self-Assessment and incident management.

1.4. “Credit risk” on-site inspections

The purpose of “Credit risk” on-site inspections is to verify the sound and prudent credit risk management within the banks of the financial centre. They are performed based on the methodology prepared by the ECB. In 2018, the ECB continued to implement new control mechanisms to carry out these on-site inspections, notably at the level of the sampling methodology and credit file reviews. In this context, the CSSF participated in several working groups overseen by the ECB.

In 2018, three agents from the OSI department contributed to a large-scale mission at a significant bank abroad in the framework of the residential real estate campaign. One agent of the OSI department also participated in the commercial real estate campaign at two significant banks abroad.

In 2018, the CSSF also carried out “Credit risk” on-site inspections at three banks in Luxembourg. These on-site inspections concerned various topics such as real estate (residential and commercial) credits, lombard loans, trade financing and corporate banking loans.

The major flaws identified during these inspections are mainly related to governance, classification of credits according to their risk as well as procedures and processes of ongoing credit monitoring and credit reporting.

As regards governance, deficiencies were identified mainly in relation to the organisation of the authorised management which may lead to independence problems with respect to internal control, the absence of regular updates of the procedural framework, the risk appetite statement and the low level of involvement of the risk control function in the decisions on credits.

As regards the classification of credits according to their risk, the CSSF noted that the procedures were sometimes incomplete and that the classification process was either missing or incorrect, all of which resulted in identification problems of non-performing exposures, forborne exposures or defaulted exposures.

As regards the ongoing credit monitoring, the CSSF noted that the credit monitoring or reporting procedures were sometimes incomplete or even missing and that the monitoring or reporting processes were sometimes ill-conceived or flawed.

The OSI department also carried out one mission in the context of the compliance with the Law of 23 December 2016 on credit agreements for consumers relating to residential immovable property and the Grand-ducal Regulation of 23 December 2016 amending the regulatory part of the Consumer Code.

1.5. “Anti-money laundering and counter-terrorist financing” (AML/CFT) on-site inspections

The AML/CFT on-site inspections are detailed in point 1.2. of Chapter XIX “Financial crime” which concerns especially the CSSF’s AML/CFT supervision.

1.6. “Corporate Governance” on-site inspections

“Corporate Governance” on-site inspections aim to assess the quality of the governance arrangements set up by the professionals pursuant to the legal and regulatory requirements. The governance arrangements of a Luxembourg entity, the “head of group” function exercised by a Luxembourg entity over its subsidiaries or branches, the organisation and effectiveness of the internal control functions of an entity, the implementation of remuneration policies as well as the implementation of a new governance model as a result of the reorganisation of a banking group may be subject to such an inspection.

In 2018, the CSSF carried out 10 “Corporate Governance” on-site inspections at credit institutions, investment firms, electronic money institutions and specialised PFS. During these inspections, an emphasis was placed on the functioning of, as well as on the interactions between, the board of directors, the authorised management, including their respective committees, and the internal control functions.

The most significant flaws, in terms of recurrence or seriousness, which were identified, in 2018, at the level of the boards of directors and their specialised committees related to the absence of regular critical assessments of the institution’s internal governance arrangements and the absence of assessments of the suitability of the authorised managers to carry out their functions.

In addition, deficiencies were observed in the approval of the guiding principles or key procedures by the board of directors and in the communication to the CSSF of any changes in the shareholding structure of a supervised entity within the set time limit.

As regards the authorised management and the management committees, the main shortcomings identified relate to the insufficient supervision of the internal control functions which, in some instances, can be explained by the authorised management’s insufficient awareness of internal control and risks. In some cases, the CSSF noticed that the authorised management did not promptly and efficiently implement the corrective measures aiming at addressing the significant flaws identified by the control functions.

Furthermore, the insufficient knowledge of the authorised management, collectively, about some critical information was observed in some cases. This occurred either because the information was not communicated to them by the authorised management of the subsidiaries or branches, or because this information was not shared between all the members of the authorised management of the supervised entity.

The findings of the on-site inspections related to the second line of defence show that the Compliance function did not systematically develop a control plan according to a risk-based approach and did not systematically document the controls carried out. In some cases, a lack of authority and independence of the Compliance function was also noted. The CSSF furthermore observed that incomplete information was sometimes provided to the Compliance function of the parent company.

The risk control function did not sufficiently cover some risks, as a result of the absence of a global assessment of the risks or because of the lack of a critical review of the limits. Moreover, the lack of participation of the risk control function in the new product approval process was observed on several occasions.

Finally, several on-site inspections showed that the internal audit function of some supervised entities was not organised so as to safeguard its independence or was not permanent. It was also noticed that some internal audit plans were either incomplete or not developed considering a risk-based approach.

1.7. “Business Model & Profitability Assessment” on-site inspections

The purpose of the “Business Model & Profitability Assessment” on-site inspections is to assess how the business and the risk strategies of an institution are aligned while its medium- and long-term financial interests are ensured. The purpose of these on-site inspections is to better understand the sources of banking income and to identify the vulnerabilities for the profitability. A Business Model & Profitability Assessment is an in-depth analysis of the viability and the sustainability of a bank.

In 2018, the CSSF carried out this type of mission in one bank of the Luxembourg financial centre. This inspection revealed notably, the lack of own strategy of the entity in Luxembourg, as a complement to the group strategy. Deficiencies were also observed in the application of the risk-pricing policy, particularly for

intra-group transactions. Furthermore, the CSSF observed shortcomings related to the identification and to the understanding of the elements impacting the economic performance, as well as the absence of rationale for the assumptions supporting the medium-term budget plan and the future own funds basis.

1.8. “MiFID” on-site inspections

The purpose of “MiFID” on-site inspections is to assess whether the implemented MiFID framework is in line with the legal and regulatory requirements.

In 2018, the CSSF carried out eight “MiFID” on-site inspections at credit institutions, investment firms and management companies authorised under Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment.

These missions included verifications regarding the new requirements under MiFID II laid down in the Law of 30 May 2018 on markets in financial instruments, the Grand-ducal Regulation of 30 May 2018 on the protection of financial instruments and funds belonging to clients, product governance obligations and rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits and in the relevant European delegated regulation.

The following most significant flaws, in terms of frequency or seriousness, were identified during the “MiFID” on-site inspections in 2018:

- shortcomings in the assessment of the suitability or appropriateness of the proposed products or services;
- shortcomings in the identification of potential situations of conflict of interest and incomplete arrangements to prevent or manage these situations;
- shortcomings identified at the level of the information communicated to clients, notably ex ante information relating to costs and associated charges of financial instruments and investment or ancillary services;
- lack of measures implemented in relation to product governance arrangements at the level of manufacturing and distribution of products as well as at the level of information exchange between the manufacturers and distributors;
- shortcomings identified in the controls performed by the internal control functions (linked, in particular, to the absence of completeness on covered topics and insufficient formalisation of the controls carried out by the compliance and internal audit functions).

1.9. “Depository bank” on-site inspections

In 2018, the CSSF conducted 14 on-site inspections regarding the “Depository bank” function, including seven at significant banks.

In the framework of these inspections, the CSSF ensured that the supervised entities carry out the depository function in compliance with the existing laws and regulations. The on-site inspections covered, in particular, the procedures and controls implemented to ensure the custody of the different types of assets, the due diligence processes with respect to the different types of parties involved in the custody of assets and the management of UCIs, the process of acceptance of new assignments, the follow-up of the delegated activities as well as the oversight duties.

The CSSF identified many weaknesses with respect to the UCIs cash flow monitoring and the other specific oversight duties, either due to incomplete controls or in relation to the periodicity of the controls. The depository must indeed define ex post oversight procedures which are appropriate in light of the characteristics of the different funds and their investments. It must, however, also take into account the quality of the controls carried out and the processes in place at the level of the fund and its providers.

Moreover, the management of conflicts of interest as well as the management of delegates in charge of the custody of assets remain issues regularly identified during these on-site inspections.

1.10. “UCI central administration” on-site inspections

In 2018, the CSSF conducted “UCI central administration” on-site inspections at one significant bank and at four specialised PFS.

These on-site inspections mainly covered the NAV calculation process, the transfer agent function, the processes of acceptance of new assignments, the procedures in place, the human and technical means available as well as the supervision of the delegated operational activities.

The major flaws noted during these on-site inspections concerned the lack of involvement, coordination and monitoring by the central administration where operational processes linked to the NAV calculation are carried out by other providers. The central administration cannot discharge itself of its liability and must, hence, have sound arrangements in this respect in order to be able to validate the NAV.

Moreover, the way the controls carried out by the entity are formalised and documented is an issue that is regularly identified during the inspections.

1.11. “IT risk” on-site inspections

The “Supervision of information systems and support PFS” department includes a specialised team in charge of conducting IT on-site inspections at the supervised entities. In 2018, this team carried out eight on-site inspections at five banks, two support PFS and one investment firm. It also participated in three on-site inspections at significant banks in the framework of the SSM.

The main flaws, in terms of frequency or seriousness, identified in 2018 during the “IT risk” on-site inspections concerned:

- IT security, including in particular the management and control of privileged accesses and the management of cyber threats, especially with respect to the remediation of critical vulnerabilities;
- the management of IT risks with very low coverage or even with no coverage at all of these risks by the second line defence;
- the internal audit, in particular with the low coverage of the IT activities and problems of independence and competence to assess the related risks;
- the continuity of activities as a whole (governance, plans and tests);
- the outsourcing, in particular the contractual aspects and operational follow-up.

1.12. “Liquidity risk” on-site inspections

The purpose of the on-site inspections related to liquidity is to assess, in a detailed manner, the situation and management of the liquidity risk within Luxembourg credit institutions.

In 2018, an on-site inspection was carried out at a bank at which deficiency in the formalisation of the internal procedures was identified.

1.13. “Risk management” on-site inspections

In 2018, the “Risk management” on-site inspections covered credit risks and, in particular, the internal risk rating models or systems in the context of European regulatory requirements or internal credit risk management.

One of the two inspections carried out in 2018 was conducted by the ECB at a significant bank in Luxembourg and the other one, also conducted by the ECB, concerned a bank abroad.

1.14. "ICAAP" on-site inspections

In 2018, the CSSF carried out one such mission at a significant bank in the framework of the SSM, the purpose of which was to check the robustness of the ICAAP by ensuring that the risks are correctly identified and quantified.

2. DECISIONS AS REGARDS SANCTIONS AND ADMINISTRATIVE POLICE TAKEN IN 2018

In 2018, the CSSF took the following decisions with respect to sanctions and administrative police. It is noteworthy that the total amount of administrative fines imposed by the CSSF in 2018 reached EUR 5,588,365.

2.1. Credit institutions

In 2018, the CSSF imposed eight administrative fines on credit institutions pursuant to Articles 63 and 63-2 of the Law of 5 April 1993 on the financial sector as well as under Article 148 of the Law of 17 December 2010 relating to UCIs and Article 51 of the Law of 12 July 2013 on alternative investment fund managers.

Thus, one fine amounting to EUR 4,000,000 was imposed due to infringements in relation to internal governance and AML/CFT professional obligations.

Two other fines amounting to EUR 47,500 and EUR 100,000 each, were imposed for non-compliance with the AML/CFT professional obligations.

Three fines amounting to EUR 37,000, EUR 55,400 and EUR 143,735 each, were imposed for infringements in relation to the depositary bank function.

One bank had to pay a fine amounting to EUR 246,230 due to non-compliance with the obligations relating to MiFID regulations.

In addition, the CSSF imposed a fine of EUR 33,000 on a credit institution for infringements in relation to internal governance.

In one case, the CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector due to non-compliance with the AML/CFT professional obligations.

2.2. Investment firms

In 2018, the CSSF imposed two administrative fines pursuant to Article 63 of the Law of 5 April 1993 on the financial sector. These fines were imposed on investment firms as legal persons.

One investment firm had to pay a fine amounting to EUR 55,000 due to non-compliance with several AML/CFT professional obligations. Following two injunctions imposed under Article 59 of the Law of 5 April 1993 on the financial sector on another investment firm, the CSSF imposed a fine of EUR 55,000 on this investment firm for non-compliance with some professional obligations relating to MiFID regulations, for failing to act in response to an injunction of the CSSF pursuant to Article 59 of the above-mentioned law, for non-compliance with the conditions relating to capital base under Article 20 of that law, for non-compliance with the capital adequacy ratio, for non-compliance with Article 19 of the above-mentioned law on the necessity to have a two-man authorised management, for non-compliance with the internal organisation and governance and for failing to address satisfactorily and within the set time limit the observations and flaws identified by the CSSF in the framework of the review of the closing documents relating to the 2016 financial year.

The CSSF also used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector on six occasions for the following reasons:

- infringements in relation to the implemented AML/CFT framework;
- infringements in relation to the internal governance arrangements and non-compliance with some legal obligations;
- failure to submit documents and information required by the CSSF in the framework of a voluntary liquidation;
- high number of shortcomings identified and recommendations issued with respect to closing documents relating to the 2016 financial year and significant amount of information and clarifications/confirmations to be provided to the CSSF.

In 2018, the CSSF filed one report in accordance with Article 23(2) of the Code of Criminal Procedure and three reports in accordance with Article 23(2) and (3) of the Code of Criminal Procedure with the State Prosecutor.

In 2018, the CSSF filed 13 complaints with the Prosecutor's Office regarding entities which provided investment services without authorisation.

2.3. Specialised PFS

In 2018, the CSSF did not impose any administrative fines on specialised PFS pursuant to Article 63 of the Law of 5 April 1993 on the financial sector.

However, it used its right of injunction in accordance with Article 59 of the above-mentioned law against 10 specialised PFS. In four cases, the injunction concerned non-compliance with the professional obligations relating to the publication of annual accounts of domiciled companies. Two injunctions were imposed in the framework of procedures for the authorisation of day-to-day managers of specialised PFS. Following the on-site inspections regarding the central administration of investment funds, the CSSF decided to order two specialised PFS to comply with the relevant regulations in force. Furthermore, the CSSF ordered one specialised PFS to take corrective measures because its financial situation no longer offered sufficient guarantees to honour its commitments. Finally, an injunction was ordered due to infringements in relation to AML/CFT.

The CSSF decided, in 2018, to temporarily withdraw the professional reputation of one natural person due to misstatements in his/her declarations of honour submitted to the CSSF.

In 2018, the authorisation of one specialised PFS has been withdrawn in accordance with Article 23(1) of the Law of 5 April 1993 on the financial sector which provides that the authorisation shall be withdrawn if the conditions for the grant thereof cease to be fulfilled.

During 2018, the CSSF also filed a report concerning one specialised PFS with the State Prosecutor in accordance with the provisions of Article 23(3) of the Code of Criminal Procedure. In addition, there has been a cooperation between the competent authorities pursuant to Article 9-1 of the Law of 12 November 2004 on the fight against money laundering and terrorist financing.

2.4. Support PFS

In accordance with Article 63 of the Law of 5 April 1993 on the financial sector, the CSSF imposed an administrative fine on two support PFS in 2018; one fine amounted to EUR 5,000 due to non-filing of the internal auditor's summary report and the other fine amounted to EUR 125,000 due to different infringements noted during an on-site inspection relating to IT governance.

2.5. Investment fund managers (IFMs)⁴

Pursuant to the provisions of Article 148(4)(e) of the Law of 17 December 2010 relating to UCIs, the CSSF imposed an administrative fine of EUR 91,000 on an IFM based on the provisions of Article 148(2)(g), (j) and (k) of the above-mentioned law and an administrative fine of EUR 60,000 on an IFM based on the provisions of Article 148(1)(b), (2)(g) and (2)(n) of that law.

Moreover, pursuant to Article 51(2) of the Law of 12 July 2013 on alternative investment fund managers, the CSSF imposed an administrative fine of EUR 5,000 on an IFM for non-compliance with the provisions of Article 17(8) of the above-mentioned law as well as of Articles 67(4), 68(1) and (2), 69(1) and 70(1) of Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

In 2018, the CSSF decided to withdraw two IFMs from the official list for non-compliance with the legal provisions.

2.6. Undertakings for collective investment⁵

In accordance with Article 51(1) of the Law of 13 February 2007 relating to specialised investment funds (SIFs), the CSSF imposed administrative fines amounting to EUR 2,000 or EUR 4,000, as the case may be, on the *dirigeants* of 23 SIFs for the non-filing of the annual financial report and on the *dirigeants* of 23 SIFs for the non-filing or incomplete filing of the management letter.

In accordance with the provisions of Article 17(1) of the Law of 5 June 2004 relating to the investment company in risk capital (SICAR), the CSSF imposed administrative fines amounting to EUR 500 each on the *dirigeants* (directors) of five SICARs for the non-filing of the annual financial report, on the *dirigeants* of five SICARs for the non-filing of the management letter and on the *dirigeants* of two SICARs for the non-filing of U1.1 reports.

Moreover, the CSSF imposed administrative fines amounting to EUR 4,000 each on three natural persons for the transmission of an incomplete declaration of honour.

Finally, the CSSF ordered a four-year temporary prohibition from exercising professional activities against a *dirigeant* of a SIF pursuant to Article 45(3)(g) of the Law of 13 February 2007 relating to specialised investment funds.

During 2018, the CSSF decided to withdraw one UCITS, seven SIFs and one SICAR from the official lists for non-compliance with the legal provisions.

2.7. Securities markets

The review of financial reports under the Transparency Law led the CSSF to issue six administrative fines, mainly due to delays in the disclosure and filing of annual and half-yearly financial reports. The total amount of these fines, imposed in accordance with Article 25 of the Transparency Law, was EUR 62,500. Moreover, the CSSF imposed an administrative fine of EUR 1,750 as regards the control of major holdings under the Transparency Law.

During one investigation in relation to market abuse under the Law of 9 May 2006 on market abuse (Market Abuse Law), which was repealed by the Law of 23 December 2016 on market abuse, the CSSF imposed, in 2018, administrative fines of EUR 41,250 and EUR 250,000 on two natural persons for market manipulation on the shares of an issuer which are admitted to trading on the regulated market of the Luxembourg Stock Exchange. These sanctions were imposed in accordance with Article 33 of the Market Abuse Law.

In the framework of an inspection regarding the implementation by a supervised entity of internal arrangements, systems and procedures to detect and report suspicious orders and transactions within the meaning of Article 16(2) of Regulation (EU) No 596/2014 of 16 April 2014 on market abuse, the CSSF imposed an administrative fine of EUR 47,500 on that supervised entity for breaching this article in accordance with the provisions of letter (b) of Article 12(2)(11) of the Law of 23 December 2016 on market abuse.

⁴ It should be pointed out that some of these administrative fines are still subject to a *recours gracieux* (review of the decision by the CSSF) or a *recours administratif* (review which is pending before the administrative courts).

⁵ It should be pointed out that some of these administrative fines are still subject to a *recours gracieux* (review of the decision by the CSSF) or a *recours administratif* (review which is pending before the administrative courts).

2.8. Audit profession

Pursuant to the provisions of point (f) of Article 43(1) of the Law of 23 July 2016 concerning the audit profession (Audit Law) and taking into account the provisions of Article 44 of this law, the CSSF imposed two administrative fines amounting to EUR 10,750 and EUR 10,000 each, on *réviseurs d'entreprises agréés*. These administrative fines were imposed based on the provisions of Article 40(2) and points (a) and (b) of Article 43(2) of the Audit Law for professional misconduct and negligence which have led to the infringement of the legal and regulatory requirements relating to statutory audits.



CHAPTER XVII

RESOLUTION

The Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), which notably transposes Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD), designates the CSSF as the resolution authority in Luxembourg. The CSSF exercises the missions and powers assigned to it as resolution authority through the Resolution Board, whereas the “Resolution” department (RES department) performs the day-to-day tasks related to these missions. The Resolution Director, Mr Romain Strock, who chairs the Resolution Board, heads the RES department.

A description of the functions and composition of the Resolution Board is available in Chapter I “Governance and functioning of the CSSF”. The Resolution Board met six times in 2018 and also took decisions by written procedure.

Set up on 1 March 2015 in order to carry out the tasks and obligations entrusted to the national resolution authority under the BRRD as well as under Regulation (EU) No 806/2014 (SRM Regulation), the RES department was composed of 15 persons as at 31 December 2018.

In line with the distribution of responsibilities, particularly between the Resolution Board and the Single Resolution Board (SRB), the RES department is in charge, among other things, at individual and group level, as concerns credit institutions and investment firms falling under the scope of the BRRD Law or the SRM Regulation, of submitting the following for decision to the Resolution Board:

- adoption of resolution plans and resolvability assessments;
- measures to address or remove impediments to resolvability;
- appointment of a special manager;
- assurance regarding a fair, prudent and realistic valuation of the assets and liabilities;
- application of simplified obligations or granting waivers, among others, to the obligation to draft a resolution plan;
- setting the minimum requirement for own funds and eligible liabilities, in particular its level;

- adoption of resolution decisions and applying resolution tools in accordance with the relevant procedures and safeguards;
- writing-down or conversion of relevant capital instruments;
- execution of the instructions issued by the SRB.

Moreover, the RES department represents the CSSF as resolution authority within international fora. Thus, the agents of the RES department participate in the work of the SRB and the EBA.

As far as the EBA is concerned, the RES department is represented in the Resolution Committee (ResCo) which is a permanent internal committee of the EBA, set up in January 2015, for the purpose of taking decisions and fulfilling tasks conferred on the EBA and the national resolution authorities under the BRRD. The voting members are the directors of the national resolution authorities within the EU. In addition, the RES department participates in the work of the Subgroup on Resolution Planning and Preparedness (SGRPP), a subgroup of the Resolution Committee.

A detailed description of the SRB's tasks, functions and composition is available in Chapter II "The European dimension of the supervision of the financial sector" of the CSSF Annual Report 2015. The Resolution Director participates in the plenary session of the SRB as well as in the extended executive session when topics concerning Luxembourg entities are being discussed. This was the case in 2018 for the adoption by the SRB, which met in extended executive session, of resolution plans of several banking groups which included Luxembourg banking subsidiaries and of resolution plans of Luxembourg banking groups or systemic banks. In this context, several executive sessions (meetings and teleconferences) have taken place focussing on the action to be taken by the SRB (as competent resolution authority) as regards the Latvian bank ABLV Bank AS and its Luxembourg subsidiary ABLV Bank Luxembourg S.A., which were given the status "failing or likely to fail" by the ECB. As regards the Luxembourg subsidiary, the SRB concluded, as for the parent undertaking, that there was no need to take any resolution action given the absence of public interest and critical functions. The SRB then instructed the national resolution authorities concerned to implement this decision in accordance with their national legislation.

Moreover, the agents of the RES department participate in the work of the following permanent working sub-committees of the SRB: SRB Resolution Committee (and its subgroups MREL Task Force and National Handbooks Expert Network), SRB Fund Committee, SRB Administrative and Budget Committee and SRB Legal Network. The CSSF also participates in the SRB ICT Network.

The RES department continues its collaboration with the SRB for the drafting of resolution plans for Luxembourg significant banks under the competence of the SRB. In this context, frequent meetings, videoconferences and information exchanges take place with the representatives of the SRB, the CSSF's department "Supervision of banks" and the relevant banks. The RES department also participates, within the Internal Resolution Teams coordinated by the SRB, in drafting resolution plans for significant banking groups in the Banking Union which have Luxembourg subsidiaries.

In a cross-border context outside the SRB, the RES department heads four resolution colleges (three colleges relating to banks for which the CSSF is the group-level resolution authority and one "European" college relating to sister banks in several EU Members States and which are subsidiaries of a third-country entity). Moreover, the RES department continues to participate in the work, meetings and teleconferences of colleges of resolution authorities chaired by group-level resolution authorities from other EU countries.

The RES department also drafted a certain number of resolution plans for less significant banks under the direct responsibility of the Resolution Board.

Resolution plans for the three colleges relating to banks for which the CSSF is the group-level resolution authority as well as several resolution plans for the aforementioned less significant banks have been adopted by the Resolution Board.

Two CSSF-CODERES circulars were published in 2018 concerning, on the one hand, the raising of 2018 contributions for the Single Resolution Fund and, on the other hand, the collection of information for the calculation by the SRB of the 2019 contributions to the same fund.



CHAPTER XVIII

PROTECTION OF DEPOSITORS AND INVESTORS

The Council for the Protection of Depositors and Investors (CPDI) is the internal executive body of the CSSF in charge of managing and administering the Fonds de garantie des dépôts Luxembourg (FGDL) and the Système d'indemnisation des investisseurs Luxembourg (SIIL). The CPDI is assisted in the performance of its duties by the CSSF department "Depositor and Investor Protection" (PDI department). In general, the PDI department performs the operational tasks of the FGDL and of the SIIL. Its workforce, unchanged in 2018, counts four staff members.

• Activities of the CPDI

The CPDI, the composition of which remains unchanged since its establishment by the Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), met 11 times in 2018. The agenda of these meetings was dominated by the first reimbursement campaign led by the FGDL (see below). In order to decide on the reimbursements to be granted to the adversely affected depositors, the CPDI collaborated, within the limits of its duties, with the CSSF as the competent authority for the fight against money laundering and terrorist financing in order to verify the proper application of exclusions linked to money laundering provided for in the BRRD Law. Particular attention was also given to the legal persons' eligibility for the deposit guarantee scheme, notably with respect to their qualification as financial institutions excluded from the scheme. The main decision-making criterion used by the CPDI to this end was the importance of the share of income from participating interests and granted loans included in the balance sheet of the legal persons concerned.

Moreover, the CPDI published five circulars relating mainly to the survey on the amount of covered deposits.

Since 1 January 2019, Mr Claude Wampach, Director of the CSSF in charge of banking supervision, replaced Mr Claude Simon, who retired, as chairman of the CPDI.

• Activities of the PDI department

In addition to the analyses carried out in the context of the above-mentioned reimbursement campaign, the work of the PDI department mainly focussed on the enhancement of the operational framework of the FGDL, including, in particular, the development of a software for the purpose of maximum automation and the monitoring of the compensation process. Other important topics were the compliance with the General Data Protection Regulation and the continuation of the multi-year programme of test exercises that the CPDI drew up in 2017 based on the EBA guidelines (EBA/GL/2016/04). In 2018, these test exercises concerned notably the capacity of the Luxembourg guarantee scheme to successfully complete a cross-border compensation¹ and the quality of the Single Customer View files² (SCV files) created by the FGDL member institutions. To this end, the PDI department carried out on-site inspections at three FGDL member institutions.

As regards the cooperation agreements which must be signed by the deposit guarantee schemes of EU Member States in accordance with the guidelines EBA/GL/2016/02, the PDI department started to negotiate bilateral agreements with eight of its EU counterparts in order to organise cross-border compensation and transfers of contributions between the schemes. This cooperation is complementary to the obligations arising from the multilateral cooperation agreement of the European Forum of Deposit Insurers (EFDI) signed by the FGDL in 2016.

Finally, the PDI department has been put in charge by the FGDL's Executive Committee to continue the necessary measures in order to provide the FGDL with a syndicated credit line allowing it to fulfil its commitments in case its financial means were insufficient. A public procurement by negotiated procedure has been launched in November 2018 to this end.

• Interventions

In 2018, the FGDL had its first intervention as part of its duty as deposit insurer. Indeed, on 24 February 2018, the CSSF observed the unavailability of deposits at the Luxembourg bank ABLV Bank Luxembourg S.A. (ABLV). This observation followed the decision of the Single Resolution Board of 23 February 2018 which was published on the website <https://srb.europa.eu/en/node/495>. Based on the information communicated to the CPDI by ABLV, each depositor indicated by ABLV was notably asked to provide an account number of a credit institution. The FGDL reimbursed the depositors via these accounts as soon as the entitlement to reimbursement was established by the CPDI. The first reimbursements were carried out on 7 March 2018. It must be pointed out that the right of the depositors of ABLV to request the reimbursement of their deposits by the FGDL will end on 24 February 2028 if the deposits remain unavailable until that date.

• Financing of the FGDL

As at 31 December 2018, the FGDL counted 104 members. The methods for calculating the contributions to the FGDL were the same as those applicable in 2017. As regards the 2018 ex ante contributions, the institutions concerned paid a total of EUR 95.2 million. The financial means of the FGDL available as at 31 December 2018 amounted to EUR 242.2 million, i.e. about 0.8% of the covered deposits existing at the beginning of 2018 (EUR 30.4 billion). The FGDL has thus reached the target level of 0.8% of covered deposits required by Article 179 of the BRRD Law. However, the covered deposits increased by 4.3% over a year so that the FGDL will have to continue collecting contributions in 2019 so as to maintain its target level. Moreover, in 2019, the FGDL will also start to collect contributions in order to build up a buffer of additional financial means which has to reach 0.8% of the covered deposits at the end of 2026 in accordance with Article 180 of the BRRD Law.

¹ It should be borne in mind that Directive 2014/49/EU on deposit guarantee schemes introduced a new obligation which states that the clients of branches of EU banks must be compensated by the national deposit guarantee scheme according to the instructions and with the resources of the scheme located in the country where the parent company is established.

² The SCV file is a database which contains information on the depositors and their deposits allowing the CPDI to determine the amounts to be reimbursed in case of failure of an FGDL member institution.



CHAPTER XIX

FINANCIAL CRIME

1. SUPERVISION OF THE CSSF FOR THE PURPOSES OF THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

1.1. Off-site supervision

The CSSF is the competent authority to ensure compliance with the professional obligations in relation to anti-money laundering and combating the financing of terrorism (AML/CFT) by all the persons subject to its supervision.

1.1.1. Credit institutions

In addition to the professional obligations on an individual basis pursuant to the AML/CFT legislation, the banks must also comply with the professional obligations on a consolidated basis, among which the following are noteworthy:

- the obligation to implement policies and procedures at group level, particularly in relation to the exchange of information within the group for the purposes of AML/CFT;
- the obligation to ensure that the branches and majority-owned subsidiaries established in another Member State comply with the national provisions of this Member State;
- the obligation to apply measures that are at least equivalent to those prescribed in Luxembourg and in the EU regarding risk assessment, customer due diligence, adequate internal organisation and cooperation with the authorities, particularly where the branches and subsidiaries are located in countries not applying or insufficiently applying AML/CFT measures;
- the obligation to apply Luxembourg rules with respect to AML/CFT when the standards of the country where the branches and subsidiaries are located are less strict than those of Luxembourg;
- the obligation to coordinate their AML/CFT policy with their branches and subsidiaries abroad.

Thus, supervision of ML/FT risks within the Luxembourg banking sector is an integral part of the banking supervision framework.

The AML/CFT supervision by the CSSF is based on a multiannual control programme combining off-site and on-site supervision. A team dedicated to the off-site supervision of ML/FT risks in banks was set up in 2017 within the CSSF's "Supervision of banks" department. This team manages the aspects of the banks' AML/CFT supervision centrally.

The purpose of the annual AML/CFT questionnaire (hereinafter, the ad hoc questionnaire) sent to banks and which comprises the collection of quantitative and qualitative data, is to assess the risk so as to better identify the current risks and to have comparable data for a harmonised assessment of the banks in Luxembourg. At the same time, the qualitative information on ML/FT risks obtained during the CSSF's on-site inspections, the analysis of the *réviseurs d'entreprises agréés* (approved statutory auditors') work via their long form reports and the analysis of the reports of the Compliance function and internal audit are key elements of the off-site supervision. Moreover, annual meetings are organised with the compliance officers and, where appropriate, with the internal auditors to expand on some aspects of their reports in this respect while taking into account the answers given by the banks in the ad hoc questionnaire.

Thus, based on the data collected through the ad hoc questionnaire, the CSSF establishes an automatic scoring for each bank. This mechanical scoring is then compared to the expert judgement based on on-site and off-site information available to the CSSF (e.g. reports of the internal control functions), which ultimately leads to a global ML/FT risk scoring. The purpose of the final assessment, reflected in the overall risk assessment per bank, in the sub-categories of internal governance and operational risks, is to determine the CSSF's off-site and on-site control programme. These final assessments are used as a key to allocate the available resources for the AML/CFT control in accordance with the core principle of risk-based supervision. The team of the "Supervision of banks" department also participates in the ML/FT risk assessment of authorisation files of new credit institutions and ensures the follow-up of remediation plans to be implemented in banks in the event of AML/CFT deficiencies. In some cases, the CSSF may decide, based on Article 54(2) of the Law of 5 April 1993 on the financial sector, to commission a *réviseur d'entreprises agréé* to carry out controls within the banks.

1.1.2. Investment firms

The control of compliance with the AML/CFT obligations by the investment firms is fully integrated in the CSSF's supervision of these entities. Thus, the supervision of ML/FT risks is subject to a multiannual control programme combining off-site and on-site supervision. Off-site supervision includes notably the analysis of the work carried out by the *réviseur d'entreprises agréé* with respect to ML/FT risks, the analysis of the reports of the internal control functions (Compliance function, internal audit function and risk control function) as well as the analysis of answers given by investment firms in the CSSF's ad hoc questionnaire. On-site supervision consists mainly of on-site inspections. In case of non-compliance with the professional obligations, the CSSF takes measures in accordance with the applicable legal sanctions regime.

The CSSF's AML/CFT strategy allowing a more efficient AML/CFT control of the professionals of the financial sector requires the adoption of a risk-based approach regarding the AML/CFT supervision. Therefore, the "Supervision of investment firms" department reviewed its method for assessing the ML/FT risks of investment firms. Based originally on essentially qualitative information, like the report of the Compliance function or the long form report of the *réviseur d'entreprises agréé*, the assessment of the ML/FT risk comprises an annual collection of quantitative and qualitative data via the CSSF's ad hoc questionnaire, which allows a better identification of the current risks and an alignment of this assessment with the other prudential practices which already usefully combine qualitative and quantitative aspects.

Based on the collected data, the CSSF establishes for each investment firm an ML/FT risk scoring. This automatic scoring faces expert judgement which may lead to adjustment based on qualitative considerations. The final result is a global ML/FT risk scoring per investment firm. This global scoring is used to prepare the control programme of the CSSF. It is used as a key to allocate available resources (on- and off-site) for the AML/CFT controls in accordance with the core principle of risk-based supervision. In addition, the collected

data allow shedding light onto different aspects of the ML/FT risk profile, such as the inherent risk (before taking into account mitigating measures) or the scope of the mitigating measures applied to the inherent risk. At a more disaggregated level, the inherent risk may be analysed in terms of customers and funds origin (“geographical risk”), the different activities of the investment firm or the products and services offered by the investment firm. By aggregating the information according to these perspectives, the CSSF obtains sectoral information which is used to prepare more global analyses, like the ML/FT risk assessment at national or European level.

1.1.3. Specialised PFS

In the framework of the AML/CFT prudential supervision, the specialised PFS were requested to participate in an online survey of the CSSF regarding AML/CFT. The CSSF included the quantitative data received in the analysis of the annual closing documents carried out in accordance with the risk-based approach regarding AML/CFT.

The process follows the same path as described above in relation to the supervision of banks and investment firms.

Thus, each specialised PFS was subject to a risk assessment with respect to AML/CFT and some observation letters concerning in particular AML/CFT were sent to the specialised PFS.

1.1.4. UCI departments

As regards more specifically the UCI departments, it should be noted that a new division called “UCI AML” was created which reports directly to the CSSF’s Executive Board and which stems from the former AML/CFT Task Force set up in 2017.

The mission of this division is notably to assist the different UCI departments in their AML/CFT supervisory measures and to play a pivotal role in the communication with the professionals on AML/CFT-related topics. The fight against proliferation financing is also an important subject.

The “UCI AML” division is furthermore in charge of the preparation, administration and analysis of the AML/CFT questionnaires (RBAC) sent to professionals of the investment fund industry on an annual basis. Based on the analysis of the answers to these questionnaires, the CSSF draws the attention of the professionals concerned to the following:

- the necessity of an increased frequency of the control of customer identification and business relationships (delegates and service providers) against the lists of financial sanctions (Targeted Financial Sanctions);
- the necessity to have an automated system to detect unusual transactions as well as the necessary analysis documentation of all the alerts;
- the obligation to perform enhanced due diligence on intermediaries located outside Luxembourg (cross-border relationships);
- the importance for IFMs to perform AML/CFT due diligence on the investments of their funds;
- the importance to adapt the procedures and training of the professionals’ employees to the specificities of investment funds.

Although the AML/CFT supervisory measures are organised around a risk-based approach, they impact all the professionals subject to the CSSF’s supervision.

1.2. On-site supervision

The “Anti-money laundering and counter-terrorist financing” (AML/CFT) on-site inspections are carried out at all financial centre’s players (among which, for example, private banking players (portfolio management, domiciliation, etc.) or registrar agents) in order to assess the quality of the AML/CFT framework against the legal and regulatory requirements.

In 2018, the “On-site inspection” (OSI) department of the CSSF carried out 32 AML/CFT on-site inspections at credit institutions¹, investment firms, specialised PFS, electronic money institutions and payment institutions. Moreover, an ad hoc mission related to AML/CFT was carried out at a credit institution.

Following the publication, on 24 July 2017, of Circular CSSF 17/661 regarding the adoption of the joint guidelines issued by the three European Supervisory Authorities (EBA/ESMA/EIOPA) on money laundering and terrorist financing risk factors, particular attention was given in 2018 to the risk-based approach implemented by the professionals. Thus, 10 of the 32 AML/CFT control missions carried out in 2018 were “thematic” missions concerning especially the analysis of the risk-based approach and, notably, the consideration by professionals of appropriate risk factors when assessing ML/FT risks and the application of adapted due diligence measures.

In this context, significant and recurring deficiencies were noted at several inspected entities, such as for example the absence of a gap analysis between the risk-based approach already applied by the professionals and the new requirements resulting from amendments made by the Law of 13 February 2018 to the Law of 12 November 2004 on the fight against money laundering and terrorist financing as well as the above-mentioned joint guidelines. Consequently, some risk factors and variables were not taken into account in the risk classification of the business relationships. Moreover, the CSSF noted on several occasions that there was no update of the assessment of ML/FT risks to which the professionals are exposed, no application of enhanced due diligence measures in situations which, by their nature, can present a higher risk of money laundering or terrorist financing as well as no regular review of the customer files according to their risk level.

Throughout 2018, particular emphasis was also given to compliance with the AML/CFT professional obligations in relation to possible offences of aggravated tax fraud or tax evasion. In this context, the CSSF observed that the tax risk was not included in the risk classification of business relationships and that there was insufficient analysis to conclude that a customer was tax transparent and to reasonably exclude the risk that a predicate tax offence was committed.

In addition, several problems were encountered in relation to name matching controls against the official lists of international financial sanctions, including, among others, unsatisfactory control frequency, given that these controls must be carried out at least when these lists are published, insufficient materialisation of the results of the analyses carried out and incomplete controls (failure to ensure the exhaustiveness of the data recorded in the system on which the controls are based).

Finally, the CSSF continues to identify recurring breaches of the obligation to report any suspicion of money laundering or terrorist financing to the Financial Intelligence Unit (FIU).

An ad hoc on-site inspection revealed deficiencies concerning the internal governance requirements related to AML/CFT, shortcomings in the application of enhanced due diligence measures and shortcomings in the monitoring of the transactions. As indicated above, breaches of the obligation to report to the FIU when suspecting money laundering or terrorist financing were also observed.

As regards more specifically the UCI departments, the “UCI On-site inspection” department² carried out 13 AML/CFT on-site inspections at IFMs in 2018. Please note also that an “AML/CFT On-site inspection” division was created within the “UCI On-site inspection” department on 1 August 2018. This division counted four agents as at 1 April 2019.

In the framework of AML/CFT on-site inspections at IFMs, the CSSF noted shortcomings with respect to the due diligence obligations, including, among others:

- insufficient documentation regarding the enhanced customer due diligence measures on intermediaries under Article 3 of CSSF Regulation N° 12-02;
- partial or complete absence of information or documentation on the origin of the funds;
- insufficient documentation on the initial due diligence and on the follow-up of initiators and distributors.

Among the other recurring observations, the CSSF noticed that some IFMs used the AML/CFT continuing education programme drawn up by the group or the parent company abroad without adapting this programme to the specificities of the investment funds managed in Luxembourg or to the standards applicable

¹ Seven of which at significant banks.

² Cf. also point 5.3. “On-site supervision” of Chapter IX “Supervision of investment fund managers and UCIs”.

in Luxembourg. The CSSF also noted in some cases that the risk assessment carried out under Circular CSSF 11/529 was not up-to-date or that it did not cover all the individual risks to which the entity or managed funds were exposed.

Furthermore, the CSSF observed several shortcomings relating to verifications of the IFMs' business relationships against the lists of sanctions and lists of politically exposed persons.

The CSSF draws attention to Sub-chapter 5.4 concerning the AML/CFT organisation laid down in Circular CSSF 18/698 of 23 August 2018.

During the coming controls, the CSSF will focus in particular on the following topics:

- The compliance with Article 3 of CSSF Regulation N° 12-02 in terms of application of enhanced due diligence on intermediaries acting on behalf of their customers: the CSSF expects that, depending on the ML/FT risks, the additional documentation required (Wolfsberg questionnaire, AML letters, AML/CFT procedures, etc.) is regularly updated and that the analysis of this documentation is laid down in writing. It should be noted that the enhanced due diligence on intermediaries is performed by applying at least Article 3-2(3) of the AML/CFT Law, Article 3(3) of the Grand-ducal Regulation of 1 February 2010 as well as Article 28 of CSSF Regulation N° 12-02, but that the content of information and supporting documentation in the file may be adapted according to the assessed ML/FT risks. The above is additional to the measures for identification and identity verification of these intermediaries.
- As regards the origin of the funds, obtaining supporting documentation is necessary when there are risk factors, notably when the amounts are high. Although, in case of low risk, an internal memo based on the plausibility check and information from a reliable and independent source is sufficient, this memo must be sufficiently detailed and specific (reference to general terms, like "independent work", "inheritance", etc., is insufficient). In this respect, the CSSF will also take into account the impact on possible tax offences (self-certification CRS).
- The CSSF will continue to pay particular attention to the monitoring of delegated activities, thus ensuring, notably, that the (initial and continuous) due diligence is sufficiently documented to identify and assess appropriately the risks resulting from the delegation.
- In the framework of the cooperation with the authorities, the CSSF considers that it is important for IFMs to register with the IT tool "goAML" of the FIU in order to be able, where appropriate, to report suspicious transactions as early as possible and to communicate with the Luxembourg authorities in charge of AML/CFT via secured channels ensuring thus complete confidentiality of the inquiries.

2. AMENDMENTS TO THE REGULATORY FRAMEWORK REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

2.1. Amendments to the European AML/CFT framework

2.1.1. Directive (EU) 2018/843 of 30 May 2018 (Vth AML Directive) amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing (IVth AML Directive)

The directive was published in the Official Journal of the EU on 19 June 2018.

The amendments introduced by the directive were explained in detail in the Newsletter of the CSSF No 210 published in July 2018 and available on the CSSF's website. The amendments include the extension of the scope of application (e.g. to the providers engaged in exchange services between virtual currencies and fiat currencies and the custodian wallet providers), the review of the due diligence obligations and the enhancement of the means of cooperation between the authorities concerned.

The deadline for the transposition of the Vth AML Directive into national law is 10 January 2020.

2.1.2. Directive (EU) 2018/1673 of 23 October 2018 on combating money laundering by criminal law

The purpose of the directive is to harmonise the definition of criminal activities which constitute predicate offences for money laundering in all Member States. Article 2 lists the offences which must be considered as criminal activity, among which tax crimes relating to direct and indirect taxes, as laid down in national law, or cybercrime.

This directive also encourages the Member States to ensure that the risks arising from the use of virtual currencies are addressed appropriately in the context of the fight against money laundering.

The directive comes with a range of sanctions applicable to natural and legal persons, without prejudice to the individualisation and application of penalties and the execution of sentences in accordance with the concrete circumstances in each individual case.

The deadline for the transposition of the directive into national law is 3 December 2020.

2.1.3. Regulation (EU) 2018/1672 of 23 October 2018 on controls on cash entering or leaving the Union and repealing Regulation (EC) No 1889/2005

This regulation complements the legal framework for the prevention of ML/FT laid down in the IVth AML Directive.

It presents a broad concept of “cash” comprising four categories: currency, bearer-negotiable instruments, commodities used as highly-liquid stores of value and certain types of prepaid cards.

For the prevention of ML/FT, this regulation imposes an obligation to declare cash which extends to natural persons entering or leaving the EU. This obligation is subject to a threshold of EUR 10,000.

It also allows the competent authorities to record useful information, including, among others, information on the nature and the amount or value of the cash, its economic provenance and intended use, where they detect amounts of cash below the threshold but there are indications that the cash might be linked to a criminal activity covered by the regulation. This information is passed on to the Financial Intelligence Unit of the Member State in question so it can take appropriate measures in the AML/CFT framework.

In addition, this regulation provides the possibility for the competent authorities to temporarily detain cash of an amount below EUR 10,000, where there are indications that it is used for criminal purposes.

In order to encourage compliance and deter circumvention, Member States must introduce effective, proportionate and dissuasive penalties for non-compliance with the obligations to declare or disclose cash.

The regulation applies as from 3 June 2021.

2.1.4. Commission Delegated Regulation (EU) 2018/1467 of 27 July 2018 amending Delegated Regulation (EU) 2016/1675 supplementing Directive (EU) 2015/849 by identifying high-risk third countries which present strategic deficiencies in their regimes on anti-money laundering and countering terrorist financing

Through this delegated regulation, the European Commission added Pakistan on the list of third countries which present strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the EU, in accordance with the criteria set out in Article 9 of the IVth AML Directive.

For details on the rationale behind this addition, please refer to the relevant regulation which is available, along with all AML/CFT regulations, on the CSSF's website (Supervision > Financial crime > AML/CFT > Laws, regulations and other texts > Regulations (EU)).

2.1.5. Non-cooperative jurisdictions for tax purposes

In accordance with the goals it set in order to put an end to the practices leading or likely to lead to a loss of tax revenue for EU Member States, the Council of the EU revised its list of non-cooperative jurisdictions for

tax purposes five times in 2018. Following the amendment of 31 October 2018, the list includes the following countries and territories: American Samoa, Guam, Samoa, Trinidad and Tobago, US Virgin Islands.

This list is revised regularly in accordance with the measures taken by the listed countries to address the litigious practices³.

2.1.6. Commission Delegated Regulation (EU) 2018/1108 of 7 May 2018 supplementing the IVth AML Directive with regulatory technical standards on the criteria for the appointment of central contact points for electronic money issuers and payment service providers and with rules on their functions

In force since 30 August 2018, the delegated regulation specifies the criteria according to which a Member State may require that an electronic money institution or a payment service provider appoints a central contact point to ensure, on behalf of the appointing institution, compliance with the AML/CFT rules and, in particular, to facilitate supervision by the competent authorities of the host countries.

This appointment is required even when the payment service providers and electronic money issuers provide services in the territory of another Member State through establishments in forms other than a branch.

Similarly, where there are reasonable grounds to believe that the ML/FT risk associated with a particular payment service provider or electronic money institution active in their territory is high, the Member States may require that this institution or provider appoints a central contact point.

Finally, the host Member States may request the central contact points to perform, on behalf of the appointing electronic money institution or payment service provider, one or more of the additional functions listed in the delegated regulation.

2.1.7. Council Regulation (EU) 2018/1542 of 15 October 2018 concerning restrictive measures against the proliferation and use of chemical weapons

The restrictive measures referred to in this regulation concern natural or legal persons, entities or bodies that “are responsible for, provide financial, technical or material support for, or are otherwise involved in, manufacturing or using chemical weapons or engaging in preparations for the use of chemical weapons, as well as those who assist or encourage such activities”.

The regulation introduces new sanctions against these natural or legal persons, entities and bodies which consist of freezing funds and economic resources they own, hold or control.

The regulation provides also for the prohibition to make funds available to natural or legal persons, entities and bodies listed in Annex I. However, the competent authorities of Member States may authorise the release or the making available of certain frozen funds under some specific strict conditions.

The regulation entered into force on 16 October 2018.

2.2. Amendments to the Luxembourg legal and regulatory framework

2.2.1. Law of 13 February 2018 (1) transposing the provisions on the professional obligations and the powers of the supervisory authorities as regards the fight against money laundering and terrorist financing of Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012, and repealing Directive 2005/60/EC and Commission Directive 2006/70/EC and (2) implementing Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006

The law was discussed in detail in point 1.2.1. of Chapter XIX “Financial crime” of the CSSF Annual Report 2017.

³ To view the related document, please follow the link https://www.consilium.europa.eu/media/36974/st_13352_2018_rev_1_en.pdf.

2.2.2. Law of 10 August 2018 on information to be obtained and held by trustees and transposing Article 31 of the IVth AML Directive

This law was discussed in detail in the Newsletter of the CSSF No 212 of September 2018 which is available on the CSSF's website.

2.2.3. Law of 10 August 2018 amending, among others, the Code of Criminal Procedure (CCP) in order to organise the Financial Intelligence Unit (FIU)

This law was discussed in detail in the Newsletter of the CSSF No 212 of September 2018 which is available on the CSSF's website.

2.2.4. Law of 1 August 2018 amending (1) the Penal Code; (2) the Code of Criminal Procedure; (3) the New Code of Civil Procedure; (4) the Law of 31 January 1948 on the regulation of air navigation, as amended; (5) the Law of 19 February 1973 on the sale of medicinal substances and the fight against drug addiction, as amended; (6) the Law of 10 August 1991 on the legal profession, as amended; (7) the Law of 17 March 1992 approving the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances signed in Vienna on 20 December 1988, amending and supplementing the Law of 19 February 1973 on the sale of medicinal substances and the fight against drug addiction and amending and supplementing some provisions of the Code of Criminal Procedure, as amended; (8) the Law of 14 June 2001 1. approving the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, signed in Strasbourg on 8 November 1990, as amended, 2. amending some provisions of the Penal Code, 3. amending the Law of 17 March 1992 approving the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances signed in Vienna on 20 December 1988, amending and supplementing the Law of 19 February 1973 on the sale of medicinal substances and the fight against drug addiction and amending and supplementing some provisions of the Code of Criminal Procedure, in order to adapt the confiscation regime

In addition to the adaptation of the penal confiscation regime, this law introduced notably, by way of Article 324c in the Penal Code, a new offence which is of particular interest in the context of the fight against money laundering and which, under certain conditions, consists in the fact that it is not possible to justify the resources corresponding to one's lifestyle or to justify the origin of the property held. It is also noteworthy that the same sentence applies when facilitating the justification of fictitious resources for persons engaged in some crimes or offences and providing them thus with a direct or indirect pecuniary benefit.

2.2.5. Ministerial regulations

In 2018, the Ministry of Finance issued nine ministerial regulations implementing UN Resolutions 1267 (1999), 1989 (2011) and 2253 (2015) concerning ISIL (Da'esh), Al-Qaeda and the persons, groups, undertakings and entities associated with them. The list relating to sanctions against ISIL (Da'esh) and Al-Qaida currently includes the names of 261 persons and 83 entities.

Another ministerial regulation of 16 November 2018 issued together by the Ministry of Justice and the Ministry of Finance amends the Ministerial Regulation of 9 July 2009 creating a committee on the prevention of money laundering and terrorist financing⁴.

2.2.6. CSSF circulars and other information

In Circular CSSF 18/698 of 23 August 2018 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law, the CSSF specifies some provisions on AML/CFT applicable to these managers and to the entities carrying out the activity of registrar agent.

⁴ <http://www.cssf.lu/en/supervision/financial-crime/aml-ctf/laws-regulations-and-other-texts/news-cat/482/>.

The CSSF also updated several times (through three circulars, the most recent being Circular CSSF 19/711) the list of countries whose AML/CFT regime has substantial and strategic deficiencies, requires the application of enhanced due diligence measures or which is not satisfactory in accordance with the FATF statements issued following its annual plenary meetings.

Circular CSSF 18/702 of 20 December 2018 draws the attention of the private banking/wealth management sector to the specific ML/FT risks present in this business area.

The CSSF also published on its website the press release of the Ministry of Finance of 20 December 2018 on the finalisation by Luxembourg of its first ML/FT risk assessment⁵.

Finally, in March 2018, the CSSF added several new questions to the “FAQ on AML/CFT and IT requirements for specific customer on-boarding/KYC methods for the identification/verification through video chat”.

3. CSSF PARTICIPATION IN MEETINGS REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING AND REGARDING INTERNATIONAL FINANCIAL SANCTIONS

3.1. International dimension

The CSSF participated in several international working groups dealing with AML/CFT issues, including the Financial Action Task Force (FATF), the Joint Committee’s Sub-Committee on Anti-Money Laundering (AMLC) under the Joint Committee of the European Supervisory Authorities, the Expert Group on Money Laundering and Terrorist Financing (EGMLTF) of the European Commission and the Anti-Money Laundering Expert Group (AMLEG) of the Basel Committee on Banking Supervision.

For the FATF and its members, the fight against terrorism remains a major cause for concern but the fight against proliferation financing is also growing in importance in its work.

In 2018, the FATF published the following key documents, among others:

- Guidance on counter proliferation financing;
- Guidance for a risk-based approach for the securities sector;
- Guidance for a risk-based approach for the life insurance sector;
- Update of Recommendation 15 and public statement on the risks associated with virtual assets.

All the publications of the FATF are available under <http://www.fatf-gafi.org/>. Please note that the CSSF regularly publishes the FATF Business Bulletins regarding AML/CFT on its website⁶ and draws the attention of the professionals to the important documents in its Newsletters, such as, for example, the FATF guidance for a risk-based approach for the securities sector explained in Newsletter No 214 of November 2018.

3.2. National dimension

At national level, the CSSF held formal meetings with representatives of the FIU and the Prosecutor’s Office. The discussions concerned in particular some suspicion reports of major importance for the Luxembourg financial centre.

Several coordination and consultation meetings of all the national authorities competent in AML/CFT were also held under the chairmanship of the Ministry of Justice and the Ministry of Finance, respectively, depending on the topics dealt with by the corresponding working groups. These meetings focussed on the work as regards the transposition of the Vth AML Directive, the decisions taken on international financial sanctions and the preparation of the FATF’s plenary meetings.

⁵ <http://www.cssf.lu/en/supervision/financial-crime/aml-ctf/additional-documentation/pressroom/>.

⁶ <http://www.cssf.lu/en/supervision/financial-crime/aml-ctf/additional-documentation/pressroom/>.

In addition to the two meetings of the Technical Committee “Fight against money laundering and the financing of terrorism” of the Commissariat aux Assurances in which the CSSF participated, the CSSF and the Commissariat aux Assurances met several times to discuss notably the Risk Assessment relating to AML/CFT.



CHAPTER XX

FINANCIAL CONSUMER PROTECTION

1. FINANCIAL CONSUMER PROTECTION AND FINANCIAL EDUCATION

In 2018, financial consumer protection has made further great strides.

Thus, the Law of 30 May 2018 on markets in financial instruments and the Grand-ducal Regulation of 30 May 2018 on the protection of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits have enriched the legal arsenal that consumers can rely on for the purpose of defending their interests in the world of finance.

The financial consumer's situation has also been improved through the amendments brought about by the Law on payment services following the entry into force of the Law of 20 July 2018, 1° transposing Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC; and 2° amending the Law of 10 November 2009 on payment services.

Henceforth, the users of payment services, holders of electronic money and all other interested parties, including consumer associations, can submit complaints to the CSSF for alleged suspicion of breach by the professionals of the financial sector of the provisions of Chapter 4 of Title II (on the issuance and redeemability of electronic money), Title III (Transparency of conditions and information requirements for payment services) and Title IV (Rights and obligations in relation to the provision and use of payment services) of the Law of 10 November 2009 on payment services. The CSSF has taken the required measures to handle these new complaints appropriately, by distinguishing them from customer complaints against CSSF supervised entities seeking out-of-court settlement to a dispute relating to the personal interests of the complainant.

Finally, the CSSF implemented Article 9 of the Law of 13 June 2017 on payment accounts under which the CSSF must create and manage a website that allows comparing the fees charged for certain payment services, as defined in Grand-ducal Regulation of 6 June 2018 on the establishment of a standardised list of

the most representative services linked to a payment account within the meaning of the Law of 13 June 2017 on payment accounts. The CSSF comparison website, launched on 1 November 2018, is available at www.frais-compte-paiement.lu.

• Task Force on consumer protection of the OECD Committee on Financial Markets

The Task Force's work on the 10 High-Level Principles of the G20 relating to financial consumer protection continued in 2018.

As regards FinTech, the Task Force focussed on how the regulatory framework could allow the development of innovative approaches as regards financial services, while ensuring an appropriate level of consumer protection.

The Task Force demonstrated its interest in the following subjects: data protection, consumer credit, Initial Coin Offerings (ICOs), financial product governance and demographic changes and their consequences as regards financial consumer protection.

• International Financial Consumer Protection Network (FinCoNet)

FinCoNet is an international organisation gathering supervisory authorities from 25 countries that are responsible for financial consumer protection. It aims at fostering information exchange and cooperation between supervisory authorities in order to encourage proper conduct of the market and strong consumer protection in banking and credit.

In 2018, FinCoNet published the report "Online and Mobile Payments: An Overview of Supervisory Practices to mitigate Security Risks". FinCoNet's publications are available on the website www.finconet.org under the section "Resources".

Moreover, in 2018, FinCoNet organised an international seminar on the developments, impacts and challenges of open banking, in cooperation with the Central Bank of Brazil.

• Financial Consumer Protection Committee (CPCF)

Following the Minister of Finance's decision to mandate the CSSF to develop and coordinate the initiatives in the field of financial education in Luxembourg, the CPCF worked on the implementation of the national strategy as regards financial education that it had drawn up.

In this context, the working groups "Credit and overindebtedness", "Financial education in the classroom" and "Pension/Insurance" identified around ten projects, including notably the branding for all the activities performed by the CPCF in financial education, the creation of an independent website to enhance financial literacy and protection of consumers, a pocket money management app for children, a budget management app for adults, a dynamic educational game (Gamebot) for teenagers and the creation of a cartography of overindebtedness. Furthermore, a pilot project promoting financial education in the classroom was initiated.

Other than that, the CPCF has examined the website comparing payment account-related fees and commented on it.

• International Network on Financial Education (INFE) of the OECD

Created in 2008 by the OECD, this international network serves as a platform to collect data on financial literacy and to develop analytical and comparative reports, research as well as policy instruments. There are 119 countries represented in the INFE, of which 84 authorities, including the CSSF, have the status of full member.

The INFE also seeks to promote and facilitate international cooperation between the different participants (politicians, regulators, associations, etc.) involved in financial education at global level.

Different working groups have been established to deal with the following topics in particular: the challenges of financial education vis-à-vis digitalisation, financial education at work, financial education for small and

medium-sized enterprises and basic financial literacy. Moreover, the tools used to measure financial literacy and financial well-being have been reviewed.

• **Committee 8 on Retail Investors of IOSCO**

The primary mandate of Committee 8 is to conduct the IOSCO’s policy work as regards financial education. Its secondary mandate is to advise the IOSCO Board on issues relating to investor protection and to work on the policies to be adopted in this field.

In 2018, IOSCO published its final report on senior investor vulnerability and a report on the studies carried out by Committee 8 and by INFE on the application of behavioural insights to financial education.

Other topics that have been discussed within the Committee were the development of a toolkit of educational material to help regulators educate investors on the risks of OTC leveraged products and the development of a core competencies framework on financial literacy for investors.

2. OUT-OF-COURT RESOLUTION OF COMPLAINTS

Since its creation, the CSSF has assumed a role of intermediary in the out-of-court settlement of disputes with professionals subject to its supervision.

The CSSF handles the complaints it receives by following the procedure provided for in the first section of CSSF Regulation N° 16-07 relating to the out-of-court resolution of complaints. As the CSSF is also on the list of qualified entities for alternative consumer dispute resolution drawn up by the Minister of Economy and on the list of alternative dispute resolution entities drawn up and published by the European Commission, the CSSF is subject to certain obligations under the Consumer Code.

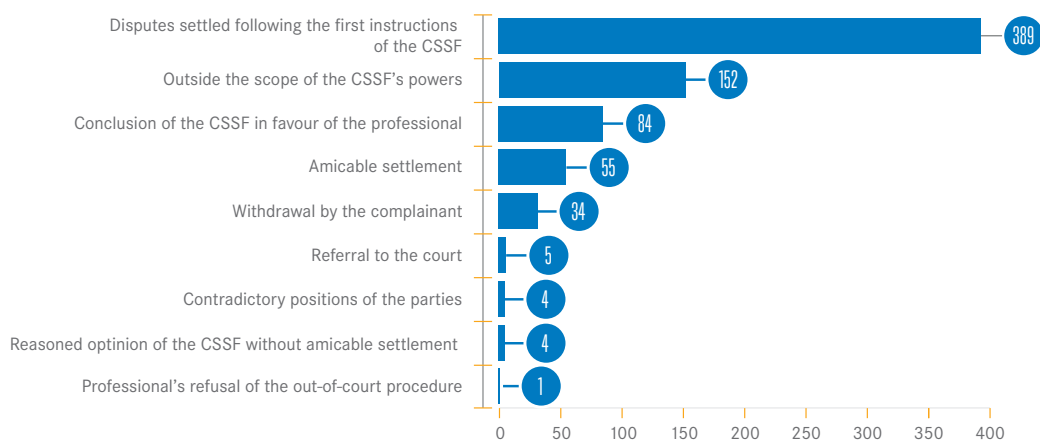
Article L.432-4 of the Consumer Code notably provides that the entities qualified for alternative consumer dispute resolution must publish an annual report. It also lays down the information to be provided in these reports.

This chapter provides information on the activity of the CSSF as qualified entity for alternative consumer dispute resolution, including the information required under Article L.432-4.

2.1. Statistics regarding CSSF complaint handling in 2018

In 2018, the CSSF received 738 complaint files and closed 728 files (including files received before 1 January 2018 and which had not been closed by the end of 2017).

Outcome of the CSSF’s intervention/reasons for closing the files



Upon reception of a financial consumer complaint, the CSSF sends an acknowledgement of receipt with useful instructions for the complainant on how to resolve the dispute with the professional without additional intervention of the CSSF. This acknowledgement of receipt indicates, among others, the full name of the manager in charge of complaints whom the complainant should contact at the entity concerned in order to reach an amicable settlement, and the link to the webpage where useful information on the out-of-court handling of complaints by the CSSF is available to the complainant.

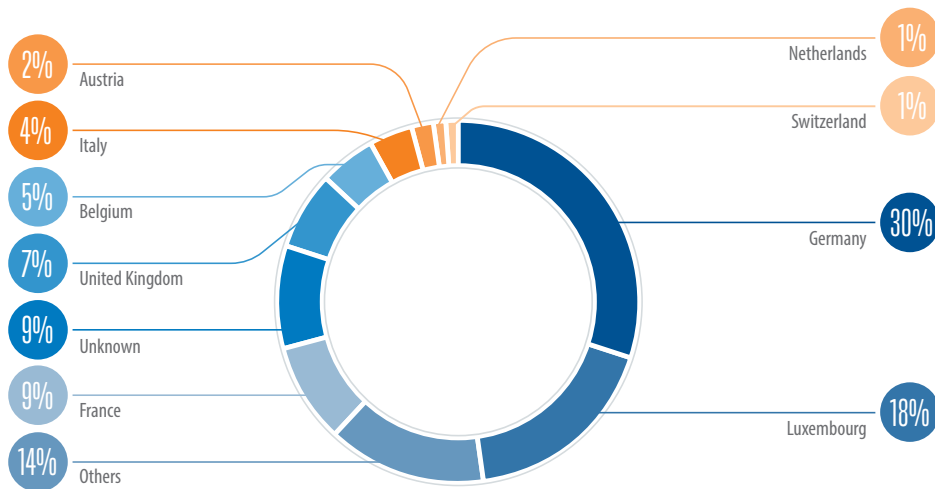
Judging by the high number of disputes that have been settled following these first instructions by the CSSF, the CSSF's approach consisting in favouring the dialogue between the parties to the disputes and not intervening immediately with the supervised entity concerned by a complaint, is bearing fruit.

It should be noted that in 2018, the CSSF took 112.17 days on average to close a duly examined file.

152 requests for the out-of-court resolution of complaints were inadmissible for the following reasons:

- complaints involving entities that are not subject to the CSSF's supervision (73%);
- complaints falling within the scope of the insurance sector (14%);
- complaints concerning a non-financial product (5%);
- failure of the complainant's capacity to act (4%);
- expiry of the one-year time limit for filing the complaint with the CSSF (2%);
- complaints already heard by a court (1%);
- complaints concerning the commercial policy of the professional (1%).

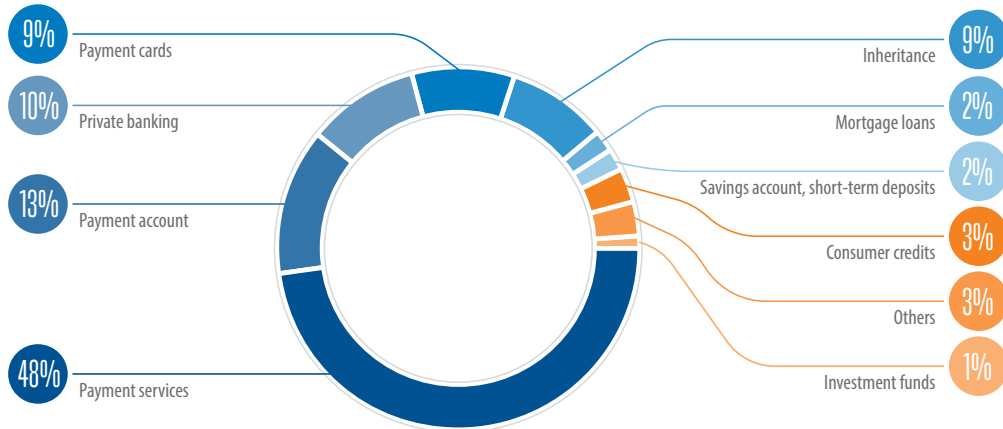
Breakdown of the disputes according to the complainants' country of residence



There is a large part of complaints from Germany with 30% of the total, which is similar to 2017 (29%).

The country of residence of the complainants is not identified in 9% of the cases, which is, in general, due to the fact that these complainants contacted the CSSF by way of emails without indicating their country of residence. Finally, the category "Others" covers 44 different countries.

Breakdown of complaints according to their object



The breakdown of complaints according to their object remained stable in 2018 compared to the previous years.

The major share of complaints (48%) concerned problems linked to the use of electronic payment services. The share of complaints relating to private banking (10%) decreased slightly as compared to the previous financial year (11% in 2017). The same holds true for complaints relating to mortgages (2% against 5% in 2017).

2.2. Complaints handled in 2018

2.2.1. Bank fees

In the context of its responsibility for out-of-court dispute settlement, the CSSF regularly receives complaints about bank fees levied by the complainants’ banks. The CSSF thus needs to ascertain whether the bank was entitled to levy the disputed fees or not.

For instance, the CSSF received a claim in which the complainant disputed the fees levied by his bank for administration and closure of his late father’s account. The complainant explained that the notary in charge of liquidating the succession of his father had asked the latter’s bank in November 2016 to sell the securities of his portfolio and to credit the notary’s account of the proceeds. The bank should close the father’s account afterwards.

The complainant noted that in January 2017, the bank had transferred the sales proceeds to the notary’s account minus account administration fees for the year 2017 and account closing fees. The complainant disputed the account administration fees debited for the year 2017, as the request to liquidate his father’s assets had been submitted by the notary on 14 November 2016 and the delay of the asset liquidation concerned was due to a lack of diligence of the bank.

Having analysed the explanations and documents filed by both parties to the dispute, the CSSF asked the bank to explain, as regards the account administration fees charged for 2017, why it had waited a certain time before closing the account of the complainant’s late father after having sold the securities in this account and obtained all the usual information with respect to a liquidation of succession from the notary. As regards the account closing fees levied by the bank, the CSSF asked the bank to explain its position with respect to Article 74(2) of the Law on payment services which provided at the time of the facts that terminating a framework contract concluded for a fixed period exceeding 12 months or for an indefinite period was free of charge for the payment service user after the expiry of 12 months¹.

¹ As a matter of fact, the late father’s account had been opened for a period exceeding 12 months.

The bank finally accepted to reimburse the complainant the account administration and closing fees.

In another case submitted to the CSSF with respect to bank fees, the complainant blamed the bank for not having fulfilled its commitments concerning the fee schedule applying to the complainant. Indeed, the complainant claimed that he had opened an account on the condition that the bank would not levy quarterly account administration fees. The complainant specified that the bank had agreed to this condition when the account was opened. He further claimed that this condition had been put down in writing in the account opening documents. It must be noted that the account manager, with whom the complainant had supposedly negotiated this preferential rate, had left the bank in the meantime.

The bank disputed the existence of a rate agreement before the CSSF, arguing that it had never agreed to free quarterly account administration. It explained that it did not have any documents substantiating the claims of the complainant, who, in addition, could not produce any evidence himself.

Moreover, the bank stressed that the disputed fees complied with its pricing conditions, which were available to the client when opening the account and at any moment later on, as the pricing conditions are made available to the customers permanently, notably via the bank's website.

After analysing the account opening documents signed by both parties, the CSSF concluded that there was no mention whatsoever of free quarterly account administration fees. As the complainant could not bring forward any elements evidencing the free account administration, the CSSF closed the case without concluding to any misconduct by the bank. This case demonstrates that bank customers should always keep written records, including, where possible, the bank's signature, of the preferential rates granted.

2.2.2. Asset management

In a case involving asset management, the private portfolio manager had invested, under a discretionary management contract, a quite significant proportion (88%) of the customer's portfolio in a single structured product indexed on the securities of a company which became insolvent shortly after. The complainant notably blamed the professional of having failed its obligation to diversify investments by investing a very substantial part of the portfolio into a single product. The customer also blamed the professional for not having been informed that the professional received financial inducements to promote the product with its customers.

As regards the complaint regarding insufficient investment diversification, the professional notably argued that the disputed structured product was perfectly adapted to the "dynamic" investor profile chosen by the customer, which meant that the investor accepted a maximum risk level for his investments in exchange for potentially very high gains. According to the manager, the customer asked to invest part of his assets in structured products he knew were risky. Moreover, the professional claimed that part of the losses sustained on the disputed structured product could have been sustained on other products as well, such as shares or another structured product. The professional also argued that if it had invested in another security, nothing proved that the complainant would not have sustained losses as well, nor that he would have retained the total capital, without any liability of the professional.

The complaint file submitted to the CSSF contained a communication of the private portfolio manager which aimed to inform the investors that had invested in the disputed structured product of the performance of their investment. In this investor communication, the private portfolio manager considered that a 3 to 6% concentration on one security was good management. Based on this information, the CSSF could convince the professional that it had not sufficiently diversified the investments in the complainant's portfolio.

As regards the complaint relating to possible remunerations received by the professional intended to promote investment of a product in customer portfolios, the professional recognised that such remunerations existed, but also claimed that the complainant "had obviously been informed" of these remunerations by referring to a prospectus which, according to the professional, had "undoubtedly" been handed to the complainant at the time he subscribed to the disputed product.

After having analysed this prospectus, the CSSF concluded that contrary to what the professional had claimed, the prospectus did not contain any information regarding possible commissions that the professional would have received. The CSSF thus concluded that the professional could not prove that the complainant had been clearly informed of the existence, nature and amount or method of calculation of the remuneration the professional received.

The professional thus failed its obligations that were imposed upon it under Article 30(1)(b) of Grand-ducal Regulation of 13 July 2007 relating to organisational requirements and rules of conduct in the financial sector and transposing Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, according to which the professional is required to clearly inform its client of “the existence, nature and amount of the fee, commission or benefit or, where the amount cannot be ascertained, the method of calculating that amount”. This information had to be “clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant investment or ancillary service”.

The CSSF closed this file concluding that the claims of the complainant were justified and invited the professional to reconsider its position in favour of the complainant.

2.2.3. Forged transfers

The CSSF regularly receives complaints from customers that are victims of forged transfers that have been executed by their bank.

Thus, there was one case where the complainant explained that he had received a letter from the car dealer containing the invoice for the new car he had ordered. However, the complainant ignored that the mail had been intercepted by a malicious person who modified the bank account information for the payment of the amount due. Unaware of this fraud, the complainant went to the bank to have the invoice paid. The transfer was executed by the bank and confirmed by the customer, who had signed the transfer order.

Shortly afterwards, the complainant understood that the bank account onto which he had transferred the purchase price was not the bank account of his car dealer, but an account within a bank located abroad, opened by a dishonest person in order to appropriate the funds meant for the car dealer. The complainant asked his bank to compensate for the loss suffered claiming the bank was at fault for not verifying if the account receiving the disputed funds was the car dealer’s account. The bank argued that it had followed the instructions of the customer by executing the disputed transfer. Moreover, the bank was able to produce a copy of the transfer order signed by the complainant.

After analysing the explanations and documents provided by both parties to the dispute, the CSSF drew the attention of the complainant to the provisions of Article 100(1) of the Law on payment services which provides that “if a payment order is executed in accordance with the unique identifier, the payment order shall be deemed to have been executed correctly with regard to the payee specified by the unique identifier”. In the case at hand, the bank had executed the fund transfer according to the IBAN code that had been communicated to it by the complainant. As a consequence, the CSSF considered that the bank had thereby not committed any mistake.

Consumers are therefore well advised to verify, when making a payment by indicating an IBAN code of the payment recipient that this IBAN really belongs to the recipient.

2.2.4. Customer responsibility in a banking relationship

A complainant blamed his bank for having debited fees for hold mail services although he had not asked the bank to hold his mail. The customer also blamed the bank for not having informed him on the measures to be taken for early redemption of bonds he held in his portfolio.

As regards the complaint regarding the hold mail fees, the bank rejected all responsibility and drew the attention of the CSSF to the fact that the complainant had opted for all correspondence relating to the bank account to be held at the time the account was opened. Indeed, the CSSF read in the account opening documents that the complainant had requested that the mail addressed to him by the bank be held at the bank. The form relating to hold mail as well as the terms and conditions of the bank, both signed by the complainant, provided that the mail was to be held by the bank. As the hold mail agreement was still in force according to the elements of the file, the CSSF considered that the hold mail fees debited from the complainant’s account were justified and compliant with the bank’s pricing conditions.

As regards the lack of information on the early redemption of the bonds held in his portfolio, for which the customer blamed the bank, the latter stated that it had requested instructions from the complainant as to the use of the amounts resulting from the redemption of these bonds. The bank also stated that the complainant had been informed that in the absence of investment instructions, the funds would be credited on his bank account. As the complainant had not reacted within the time limit, the bank credited the funds from the redemption of bonds on the complainant's bank account.

Upon analysis of the file, the CSSF noted that the bank had expressly asked the complainant to communicate instructions as regards the use to be made of the amounts resulting from the redemption of the securities. Therefore, the bank could not be reproached for lack of information in this regard. Moreover, the CSSF considered that the complainant was obliged to retrieve the mail held within the bank. If the complainant had ensured to view the mail deposited within the bank, he would have been informed that the bank had asked about the use to be made of the amount resulting from the redemption of his securities. Finally, as the complainant had not entered into a management agreement with the bank, he had to take decisions regarding his portfolio management himself.

2.2.5. Interest rate

The CSSF often receives complaints regarding mortgage loans.

In one of these complaints, the complainant blamed the bank for having refused to lower the (variable) interest rate fixed in his mortgage loan agreement although there had been an overall drop in interest rates. The bank referred to its terms and conditions which provided that it could fix interest rates as it deems appropriate based on market assessment. The complainant disputed the applicability of these terms and conditions to its mortgage loan agreement.

The CSSF analysed the mortgage loan signed by the complainant and noted that this contract did not include any referral to the bank's terms and conditions. In order to demonstrate that the complainant had indeed accepted its terms and conditions, the bank produced a fact sheet that had been established and signed by the complainant more than four years after signing the mortgage loan and which states: "signature(s) hereinafter shall mean contractual commitment and acceptance for the areas: Entry into business relationship, Operational Terms and Conditions". The bank argued that according to this fact sheet, the complainant had accepted its terms and conditions.

The CSSF concluded that even though terms and conditions are mentioned in the fact sheet signed by the complainant, there was no information allowing verifying to which specific terms and conditions the fact sheet was referring. In addition, as the fact sheet had been signed four years after the conclusion of the mortgage loan agreement, there was no proof whatsoever that the complainant had known or accepted the terms and conditions that were applicable at the moment the agreement was signed.

Finally, the CSSF sought to determine the intentions of the parties when they agreed to the disputed mortgage loan agreement in order to determine if, as stated by the complainant in the complaint, the bank misbehaved with respect to its contractual obligations, notably by not lowering its lending interest rate. To this end, the CSSF referred to Article 1134 of the Civil Code which provides that "agreements legally entered into operate as law for those who engaged in them (...)" and that "they must be executed in good faith".

The CSSF's attention was drawn to a mail of the bank in which it attempted to justify its refusal to lower the variable lending rate of the mortgage loan through the fact that the complainant had not regularly paid the agreed instalments. However, the loan agreement provided that the bank had "without prejudice to any other legal means, the right to sell the mortgaged estates of the debtor should the debtor not execute its obligations in a strict manner". The CSSF concluded that if the bank had intended to penalise certain proven payment irregularities, the penalty provided for by the agreement was the sale by the bank of the mortgaged estates of the complainant. There was no provision in the mortgage loan agreement that provided in case of non-execution by the complainant of his contractual obligations, that the bank could decide, without further explanations, not to lower the lending rate of the complainant. The extremely strict behaviour of the bank towards the complainant was all the more striking as the bank had written to the complainant that it would be

“flexible” and “tolerant” when assessing certain irregularities in the payment of instalments. As a consequence, the CSSF concluded in favour of the complainant and requested the bank to reconsider its position.

2.3. FIN-NET

FIN-NET was launched in 2001 by the European Commission with the purpose of enhancing cooperation between national ombudsmen in financial services and offering consumers easy access to extra-judicial mechanisms for cross-border dispute resolution in the area of financial services.

In 2018, the CSSF took part in the two half-yearly plenary meetings of the network. The FIN-NET members exchanged their views on topical issues, including the potential consequences of Brexit on out-of-court dispute settlement. Other topics included the implications of virtual currencies and Initial Coin Offerings (ICO) on consumers.

In June 2008, the CSSF took part in the first meeting of the representatives of the qualified entities for alternative dispute resolution that are on the list of the European Commission. This meeting allowed exchanging views on a multitude of topics relating to alternative dispute resolution.



CHAPTER XXI

BANKING AND FINANCIAL LAWS AND REGULATIONS

1. DIRECTIVES AND REGULATIONS UNDER NEGOTIATION AT EU LEVEL

The CSSF participates in the groups dealing with the proposals for directives or regulations mentioned below.

1.1. Proposal for an enabling EU framework on covered bonds

Within the context of the Capital Markets Union, the European Commission proposed, in March 2018, a dedicated EU framework for covered bonds, consisting of a directive and a regulation.

The proposal for a directive lays down the conditions that bonds need to meet to be recognised as covered bonds under EU law. It also strengthens investor protection by imposing specific supervisory duties in relation to covered bonds. The proposal is complemented by a proposal for a regulation amending Regulation (EU) No 575/2013 (CRR) which sets forth rules for the capital requirements when institutions invest in covered bonds.

1.2. Proposal for a regulation in order to establish a European Deposit Insurance Scheme (EDIS)

The proposal was discussed in detail in the previous two annual reports of the CSSF. In 2018, the proposal did not undergo major changes. Following the Euro Summit of 29 June 2018, the leaders stated that, adhering to all elements of the 2016 roadmap for the finalisation of the Banking Union established by ECOFIN, in an appropriate sequence, work should start on a roadmap for beginning political negotiations on the European Deposit Insurance Scheme.

1.3. Proposal for a directive on credit servicers, credit purchasers and the recovery of collateral (NPL Directive)

Proposal for a regulation amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (NPL Regulation)

On 14 March 2018, the European Commission published new measures aiming to reduce the high level of non-performing loans (NPLs) in the European banking sector. This package consists of a directive and a regulation, which aim at:

- fostering the development of secondary markets for NPLs in the EU (by defining credit servicers and credit purchasers activities as well as requirements for the transfer of an NPL to a non-credit institution);
- introducing an accelerated extrajudicial collateral enforcement process (not applicable to residential mortgages);
- introducing a “prudential backstop” to ensure a common minimum coverage level for new loans that become NPLs (by amending the CRR).

1.4. Proposal for a directive amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures

Proposal for a regulation amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and amending Regulation (EU) No 648/2012

Proposal for a directive amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms

Proposal for a regulation amending Regulation (EU) No 806/2014 as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms (SRMR 2)

The texts, the discussions on which ended at the beginning of 2019, were dealt with in detail in the CSSF Annual Report 2016.

1.5. Proposal for a regulation amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 345/2013 on European venture capital funds, Regulation (EU) No 346/2013 on European social entrepreneurship funds, Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2015/760 on European long-term investment funds, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market

The text, which was still subject to discussions in 2018, was dealt with in detail in the CSSF Annual Report 2017.

1.6. Proposal for a regulation on a pan-European Personal Pension Product

On 13 February 2019, the EU Permanent Representatives backed the future pan-European Personal Pension Product (PEPP), proposed by the European Commission in June 2017 in the framework of the strengthening of the Capital Markets Union. Within the EU, the rules concerning the PEPPs currently diverge as they are set at national level. The purpose of the new regulation is to create a pan-European framework for supplementary pension which will not replace the national personal pension schemes and which is presented as an individual pension product, subscribed on a voluntary basis. The PEPP will thus be the first standardised pension product entirely transferable throughout Europe. It will offer pension savers more choice between the different options with different risk profiles, protect the consumers by ensuring that the pension savers know the main features of a PEPP and provide the savers with the possibility to change providers in their country as well as in another EU country. The text still needs to undergo legal and linguistic adjustments before the European Parliament and the Council officially adopt it.

1.7. Proposal for a regulation amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks

The proposal is further detailed in point 8. of Chapter XII “Supervision of securities markets”.

2. DIRECTIVES AND REGULATIONS TO BE TRANSPOSED INTO NATIONAL LAW

2.1. Directive (EU) 2016/2341 of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision

The purpose of the directive, which was discussed in detail in the CSSF Annual Report 2016, is to set a better framework for the activities and supervision of institutions for occupational retirement provision (IORP), i.e. the pension funds of the second pillar pension system.

The bill that transposes the directive into Luxembourg law was submitted to the Chambre des Députés in October 2018. This bill provides the supervisory authorities, i.e. the CSSF, the Commissariat aux Assurances and the Inspection Générale de la Sécurité Sociale, with powers and instruments necessary to ensure efficient and coordinated supervision of pension institutions. Moreover, it aims to facilitate the cross-border activities of IORPs and the cross-border transfer of occupational pension schemes.

2.2. Regulation (EU) 2017/2402 of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (STS Securitisation Regulation)

Submitted on 6 August 2018, the purpose of the bill no 7349 is to operationalise the STS Securitisation Regulation as well as different EU regulations regarding investment funds which were adopted in the last years and which cover in particular European venture capital funds (EuVECAs), European social entrepreneurship funds (EuSEFs), European long-term investment funds (ELTIFs) and money market funds.

For each type of fund, the bill determines the competent authority (namely the CSSF or the CSSF and the Commissariat aux Assurances), its/their powers and the administrative sanctions.

The STS Securitisation Regulation is further detailed in point 2. of Chapter X “Supervision of securitisation undertakings”.

2.3. Directive (EU) 2018/843 of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (“5th AMLD”)

Directive (EU) 2018/1673 of 23 October 2018 on combating money laundering by criminal law

The directives are further detailed in points 2.1.1. and 2.1.2. of Chapter XIX “Financial crime”.

3. LAWS AND REGULATIONS ADOPTED IN 2018

3.1. Law of 13 February 2018 (1) transposing the provisions on the professional obligations and the powers of the supervisory authorities as regards the fight against money laundering and terrorist financing of Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012, and repealing Directive 2005/60/EC and Commission Directive 2006/70/EC and (2) implementing Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006

The law was discussed in detail in point 1.2.1. of Chapter XIX “Financial crime” of the CSSF Annual Report 2017.

3.2. Law of 27 February 2018 on interchange fees and amending several laws relating to financial services

The Law of 27 February 2018 has two objectives: on the one hand, it implements some provisions of Regulation (EU) 2015/751 of 29 April 2015 on interchange fees for card-based payment transactions and, on the other hand, it adjusts several laws on the financial sector.

In order to operationalise Regulation (EU) 2015/751, the law designates the CSSF as the competent authority in Luxembourg which will be granted investigation and enforcement powers necessary for the performance of its duties. The law provides also for a cap of the interchange fee for national debit card transactions which is set at 0.12% of the transaction value. The aim is to ensure that the level of the interchange fees is close, as regards what can be considered as medium transactions, to the level of the interchange fee applied prior to Regulation (EU) 2015/751.

With respect to investment funds, the law amends, among others, the depositary regime applicable to UCIs governed by Part II of the Law of 17 December 2010 relating to UCIs (hereinafter UCIs Part II). As regards the depositary regime applicable to UCIs Part II, from now on, only UCIs Part II which are distributed to retail investors established in Luxembourg will remain within the scope of the current regime, i.e. the depositary regime applicable to UCITS. All other UCIs Part II fall henceforth within the scope of the depositary regime laid down in the Law of 12 July 2013 on alternative investment fund managers or the Law of 13 February 2007 relating to specialised investment funds, provided that their instruments of incorporation explicitly indicate that the marketing of shares or units of funds to retail investors established in Luxembourg is prohibited. If this reference is not included in the fund’s instruments of incorporation, the regime applicable before the amendment to the 2010 Law will continue to apply. As a reminder, prior to this amendment, in accordance with Article 88-3 of the 2010 Law, all depositaries of UCIs Part II had to comply with the regime applicable to UCITS depositaries, irrespective of the cap or type of investors to which these UCIs Part II were distributed (retail investors or professional investors). Following the amendment to the 2010 Law, this regime became nuanced so as to take into account the status of the manager, the type of investors to which the UCIs Part II are distributed and the location where these investors are established.

Moreover, the Law of 27 February 2018 extensively amends Article 41 of the Law of 5 April 1993 on the financial sector (hereinafter the LFS) and clarifies the legal regime of exceptions to the obligation to maintain professional secrecy by including paragraph 2a consisting of two distinct sub-paragraphs. This revision removes some legal barriers to the information flow and adapts the Luxembourg legal framework to the globalisation of financial services. The main purpose of the legislative amendment is to facilitate the use of outsourcing, which was a source of legal uncertainty before the reform, by removing the risk of criminal sanctions for lifting the secrecy via a prior consent of the client¹. Thus, the first sub-paragraph of Article 41(2a) of the LFS lays down an extension of the scope of exceptions to professional secrecy by allowing access to confidential data for all persons established in Luxembourg, provided that (i) these persons are under the supervision of the CSSF, the ECB or the Commissariat aux Assurances, (ii) they are bound by secrecy which is subject to criminal sanctions, and (iii) the confidential information is communicated to them in the framework of a service contract. The second sub-paragraph of Article 41(2a) of the LFS aims at cases of outsourcing which do not fall within the legal regime of the first sub-paragraph, irrespective of the fact that the providers of the outsourced services are established in Luxembourg or abroad. This second sub-paragraph introduces an exception to professional secrecy for entities which are in charge of the outsourced service provision as well as for employees and other persons working for these entities, provided that (i) the persons with access to confidential information are subject to a legal obligation of professional secrecy or are bound by a confidentiality agreement, and (ii) the client has accepted, in accordance with the law or according to the arrangements for information agreed on by the parties, the outsourcing of the services, the type of information transmitted in the context of the outsourcing and the country of establishment of the entities that provide outsourced services. In so far as they apply, any outsourcing must observe the organisational requirements laid down in Article 36-2 of the LFS (also introduced by the Law of 27 February 2018). Finally, this new flexibility is without prejudice to the Law of 1 August 2018 on the organisation of the National Data Protection Commission and implementing Regulation (EU) 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation, GDPR), amending the Labour Code and the Law of 25 March 2015 laying down the salaries and promotion process of civil servants, as amended.

3.3. Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 with regard to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies

The regulation applies as from 21 July 2018 except for Article 1 which is applicable as from 1 January 2019.

3.4. Law of 17 April 2018 on benchmarks

The law implements Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (Benchmark Regulation).

The law is further detailed in point 8. of Chapter XII “Supervision of securities markets”.

3.5. Law of 17 April 2018 on key information documents for packaged retail and insurance-based investment products (PRIIPs)

The law implements Regulation (EU) No 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs, applicable since 31 December 2016) into Luxembourg law and designates the CSSF and the Commissariat aux Assurances as competent authorities to ensure compliance with this regulation.

¹ The law aims at facilitating the outsourcing by the supervised persons to service providers, whether these providers are persons belonging or not to the group of the delegate or persons located in Luxembourg or abroad.

3.6. Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 with regard to regulatory technical standards on settlement discipline

The regulation which was published in the Official Journal of the EU on 13 September 2018 and which enters into force on 13 September 2020, proposes measures to prevent and address settlement fails and to encourage settlement discipline. It also specifies, among others, the operational details of the buy-in process.

3.7. Law of 30 May 2018 on markets in financial instruments

The law transposes Directive 2014/65/EU on markets in financial instruments (MiFID II) and implements some provisions of Regulation (EU) No 600/2014 on markets in financial instruments (MiFIR), which entered into force on 3 January 2018, into Luxembourg law.

The new regulation of financial markets aims at addressing the regulatory loopholes identified during the financial crisis of 2008 and adapting the legislation to the changes with respect to financial products and technology incurred by financial markets since the entry into force of MiFID, as well as making the financial markets more resilient and transparent while enhancing investor protection and providing the supervisory authorities with more efficient powers. More stringent organisational requirements including in particular the product governance and more extensive requirements with respect to members of the management bodies of investment firms, credit institutions and market operators aim at enhancing investor protection. The purpose is to ensure that investors are offered products which better suit their profile. Investors may rely on objective and independent advice if they so wish and the structure of the fees and remuneration of advisers must not impede this advice.

3.8. Grand-ducal Regulation of 30 May 2018 on the protection of the financial instruments and funds belonging to clients, product governance obligations and rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits

The purpose of the regulation is to transpose Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits. Moreover, the regulation amends certain provisions of the Grand-ducal Regulation of 13 July 2007 relating to the keeping of the official listing for financial instruments and repeals the Grand-ducal regulation of 13 July 2007 relating to organisational requirements and rules of conduct in the financial sector.

3.9. CSSF Regulation N° 18-03 of 5 June 2018 (1) implementing certain discretions of Regulation (EU) No 575/2013 and implementing Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9) and (2) repealing CSSF Regulation N° 14-01

The purpose of the CSSF regulation is to implement into Luxembourg law measures for less significant institutions that the Single Supervisory Mechanism recommended to national competent authorities with respect to options and discretions provided for in Regulation (EU) No 575/2013 (CRR), Directive 2013/36/EU (CRD IV) and Commission Delegated Regulation (EU) 2015/61 with regard to liquidity coverage requirement.

3.10. Law of 6 June 2018 on transparency of securities financing transactions

The law implements Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 and amends the Law of

17 December 2010 relating to UCIs, the Law of 12 July 2013 on AIFMs as well as the Law of 7 December 2015 on the insurance sector.

It designates the CSSF and the Commissariat aux Assurances as competent authorities and lays down, in particular, that these authorities are competent to impose administrative sanctions and other administrative measures in case of breach of the set rules.

3.11. Law of 6 June 2018 on central securities depositories

The law implements Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (CSDR).

The law designates the CSSF as the competent authority responsible for carrying out the duties under the regulation for the initial authorisation and supervision of central securities depositories. It confers on the CSSF the indispensable supervisory and investigatory powers to exercise its functions as well as the power to impose sanctions and take other administrative measures applicable to breaches of the CSDR requirements.

3.12. Law of 22 June 2018 amending the Law of 5 April 1993 with respect to the introduction of renewable energy covered bonds

The purpose of the law is notably to provide for a legal framework for a new type of covered bonds focussed on renewable energy in order to complete the range of products available to market players. With the creation of the renewable energy covered bonds, the Luxembourg financial centre acquired a financial product subject to very high standards and with a direct link to the global sector of renewable energy. Thus, the law is in line with the diversification strategy of the financial sector.

3.13. Commission Delegated Regulation (EU) 2018/1618 of 12 July 2018 amending Delegated Regulation (EU) No 231/2013 as regards safe-keeping duties of depositaries

Commission Delegated Regulation (EU) 2018/1619 of 12 July 2018 amending Delegated Regulation (EU) 2016/438 as regards safe-keeping duties of depositaries

These regulations aim at notably harmonising the safe-keeping regimes applicable to depositaries of UCITS and AIFs, clarifying the asset segregation requirements and supplementing these requirements with additional security, particularly where the depositary delegates some of its functions to a third party. They are applicable as from 1 April 2020.

3.14. Law of 20 July 2018 (1) transposing Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market, and (2) amending the Law of 10 November 2009 on payment services

The law is further detailed in point 1. of Chapter VIII “Supervision of payment institutions and electronic money institutions”.

3.15. Law of 25 July 2018 transposing Directive (EU) 2017/2399 of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy

The Law of 25 July 2018 transposes Directive (EU) 2017/2399 amending Article 108 of Directive 2014/59/EU (BRRD) into national law. Thus, the Luxembourg insolvency laws give ordinary unsecured debt instruments and other ordinary unsecured liabilities that are not debt instruments a higher

priority ranking than the new non-preferred senior class of debt instruments created by the above-mentioned law. This new non-preferred senior class of debt instruments will have a higher priority ranking in the national insolvency laws than own funds instruments and any subordinated liabilities that do not qualify as own funds.

This new non-preferred senior class of debt instruments will improve the efficiency of bail-in by limiting, and even avoiding, its application to non-covered deposits.

3.16. Law of 10 August 2018 on information to be obtained and held by trustees

The law is further detailed in point 2.2.2. of Chapter XIX “Financial crime”.

3.17. Law of 10 August 2018 amending, among others, the Code of Criminal Procedure for the purpose of organising the Financial Intelligence Unit (FIU)

The law is further detailed in point 2.2.3. of Chapter XIX “Financial crime”.

LIST OF ABBREVIATIONS

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AML/CFT	Anti-Money Laundering and Counter-Terrorist Financing
APM	Alternative Performance Measures
ASSEP	Pension savings association
BCL	Banque centrale du Luxembourg - Luxembourg Central Bank
BRRD	Bank Recovery and Resolution Directive - Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms
COREP	Common Reporting
CPDI	Conseil de protection des déposants et des investisseurs - Council for the Protection of Depositors and Investors
CRD IV	Capital Requirements Directive - Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms
CRR	Capital Requirements Regulation - Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms
CSDR	Central Securities Depositories Regulation - Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories
CSSF	Commission de Surveillance du Secteur Financier - Financial sector supervisory commission
EBA	European Banking Authority
EC	European Community
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation - Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	Euro
FATF	Financial Action Task Force
FGDL	Fonds de garantie des dépôts Luxembourg - Deposit guarantee fund Luxembourg
FINREP	Financial Reporting
FIU	Financial Intelligence Unit
FSB	Financial Stability Board
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IFM	Investment Fund Manager
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process

IMF	International Monetary Fund
IML	Institut Monétaire Luxembourgeois - Luxembourg Monetary Institute (1983-1998)
IOSCO	International Organization of Securities Commissions
ITS	Implementing Technical Standards
JST	Joint Supervisory Team
LCR	Liquidity Coverage Requirement
LPS	Law of 10 November 2009 on payment services
LSI	Less significant institution
MIFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
NAV	Net Asset Value
NSFR	Net Stable Funding Requirement
OECD	Organisation for Economic Co-operation and Development
PFS	Professional of the Financial Sector
PIE	Public-Interest Entity
PSD2	Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market
RTS	Regulatory Technical Standards
SEPCAV	Pension savings company with variable capital
SI	Significant institution
SIAG	Self-managed investment company
SICAR	Investment company in risk capital
SIF	Specialised Investment Fund
SIIL	Système d'indemnisation des investisseurs Luxembourg - Investor Compensation Scheme Luxembourg
SRB	Single Resolution Board
SRC	Systemic Risk Committee
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
UCI	Undertaking for Collective Investment
UCITS	Undertaking for Collective Investment in Transferable Securities
2010 Law	Law of 17 December 2010 relating to undertakings for collective investment
2013 Law	Law of 12 July 2013 on alternative investment fund managers



COMMISSION DE SURVEILLANCE
DU SECTEUR FINANCIER

283, route d'Arlon
L-2991 Luxembourg