COMMISSION
DE SURVEILLANCE
DU SECTEUR
FINANCIER

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The subprime mortgage crisis, which began in 2007 in the United States, triggered a global financial crisis that resonated for many years. Ten years later, thanks to reinforced and modernised international and European banking regulations, banks are now better capitalised and hold higher-quality capital. An agreement was reached at the end of 2017 as regards the Basel III reforms initiated by the G20 in response to the financial crisis. Luxembourg banks will remain relatively unscathed by this reform. They are generally well capitalised but it is nevertheless important to stay sharp, especially in respect of the real estate market risks, with a continuous price growth and historically low interest rates. The government submitted a draft law in 2017 providing the possibility to ensure healthy loan conditions for residential real estate mortgages, in case the Systemic Risk Board identifies rising vulnerabilities in the households' balance sheets.

Overall, 2017 has been a good vintage for the Luxembourg financial centre. The total number of banks remained stable. The transformation of a number of international financial institutions located in the Grand Duchy of Luxembourg into branches along with the merger of several institutions that do not possess the critical mass, in particular to meet the regulatory cost, is a phenomenon that is expected to continue. This situation is counterbalanced by a number of banks and investment firms which established or showed an interest in establishing or extending their activities in Luxembourg, notably in response to Brexit. In the field of investment funds, assets under management reached a record EUR 4,159 billion at the end of 2017, and as regards fund managers, a growth was recorded especially for alternative investment fund managers. The number of persons employed in the financial sector subject to the CSSF supervision slightly increased and exceeded 46,000 people at the end of 2017.

However, these figures do not reflect a number of risks which our financial sector will have to face in the short and medium term:

- Political risk. The elections in several European countries in 2017 showed a rise in power of populist parties. Even if their accession to power was narrowly averted, this danger is far from being overcome in a European Union which, on the one hand, is at a loss to explain the importance of a political project and, on the other hand, can hardly find solutions to important societal phenomena such as immigration or unemployment.

- Economic risk. While there are generally no issues with non-performing loans in the Grand Duchy, the same cannot be said for all the countries of the European Union. The probability of default of some banks in these countries is still real and could affect the European economy.

- Profitability risk. As a result of ever-rising costs to be borne by the supervised entities, revenues increase at a slower pace, which in the medium term will be a concern for a number of players with regard to their business plan.

- Reputational risk and legal risk. While the vast majority of the supervised entities comply with the investor and consumer protection rules and the rules designed to prevent money laundering and terrorist financing and have put in place adequate governance and internal controls, we had to note that not all the entities did, which raises problems not only for the relevant entities but also for the financial centre as a whole. The CSSF imposed severe sanctions on the offenders and will continue to do so in case of breach of the conduct of business rules.

- Employment risk. We have found that more and more supervised entities have recourse to outsourcing in other countries, within the group or through specialised providers. In parallel, digitalisation, robotisation and new entrants will pose a challenge for traditional players, in particular in terms of employment.

- Risk of fraud. Cybercrime prevention will be one of the major challenges in coming years and the relevant players must take proper measures to mitigate this risk. GIOIA TAURO

Following the referendum of June 2016, the British government notified the European Presidency in March 2017 of its wish to leave the EU by the end of March 2019. This is a lose-lose situation for all the parties and failure to include the services, and more specifically the financial services, into the separation agreement and the post-Brexit arrangements may pose a significant problem for financial institutions on both sides of the Channel, due to the very high dependencies between the British and the EU-27 financial centres, including Luxembourg. The hard Brexit scenario, and/or the absence of an agreement on financial services, is becoming increasingly likely. Consequently, time is of the essence for the relevant supervised entities which are not yet prepared for such a scenario.

The CSSF closely monitors technological developments, and in particular the emergence of the FinTech. It will contribute to the adaptation of the regulatory framework where necessary or useful by reconciling, on the one hand, the needs for consumer and investor protection and, on the other hand, the benefits of innovation. The CSSF maintains sustained dialogue with the industry and the government in this respect. Recent studies have shown that part of the industry is, unfortunately, still ill-prepared for technological changes. Some technologies such as the DLT or the blockchain will transform the financial sector in a sustainable way. While these technologies are new, the associated risks are long-standing, such as the risk of partial or total loss of investment, the risk of fraud or the money laundering risk, and there is an absence of sound governance to control them. We published warnings for instance in relation to cryptocurrencies and ICOs in order to avoid that unsophisticated investors are lured with promises of explosive gains without assessing the risks.

Recurrent studies show a lack in financial education in all the countries, including Luxembourg. In addition to some special laws, the government entrusted the CSSF with a broader mission of financial education in July 2017. The CSSF developed a national strategy in this regard and set up, together with many players operating in this field, three working groups whose mission is to develop concrete actions in the following areas, identified as priorities: (i) education in primary and secondary schools as well as education of adults, (ii) indebtedness and (iii) supplementary pension plans.

In order to cope with steadily more complex and ever more numerous missions, the CSSF has increased its staff and modernised its infrastructure over the last years, and will continue to do so. Over 800 agents are devoted to working on the supervision of the financial sector and performing the related tasks. The quality of their work has also contributed to the image of the financial sector and its development. The CSSF enjoys and shall continue to enjoy operational and budgetary autonomy. It is committed to review its operational processes on an ongoing basis, continues modernising its working tools and explores how it could use new technologies, such as machine learning and artificial intelligence.

I wish you an insightful reading!

Claude Marx
Director General

TABLE OF CONTENTS

Chapter I

GOVERNANCE AND FUNCTIONING OF THE CSSF 7

1. Principles
2. Governing bodies
3. Committees
4. Human resources
5. CSSF library
6. Budget and annual accounts of the CSSF - 2017

Chapter II

THE EUROPEAN DIMENSION OF THE SUPERVISION OF THE FINANCIAL SECTOR 19

1. Supervision of banks
2. Supervision of financial markets
3. Cooperation within other European bodies

Chapter III

MACROPRUDENTIAL SUPERVISION OF THE FINANCIAL SECTOR 29

1. Macroprudential supervision in the European and national context
2. Implementation of the macroprudential policy

Chapter IV

THE INTERNATIONAL DIMENSION OF THE CSSF'S MISSION 35

1. Basel Committee on Banking Supervision
2. International Organization of Securities Commissions
3. International Monetary Fund (IMF)

Chapter V

FINANCIAL INNOVATION 39

Chapter VI

SUPERVISION OF BANKS 45

1. Developments in the banking sector in 2017
2. Prudential supervisory practice

Chapter VII

SUPERVISION OF PFS 63

1. Investment firms
2. Specialised PFS
3. Support PFS

CHAPTER VIII

SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS 73

1. Regulatory framework
2. Payment institutions
3. Electronic money institutions

CHAPTER IX

SUPERVISION OF INVESTMENT FUND MANAGERS AND UCIS 75

1. Authorised investment fund managers
2. Other investment fund managers
3. Cross-border activities
4. Evolution of the UCI sector in 2017
5. Prudential supervisory practice

CHAPTER X

SUPERVISION OF SECURITISATION UNDERTAKINGS 89

1. Developments of authorised securitisation undertakings
2. Developments in the regulatory framework

CHAPTER XI

SUPERVISION OF PENSION FUNDS 91
1. Development of pension funds in 2017
2. Development of liability managers in 2017

CHAPTER XII

SUPERVISION OF SECURITIES MARKETS 95
1. Approval of prospectuses for securities relating to offers to the public or admissions to trading on a regulated market
2. Takeover bids
3. Mandatory squeeze-out and sell-out of securities
4. Supervision of issuers of securities of which the CSSF is the competent authority
5. Enforcement of financial information
6. Supervision of markets and market operators
7. Investigations and cooperation
8. Indices used as benchmarks

CHAPTER XIII

SUPERVISION OF INFORMATION SYSTEMS 111
1. Activities in 2017
2. Supervision of information systems in practice

CHAPTER XIV

SUPERVISION OF THE REMUNERATION POLICIES 117

CHAPTER XV

PUBLIC OVERSIGHT OF THE AUDIT PROFESSION 119
1. Legal, regulatory and normative framework of the audit profession
2. Quality assurance review
3. Overview of the population of *réviseurs d'entreprises* in Luxembourg
4. Cooperation agreements

CHAPTER XVI

INSTRUMENTS OF SUPERVISION 129
1. On-site inspections
2. Decisions as regards sanctions and administrative police taken in 2017

CHAPTER XVII

RESOLUTION 141

CHAPTER XVIII

PROTECTION OF DEPOSITORS AND INVESTORS 143

CHAPTER XIX

FINANCIAL CRIME 145
1. Amendments to the regulatory framework regarding the fight against money laundering and terrorist financing
2. CSSF participation in meetings regarding the fight against money laundering and terrorist financing and regarding international financial sanctions

CHAPTER XX

FINANCIAL CONSUMER PROTECTION 151
1. Financial consumer protection and financial education
2. Out-of-court resolution of complaints

CHAPTER XXI

BANKING AND FINANCIAL LAWS AND REGULATIONS 161
1. Directives and regulations under negotiation at EU level
2. Directives to be transposed into national law
3. Laws and regulations adopted in 2017

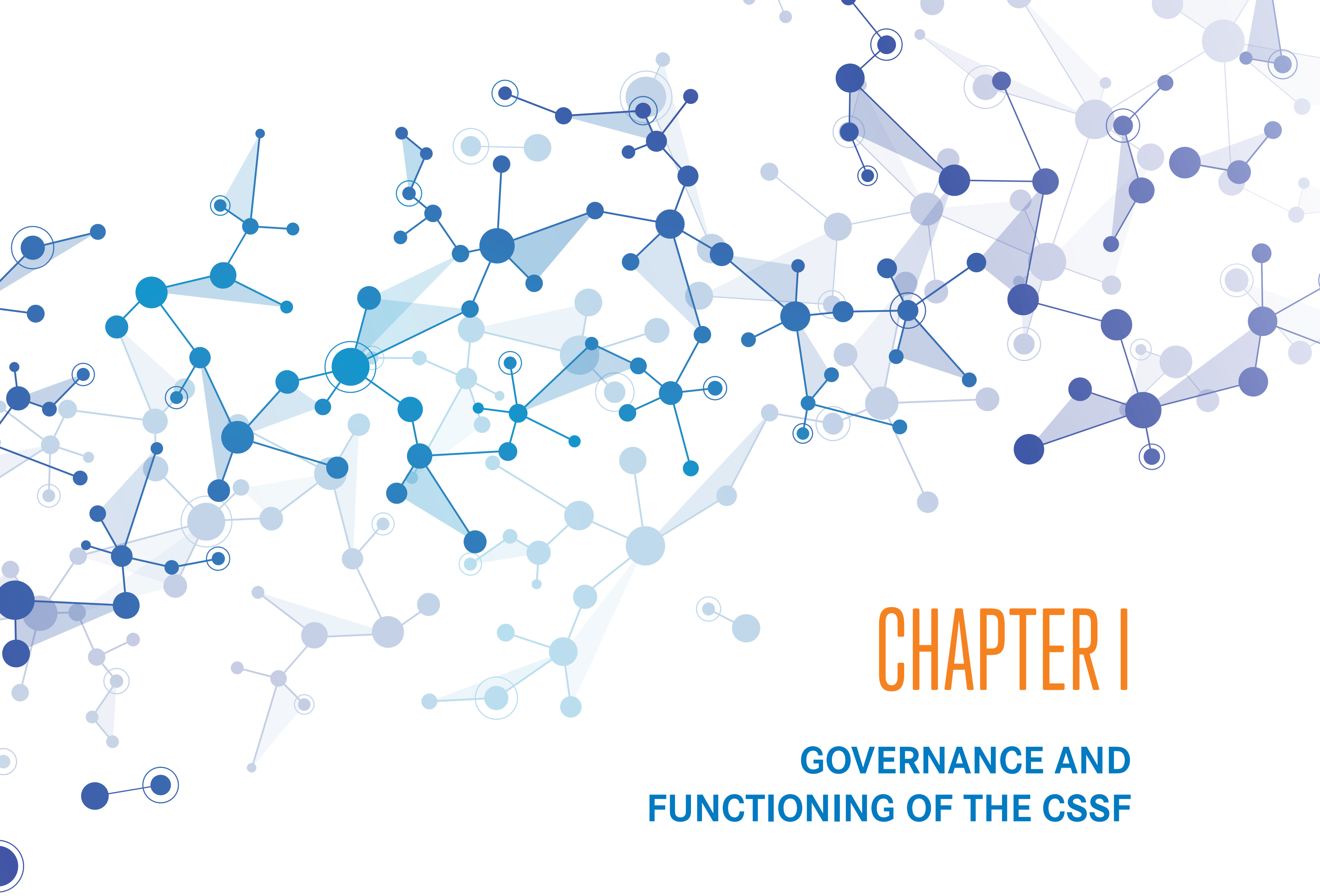
ANNEX

List of abbreviations 168

Agents hired in 2017 and 2018: Departments "Executive Board secretariat", "General secretariat" and "Supervision of banks"

From left to right: Sheila BESCH, Jil MULLER, Matthias SCHMIDT, Anne AREND, Gilles KLEIN, Valéry VILLEVAL, Diane FRIEZ, Sarah MAUS

Absent: Viviane MÜLLER, Cong Tin THAI, Quentin VON STERNBERG



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 is obliged to address to the Board and the Government.

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	Rima Adas	Institut des réviseurs d'entreprises (up to 31 December 2017)
	Daniel Croisé	Member of the Board of the Institut des réviseurs d'entreprises (as from 1 March 2018)
	Serge de Cillia	Director General of the Luxembourg Bankers' Association
	Marny Schmitz	*Attaché*, 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	*Conseiller*, 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
	Karin Guillaume	*Premier conseiller* to the *Cour d'appel* (Court of Appeal)
Secretary	Nicole Lahire	*Conseiller*, CSSF

Council for the Protection of Depositors and Investors

Chairman	Claude Simon	Director, CSSF
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	*Premier conseiller* to the *Cour d'appel* (Court of Appeal)
Secretary	Laurent Goergen	*Attaché*, CSSF

Executive Board

Director General	Claude Marx
Directors	Simone Delcourt
	Claude Simon
	Françoise Kauthen
	Jean-Pierre Faber

Executive Board of the CSSF

Left to right: Claude SIMON, Simone DELCOURT, Claude MARX, Jean-Pierre FABER, Françoise KAUTHEN

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 a financial sector supervisory commission (Commission de Surveillance du Secteur Financier), on any draft law or grand-ducal regulation in the field of the financial sector falling within the competence 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 regulations overall or for specific issues. The external members of the committee are appointed by the Minister of Finance.

Committee composition:

Executive Board of the CSSF:	Claude Marx (Chairman), Simone Delcourt, Claude Simon, Françoise Kauthen, Jean-Pierre Faber
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 regulation of public oversight of the audit profession overall 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 a financial sector supervisory commission (Commission de Surveillance du Secteur Financier).

Committee composition:

Executive Board of the CSSF:	Claude Marx (Chairman), Simone Delcourt, Claude Simon, Françoise Kauthen, Jean-Pierre Faber
Members:	Anouk Agnes, Daniel Croisé, Serge de Cillia, Yasmin Gabriel, Jean-Michel Pacaud, 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 issues. 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 Simon
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 areas of the financial sector, give their advice on any issue relating to their activities and contribute to the drawing-up and interpretation of the regulations relating to areas covered by the respective committees. In addition to the permanent committees listed below, ad hoc committees are formed to examine specific subjects.

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;
- Depositaries Committee;
- Investment Fund Managers Committee;
- Corporate Governance Committee;
- Capital Markets Committee;
- Financial Consumer Protection Committee;
- Audit Technical Committee;
- Securitisation Committee.

4. HUMAN RESOURCES

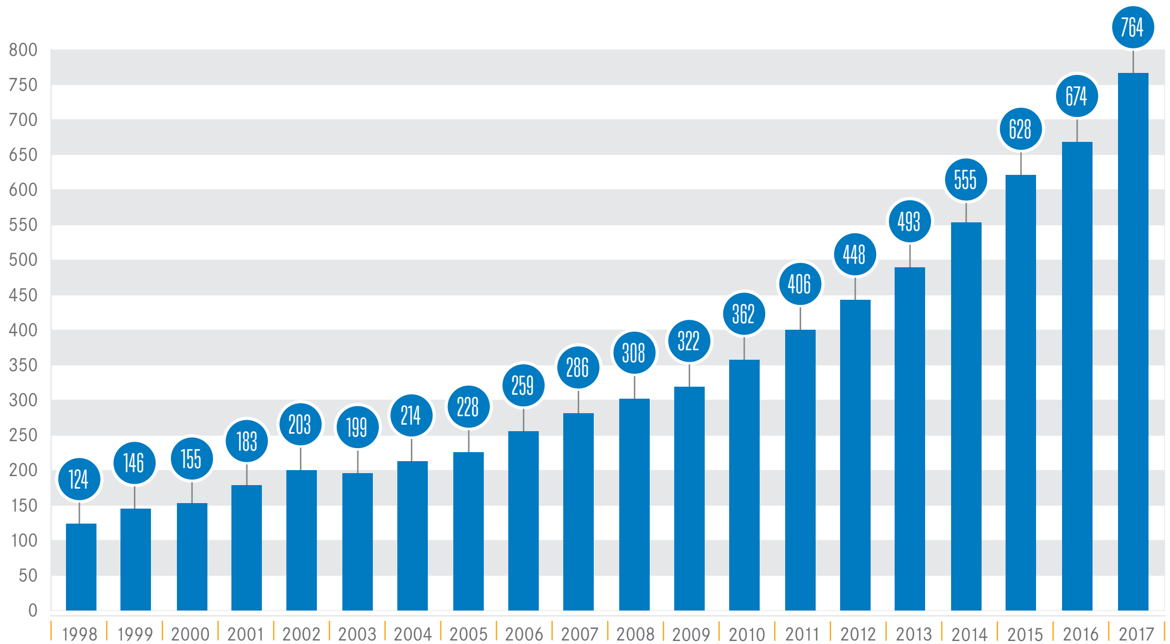
4.1. CSSF staff

In constant growth since 2010, the CSSF staff continued to increase in 2017 with the recruitment of 106 new agents. Following the resignation of 16 agents over that period, total employment reached 764 people as at 31 December 2017, representing a 13.35% increase compared to 2016. This is the equivalent of 682.5 full-time jobs, i.e. a 13.47% growth compared to 2016.

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 agents benefitting from part-time employment, partial leave, parental leave or unpaid leave as at 31 December 2017 rose to 186, i.e. 24.54% of total staff.

During 2017, the CSSF received 3,965 job applications (+60% as compared to 2016), including 81 internal applications, and participated in several recruitment events (UniCareers, European Meeting of Luxembourg Students, Plug&Work, Business-Students Meeting). Recruitment was mainly based on language skills and the research of experienced profiles.

Movements in staff numbers



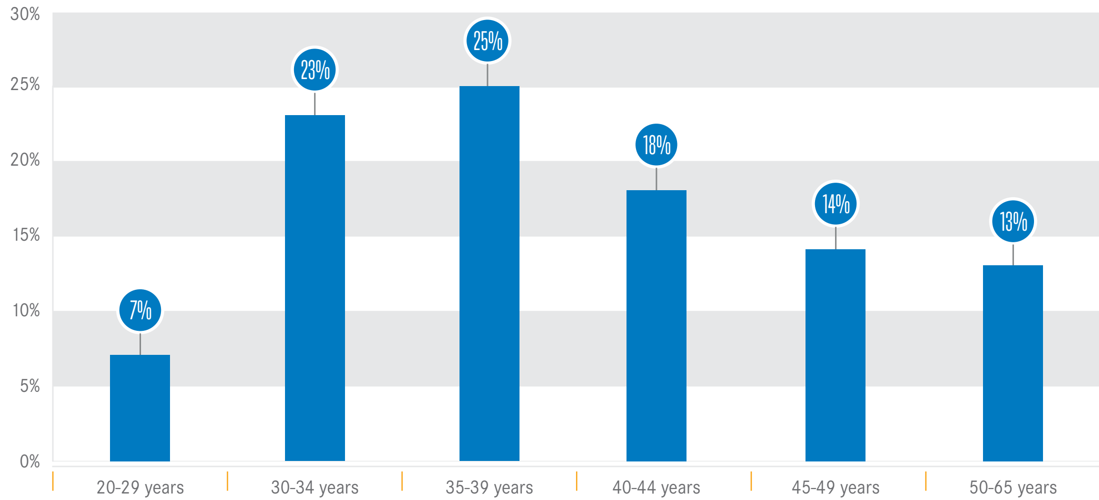
CSSF agents represent 15 nationalities, the Luxembourg nationality being the most represented with 56.94% of total staff. However, the percentage of Luxembourg agents is falling continuously.

Breakdown of staff by nationality

Nationality	Number of agents
Luxembourgish	435
French	175
Belgian	80
German	40
Italian	11
Polish	4
Austrian	3
Spanish	3
Dutch	3
Portuguese	3
Bulgarian	2
Romanian	2
English	1
Greek	1
Irish	1
Total	**764**

The average age of CSSF staff members increased slightly from 39.31 years as at 31 December 2016 to 39.38 years at the end of 2017. Women make up 46.57% of total staff and men 53.43%.

Breakdown of staff by age



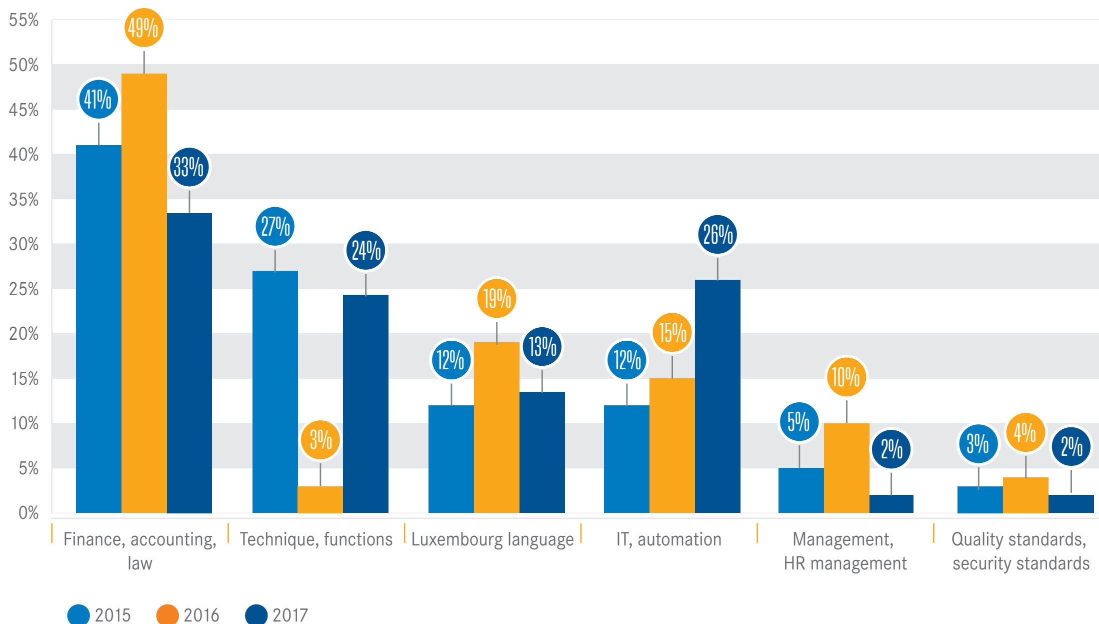
4.2. Staff training

In 2017, CSSF staff attended in total 27,750 training hours, which represents an average of 6.5 training days per agent. As it is capital that the agents' expertise is at any time 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.

Given the entry into force, on 1 October 2015, of the reform of the civil servant status and the alignment, on 16 December 2016, of the CSSF's organic law with the measures of the reform, the training courses organised for the internship to become a civil servant were postponed to 2017. As the courses undertaken for the internship generally concern the category "Technique/functions", the number of training courses taken in this category in 2017 increased substantially compared to 2016.

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. 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.

6. BUDGET AND ANNUAL ACCOUNTS OF THE CSSF - 2017

6.1. CSSF budget

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

The 2017 budget was drawn up in accordance with the principles which have proved their worth in the previous years. It was approved by the CSSF's Board on 1 December 2016.

The key factors that have affected the 2017 budget are the following.

- Considering the additional staff needs, in particular in the context of the consolidation of the new architecture for banking supervision in Europe by the ECB and the development related to on-site supervision, the budget included an increase in CSSF staff, in terms of operational and support departments.
- Notwithstanding the end of the construction of the CSSF's new headquarters in 2015, the surface capacity proved increasingly insufficient to welcome all the staff, forcing the CSSF to operate two buildings as from 1 September 2016. With regard to the longer term, the CSSF conducted, during the financial year 2017, a survey on real estate strategies to be implemented beyond 2019.
- In accordance with the recommendations of the Board of the CSSF, efforts for the consolidation of the quality of the IT infrastructure and operation continued and were included in the 2017 budget. In this context, the 2017 budget notably anticipated significant IT projects in view of the development of the ECB's IT framework as part of the banking supervision in Europe (SSM). In addition, the 2017 budget took account of the work performed for the implementation of the IT infrastructure in relation to the Fonds de garantie des dépôts Luxembourg (FGDL).

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 2017, the amount of operating costs and investment costs remained below the budgeted amounts set for 2017.

6.2. Annual accounts of the CSSF - 2017

BALANCE SHEET AS AT 31 DECEMBER 2017

Assets	*EUR*
Fixed assets	61,813,734.44
- Intangible fixed assets	5,657,737.50
Development costs	3,769,714.26
Payments on account and intangible assets in progress	1,888,023.24
- Tangible fixed assets	56,155,996.94
Land and constructions	54,638,684.82
Other fixtures, fittings, tools and equipment	1,517,312.12
Current assets	58,722,076.45
- Debtors	2,758,399.72
Trade debtors with a residual term of up to one year	2,753,005.86
Other debtors with a residual term of up to one year	5,393.86
- Cash at banks, in postal cheque accounts, cheques in hand	55,963,676.73
Prepayment and accrued income	4,254,250.29
Balance sheet total (assets)	**124,790,061.18**
Liabilities	
Own capital	61,118,536.37
- Profit brought forward	56,086,117.35
- Result for the financial year	5,032,419.02
Provisions	4,478,965.03
- Other provisions	4,478,965.03
Liabilities	59,158,659.78
- Amounts owed to credit institutions	55,096,324.87
with a residual term of up to one year	4,212,991.50
with a residual term of over one year	50,883,333.37
- Debts on purchases and provision of services	2,568,657.99
with a residual term of up to one year	2,568,657.99
- Other debts	1,493,676.92
Tax debts	378,686.33
Social security debts	875,301.67
Other debts with a residual term of up to one year	239,688.92
Prepayment and accrued income	33,900.00
Balance sheet total (liabilities)	**124,790,061.18**

PROFIT AND LOSS ACCOUNT AS AT 31 DECEMBER 2017

	EUR
Net turnover	**97,111,666.15**
Other operating income	**140,534.97**
Raw materials and consumables and other external charges	**-9,466,597.78**
- Raw materials and consumables	-372,263.05
- Other external charges	-9,094,334.73
Staff costs	**-74,820,339.35**
- Wages and salaries	-70,241,970.02
- Social security costs	-3,103,186.17
relating to pensions	-641,447.14
other social security costs	-2,461,739.03
- Other staff costs	-1,475,183.16
Value adjustments	**-4,093,854.20**
- on formation expenses and tangible and intangible fixed assets	-4,093,854.20
Other operating charges	**-2,735,060.04**
Other interests and financial revenues	**12,500.00**
- Other interests and financial revenues	12,500.00
Interests and other financial charges	**-1,116,430.73**
- Other interests and financial charges	-1,116,430.73
Result for the financial year	**5,032,419.02**

Financial controller EY

Agents hired in 2017 and 2018: Legal Department and departments “Public oversight of the audit profession” and “Personnel, administration and finance”

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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 2017, the CSSF continued to perform its tasks as a member of the SSM. Via its participation in the Supervisory Board of the SSM, the CSSF contributed to over 1,850 decisions concerning significant banks and banking groups which are under the direct supervision of the European Central Bank (ECB). The continued participation in the Joint Supervisory Teams (JSTs) of the ECB ensured the CSSF's involvement in the prudential supervision of significant banks and banking groups established in Luxembourg. In addition, the CSSF cooperated with the ECB as regards the supervision of less significant Luxembourg banks and banking groups which remain under the direct supervision of the CSSF. As in previous years, CSSF experts contributed to the work of numerous committees and working groups established by the ECB.

In 2017, the SSM further streamlined its decision-making process by implementing a framework for delegating decision-making powers which allows that certain types of routine supervisory decisions may be adopted by ECB senior managers instead of the Supervisory Board and the Governing Council. For the time being, the delegation framework applies to the assessment of fit and proper requirements and to amendments to significance of supervised entities. The possibility to adopt decisions by delegation depends on certain criteria relating, among others, to the size and nature of the concerned bank. Since the entry into force of the delegation framework in June 2017, over 85% of relevant fit and proper assessments for Luxembourg banks were taken by delegation.

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

In 2017, the SSM continued to work on the issue of the high level of non-performing loans (NPLs) in some European countries. In March 2017, the SSM published an NPL guidance[1] requiring significant banks to submit strategies regarding the effective management and ultimate reduction of NPL stocks. The guidance is mainly targeted at significant banks with high levels of NPLs. In the end of 2017, the SSM published a draft addendum to the guidance setting clear expectations for minimum levels of prudential provisions for newly classified NPLs as of 1 April 2018. In concrete terms, the draft 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. These expectations will be subject to a case-by-case assessment and will not be binding requirements which trigger automatic actions.

Besides NPLs, the targeted review of internal models (TRIM)[2] remained one of the supervisory preoccupations of the SSM with a continued scrutiny of the internal models that significant banks use to calculate the risk-weights of their assets.

Another important area that required major supervisory attention in 2017 was Brexit. In order to prepare for Brexit, the SSM has developed several policy stances that are meant to ensure that relevant issues are dealt with consistently by supervisors throughout the SSM. Against this background, the SSM published FAQs[3] on its banking supervision website clarifying its stance on a number of issues that have arisen in the context of Brexit. Topics that have been covered are for example authorizations and license applications of banks relocating to the euro zone, the assessment of back-to-back booking models, as well as internal governance and risk management expectations.

In May 2017, the ECB also published a guide to fit and proper assessments[4] clarifying criteria and processes for determining suitability of members of the management bodies of significant credit institutions. The aim of the guide is to harmonise the assessment of the qualifications, skills and proper standing of a candidate for a position on the management body of a bank.

The SSM's supervisory priorities for 2018 remain largely unchanged compared to 2017. For the year 2018, the SSM identified business model and profitability risk, credit risk, risk management and activities comprising multiple risk dimensions (e.g. Brexit) as areas of priority.

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

In 2017, the operational framework for the supervision of LSIs has been further streamlined through the development and implementation of additional joint supervisory standards and common methodologies, for instance in the area of the conduct of on-site inspections at LSIs and the supervision of risks arising from specific business models.

During the same period, the ECB has extended the harmonisation of the exercise of certain options and discretions available in EU banking law to the LSI sector. After a public consultation that ended in January 2017, a Guideline[5] and a Recommendation[6] to the national competent authorities were published in April 2017. Through its Circular CSSF 18/682, the CSSF has informed the Luxembourg LSI sector that it intends to comply with the Guideline and the Recommendation.

Another important achievement in 2017 was the finalisation of a common methodology for the Supervisory Review and Evaluation Process (SREP) for LSIs. The methodology is based on that applied to significant institutions and uses the same structural elements and building blocks in a proportionate manner. The final implementation of the new methodology for all LSIs is planned for end 2020.

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[1] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf?e05069a6e704cd149d605466e550f30d.

[2] https://www.bankingsupervision.europa.eu/about/ssmexplained/html/trim.en.html.

[3] https://www.bankingsupervision.europa.eu/banking/relocating/html/index.en.html.

[4] https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170515.en.html.

[5] https://www.bankingsupervision.europa.eu/ecb/legal/pdf/celex_32017o0009_en_txt.pdf.

[6] https://www.bankingsupervision.europa.eu/ecb/legal/pdf/celex_52017hb0010_en_txt.pdf.

Moreover, a guide to assessments of fintech credit institution license applications[7] was published for consultation in autumn 2017. It aims to increase transparency for potential fintech credit institution applicants (i.e. entities with a business model in which the production and delivery of banking products and services are based on technology-enabled innovation).

1.2. European Banking Authority (EBA)

In 2017, the EBA's work continued to focus on issues relating to the practical application of the regulatory requirements under the CRD IV/CRR framework[8], the Bank Recovery and Resolution Directive (BRRD)[9] and the Deposit Guarantee Schemes Directive (DGSD)[10]. A growing number of subjects relating to the practical application of the provisions of the Payment Services Directive 2 (PSD2)[11], which will enter into force in 2018, as well as topics that have been raised in the context of FinTech, consumer protection and Brexit 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

The EBA produced several pieces of work relating to the topic of prudential consolidation and the definition of the regulatory perimeter of prudential consolidation. The consultation paper on draft regulatory technical standards (RTS) on the methods of prudential consolidation in accordance with Article 18 of the CRR was published on 9 November 2017 for a period of three months. Pursuant to Article 18(1), CRR institutions shall fully consolidate all institutions, financial institutions and, as applicable, ancillary services undertakings, that qualify as their subsidiaries or, where relevant, the subsidiaries of their parent financial holding company or parent mixed financial holding company. Under certain circumstances, Article 18 of the CRR allows for the application of a different method of consolidation, namely proportional consolidation, the application of another appropriate method such as the aggregation method or the equity method. The draft RTS elaborate on the conditions and, where relevant, criteria to be taken into consideration by competent authorities when determining whether and how undertakings shall be included in the prudential perimeter of consolidated supervision of an institution or, where relevant, of a parent financial holding company or a parent mixed financial holding company.

The consultation paper was published simultaneously to the EBA Opinion to the European Commission and the EBA Report on the prudential treatment of other financial intermediaries (OFIs) and regulatory perimeter issues. These documents provide a summary of issues identified in the application of the definition of "financial institution" and "ancillary services undertaking", concepts which are of particular relevance to ensure a harmonised application of the European legislative framework on prudential consolidation. In its Opinion and its Report, the EBA observes that these terms are prone to inconsistent interpretation across the EU.

The aforementioned documents are also to be read in conjunction with the Guidelines on the identification and management of step-in risk published by the Basel Committee on Banking Supervision in October 2017. According to the Guidelines, "step-in risk" is the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support. The Guidelines include several indicators that banks should use in order to identify entities bearing step-in risk for the bank. The Guidelines provide certain flexibility on the measures to be applied to address step-in risk.

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[7] https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/licensing_and_fintech.en.html.

[8] 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).

[9] Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD).

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

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

1.2.2. Securitisation and covered bonds

Within the context of the Capital Market Union, a new European securitisation framework aiming to establish a safe securitisation market in Europe was adopted in 2017. The framework comprises two regulations which will apply from 1 January 2019. Regulation (EU) 2017/2402 of 12 December 2017 lays down a general framework for securitisation and creates a specific framework for simple, transparent and standardised securitisation (STS Regulation)[12]. This regulation includes due diligence, risk retention and transparency rules that will apply to all securitisation products. It also defines a set of criteria to identify simple, transparent and standardised (STS) securitisations which are less risky and could qualify for more favourable capital rules under the CRR. Regulation (EU) 2017/2401 of 12 December 2017[13] amends the CRR to make the capital treatment of securitisations for credit institutions and investment firms more risk-sensitive and able to properly reflect the specific features of STS securitisations.

The STS Regulation mandates the EBA to deliver 22 regulatory technical standards (RTS) or guidelines to facilitate its application. On 15 December 2017, the EBA published two consultation papers on draft RTS which specify the requirements for originators, sponsors and original lenders in terms of risk retention and the underlying exposures that are to be deemed homogeneous in terms of asset types, respectively. The EBA is currently working on guidelines which should allow the industry to gain a better understanding of the criteria laid down in the STS Regulation to comply with the requirements for a STS securitisation.

Furthermore, with reference to Articles 243 and 244 of the CRR, the EBA published on 19 September 2017, on its own initiative, the Discussion Paper on the significant risk transfer in securitisation. This discussion paper aims at seeking stakeholders' views on how to further harmonise the regulation and supervision of the risk transfer through securitisation.

1.2.3. Large exposures regime

On 14 November 2017, the EBA published the Guidelines on the treatment of connected clients as defined in the CRR, which will apply from 1 January 2019 and replace the 2009 CEBS Guidelines on the implementation of the revised large exposures regime. Their aim 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 these 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.

Those 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, which apply from 1 January 2017. The EBA Guidelines on limits on exposures to shadow banking provide guidance to institutions as regards the definition of shadow banking entities, as well as the approaches to internally manage exposures to such entities. They do however not include requirements concerning the reporting of such exposures.

1.2.4. Internal ratings-based (IRB) approach for credit risk

In the context of the regulatory review of the IRB approach within the scope of the CRR, the EBA published two documents on 20 November 2017. The EBA's qualitative survey on IRB models of January 2017 allowed to identify the existence of unjustified variability of the capital requirements due to differences in internal models practices. The Guidelines on the estimation of risk parameters for non-defaulted exposures, namely of the probability of default (PD) and the loss given default (LGD), and on the treatment of defaulted exposures under the advanced IRB approach, including estimation of parameters such as expected loss best estimate (ELBE)

[12] 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.

[13] Regulation (EU) 2017/2401 of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

and LGD in-default have been issued with a view to reduce the aforementioned unjustified variability. They provide guidance on definitions and modelling techniques used in the estimation of risk parameters under the advanced IRB approach for both non-defaulted and defaulted exposures. The Report on IRB modelling practices provides an impact assessment for the major policy choices made in the aforementioned guidelines.

1.2.5. Own funds

The EBA is in charge of monitoring the quality of own funds instruments in accordance with Article 80 of the CRR. In this context, the EBA has released several updates of its list of Common Equity Tier 1 (CET1) instruments that are eligible under the CRR. There has been no modification as regards the types of instruments recognised for Luxembourg.

In addition, the EBA has continued to review the terms and conditions of issuances of Additional Tier 1 (AT1) capital of institutions. With a view to further enhance the robustness of institutions' own funds, a project to review the compliance with the CRR of CET1 instruments that were issued before the entry into force of the CRR has been initiated.

On 23 May 2017, the EBA has published an opinion on own funds in the context of the CRD IV/CRR review proposal, together with a report on the monitoring of Common Equity Tier 1 instruments issued by EU institutions.

1.2.6. EBA opinion on Brexit

In October 2017, the EBA released its Opinion on issues related to the departure of the United Kingdom from the EU with a view to provide guidance on supervisory expectations and to address regulatory and supervisory arbitrage risks that arise as a result of increased requests from entities seeking to relocate to the EU27 within a relatively short period of time. This Opinion aims to provide practical recommendations to credit institutions, investment firms and other financial services firms, as well as to EU competent authorities, and to highlight to the European Commission areas of the legislative framework which could be updated to respond to challenges posed by the Brexit.

1.2.7. 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 shall periodically organise and conduct peer reviews of some or all of the activities of the concerned authorities.

In 2017, the EBA issued a peer review report with respect to the EBA Guidelines on the criteria to determine the conditions of application of Article 131(3) of CRD IV in relation to the assessment of other systemically important institutions (O-SIIs). This exercise was aimed at assessing both the effective application across the different EU jurisdictions as well as in certain EEA countries of the provisions set out in these guidelines and the processes implemented by the concerned authorities to achieve an appropriate evaluation of the conditions used to determine institutions as O-SIIs.

1.2.8. Payment services

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

In 2017, the following mandates were finalised and published by the EBA:

- Final draft RTS and ITS on EBA register under PSD2;
- Final Guidelines on professional indemnity insurance under PSD2;
- Final draft RTS on central contact points under PSD2;
- Final Guidelines on security measures for operational and security risks under PSD2;
- Final Guidelines on procedures for complaints of alleged infringements of PSD2;
- Final Guidelines on major incident reporting under PSD2;
- Final Guidelines on authorisation and registration under PSD2;
- Final draft RTS on strong customer authentication and common and secure communication under PSD2.

These RTS and ITS were transmitted to the European Commission for adoption.

1.2.9. Governance

On 26 September 2017, the EBA published the following reports with respect to governance:

- EBA guidelines on the assessment of the suitability of members of the management body and key function holders; and
- the guidelines on internal governance.

These reports will enter into force on 30 June 2018.

Moreover, the CSSF draws attention to the entry into force on 3 January 2018 of the EBA Guidelines of 22 March 2016 on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18) for manufacturers and distributors as an integral part of the general organisational requirements linked to internal control systems of firms.

Finally, the EBA is currently drafting guidelines that specify the requirements to be complied with in relation to outsourcing in order to update the CEBS Guidelines of 14 December 2006. These revised guidelines will take into account the EBA's "Recommendations on outsourcing to cloud service providers" of 20 December 2017 (EBA/REC/2017/03).

1.2.10. Transparency

Following the publication of the document "Revised Pillar 3 disclosure requirements" by the Basel Committee in January 2015, the EBA published, on 14 December 2016, its Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA/GL/2016/11) which aim at ensuring consistent implementation of this Basel document within the EU.

These guidelines do not amend the disclosure requirements defined in Part Eight of Regulation (EU) No 575/2013, but aim at harmonising the presentation of information to be disclosed. The CSSF published Circular CSSF 17/673 in order to draw the attention of the institutions to the aforementioned guidelines which entered into force on 31 December 2017 and with which the CSSF intends to comply in its capacity as competent authority. The guidelines will apply to the disclosures of G-SIIs in accordance with Delegated Regulation (EU) No 1222/2014 and of O-SIIs in accordance with Article 131(3) of Directive 2013/36/EU as specified in the EBA Guidelines (EBA/GL/2014/10).

1.2.11. Consumer protection

In 2017, the EBA published the following documents in respect of consumer protection:

- the Consumer Trends Report 2017;
- the Report on innovative uses of consumer data by financial institutions;
- the Discussion Paper on the EBA's approach to financial technology (FinTech) (EBA/DP/2017/02);
- the Final report on the Guidelines on procedures for complaints of alleged infringements of Directive (EU) 2015/2366 (EBA/GL/13).

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 2017, 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 publications[14] were made in 2017, among others.

On 12 January 2017, ESMA published an opinion (ref.: ESMA50-1215332076-23) in relation to the exclusion of UCITS management companies/AIFMs from the scope of MiFID (MiFIR Intervention Powers). In this opinion addressed to the European Parliament, the Council and the European Commission, ESMA requests clarification at European level in order to allow ESMA and the national competent authorities to apply restrictions and prohibitions directly to UCITS management companies/AIFMs and not only to the entities subject to MiFID.

On 30 January 2017, ESMA published an opinion (ref.: ESMA34-43-296) concerning UCITS share classes. This opinion, addressed to national authorities, which aims at promoting consistency in supervisory practices, follows the consultation launched by ESMA on 6 April 2016 (ref.: ESMA/2016/570) and reflects ESMA's view regarding the structuring of share classes, notably in order to ensure a common investment objective and avoid contagion among classes.

On 7 April 2017, ESMA published its final report (ref.: ESMA34-43-340) following the "Thematic study on notification frameworks and home-host responsibilities" in the context of the UCITS Directive and the AIFMD.

On 13 July 2017, ESMA published an opinion (ref.: ESMA34-45-344) which aims to ensure a consistent supervisory approach in times when, in the light of Brexit, more and more UK-based firms consider reinforcing their position in the EU.

On 20 July 2017, ESMA addressed an opinion (ref.: ESMA34-45-277) to the European institutions (European Parliament, European Commission and Council of the EU) relating to rules governing omnibus accounts and asset segregation under the provisions of the UCITS V Directive and the AIFMD. The opinion presents suggestions to the EU institutions to clarify the legislative provisions concerning (i) the asset segregation requirement at the different levels of the custody chain under the depositary level and (ii) the extent of the CSD exemption under the UCITS Directive and the AIFMD according to which custody of assets by a securities settlement system as designated for the purposes of Directive 98/26/EC should not be considered to be a delegation of custody functions. This opinion is the result of two public consultations held on 1 December 2014 (ref.: ESMA/2014/1326) and on 15 July 2016 (ref.: ESMA/2016/1137) and two roundtables with the industry on 20 July and 14 September 2016.

On 8 August 2017, ESMA published feedback to its consultation paper (ref.: ESMA34-49-82) concerning Regulation (EU) 2017/1131 of 14 June 2017 on money market funds (MMF Regulation). This consultation paper was published on 24 May 2017 and covered the draft technical advice, implementing technical standards and guidelines on issues relating to credit risk assessment, certain types of financial collateral under reverse repo

[14] https://www.esma.europa.eu/regulation/fund-management.

transactions, the reporting to be put into place by money market UCIs and stress tests. On 17 November 2017, ESMA published its final report concerning the MMF Regulation. It summarises the responses received by ESMA in the context of the public consultation of May 2017 and includes the final versions of the draft technical advice, implementing technical standards and guidelines on the stress tests performed by the money market fund managers under the MMF Regulation. It should be noted that one point remained open, namely ESMA's interpretation, disputed by many players, in the consultation paper according to which the unit cancellation mechanism (used by money market UCIs with constant NAV to maintain a constant NAV in a negative interest rate environment) would be prohibited under the new regulation.

During 2017, 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).

2.1.2. Fair value measurement in financial statements under IFRS

On 12 July 2017, ESMA published the report "Review of Fair Value Measurement in the IFRS Financial Statements" (ref.: ESMA32-67-284) which aims at assessing the level of compliance and comparability of financial statements under IFRS 13 in the context of the IASB's Post Implementation Review. Based on a sample of 78 issuers, it can be concluded that the requirements of the standard have been well implemented in general. Areas for improvement include disclosure effectiveness (too general and not entity-specific), information on control premiums/discounts and the link between the level of market activity and fair value.

2.1.3. Consumer protection

ESMA published the following documents in relation to consumer protection:

- on 31 March 2017, a general statement on Product Intervention which provided the opportunity to communicate ESMA's position on contracts for difference (CFDs), binary options and other speculative product offers to retail investors;
- on 31 July 2017, a consultation paper on the guidelines on certain aspects of the MiFID II suitability requirements; the consultation ended on 13 October 2017;
- on 13 November 2017, a statement on initial coin offerings (ICOs) to investors and professionals.

In 2017, ESMA also prepared and published new Q&As concerning MiFID II/MiFIR regulations.

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, 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.

• Review Panel

The purpose of the Review Panel is to assist EIOPA in ensuring consistent and harmonised implementation of EU legislation in the Member States.

In 2017, the CSSF contributed to a peer review in order to assess the investment of assets of institutions for occupational retirement provision in accordance with the prudent person rule. The outcome of this exercise should be published in the second quarter of 2018.

3.2. Committee of European Auditing Oversight Bodies (CEAOB)

Established by Regulation (EU) No 537/2014, the CEAOB 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.

In November 2017, the CEAOB adopted its 2018 work programme. The following priorities have been set: development of the activities of the sub-groups and colleges, sharing experiences following the implementation of the new audit legislation and development of an efficient communication and awareness-raising strategy.

Agents hired in 2017 and 2018: Departments "Accounting, auditing and transparency", "Supervision of specialised PFS", "Supervision of securities markets" and "Single Supervisory Mechanism"

From left to right: Artur PÎNZARI, Nathalie DARAIZE, Luc SCHAUS, Tanja EWERT, Michel MENDES, Laurence COLLING, Iwona SEREDYNSKA, Lynn KARPEN, Vincenzo AMATO, Laurence VIVARIE, Stephanie HECK, Claire Océane CHEVALLIER

Absent: Lauren TOUSSAINT

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 the national and international stage. Both areas have become strongly intertwined and thus the coordination has become 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 is involved in financial stability issues for the whole financial sector, including banks, insurance companies, financial markets and all the activities outside the regular banking system, the so-called shadow banking system 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 the global level. As designated macroprudential authority, the CSSF participates in the ESRB work through its committees and working groups, such as for example the Expert Group on Investment Fund Liquidity and Leverage. The ESRB issues recommendations and opinions which may in return affect practices in 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. More specifically, 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 CRD IV. At 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. Comité du Risque Systémique (CdRS) - Systemic Risk Board (SRB)

The SRB has been established as the Luxembourg macroprudential authority by the law of 1 April 2015[1] with the mandate to coordinate the implementation of macroprudential policy at national level. The SRB 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 SRB is chaired by the Minister of Finance and the BCL is entrusted with the secretariat. The SRB 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 SRB 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 SRB.

In 2017, the SRB met three 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, 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 SRB in 2017 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. The legal text has been approved by the Government and was deposited in Parliament in December 2017. The text foresees the possibility to assure sound lending conditions in mortgage credit in case the SRB detects rising vulnerabilities in household balance sheets[2].

Interlinkages between banks and investment funds and the so-called shadow banking activity were analysed in a working group. The SRB also issued four recommendations on the setting of the countercyclical buffer and one opinion on the institutions considered as systemically important at national level.

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

[2] http://www.chd.lu/wps/portal/public/Accueil/TravailALaChambre/Recherche/RoleDesAffaires?action=doDocpaDetails&id=7218 for the text of the legal proposal and all related documents.

Opinions and recommendations of the SRB and the corresponding CSSF decisions

SRB recommendation/opinion	CSSF relevant decision
Recommendation of the Systemic Risk Board of 2 December 2016 concerning the setting of the countercyclical capital buffer for the first quarter of 2017 (CRS/2017/001)	CSSF Regulation N° 16-15
Recommendation of the Systemic Risk Board of 6 March 2017 concerning the setting of the countercyclical capital buffer for the second quarter of 2017 (CRS/2017/002)	CSSF Regulation N° 17-01
Recommendation of the Systemic Risk Board of 29 May 2017 concerning the setting of the countercyclical capital buffer for the third quarter of 2017 (CRS/2017/003)	CSSF Regulation N° 17-02
Recommendation of the Systemic Risk Board of 5 September 2017 concerning the setting of the countercyclical capital buffer for the fourth quarter of 2017 (CRS/2017/004)	CSSF Regulation N° 17-03
Opinion of the Systemic Risk Board of 9 October 2017 concerning the annual designation and buffer calibration of other systemically important institutions (CRS/2017/005)	CSSF Regulation N° 17-04
Recommendation of the Systemic Risk Board of 30 November 2017 concerning the setting of the countercyclical capital buffer for the first quarter of 2018 (CRS/2017/006)	CSSF Regulation N° 17-05

2. IMPLEMENTATION OF MACROPRUDENTIAL POLICY

The CRD IV framework has endowed national authorities with buffers that specifically 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. 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 SRB 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 example, the Household Finance and Consumption Survey carried out by the BCL in the context of the Eurosystem shows that in aggregate, some 77% of household real assets are in real estate[3]. This is much higher than for example in the neighbouring countries Germany and France, where this value is just above 61% or the euro area where it stands at 67.8%. 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 SRB meetings.

[3] The Household Finance and Consumption Survey (HFCN), second wave, was published in 2017 (data for 2014); please refer to http://www.ecb.europa.eu/pub/economic-research/research-networks/html/researcher_hfcn.en.html for further details.

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 SRB invited member institutions, including the CSSF, to prepare a draft bill with a view to put in place a legal framework for borrower-based measures. The Luxembourg Government deposited the draft bill in Parliament in December 2017. The draft bill enables the SRB in cooperation with the BCL and the CSSF to enact borrower-based measures such as, among others, loan-to-value and debt service-to-income limits.

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 SRB 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 real estate market.

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 is then approved by the SRB. 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. The analysis of the indicators did however not suggest any countercyclical buffer activation as of yet and the rate has been set at 0% by the CSSF for all quarters of 2017[4].

2.3. Structural risk

Structural systemic risks are to be addressed through the O-SII buffer[5]. 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.

In 2017, the CSSF, acting as designated authority, identified eight domestic financial institutions as systemically important. These institutions were designated in a step-wise approach on the basis of CSSF Regulation N° 17-04. As a first step, systemically important institutions are designated according to the EBA

[4] Please refer to CSSF Regulations N° 17-03, N° 17-02, N° 17-01 and N° 16-15 (http://www.cssf.lu/en/documentation/regulations/laws-regulations-and-other-texts/).

[5] 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 Financial Stability Board (www.fsb.org).

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 SRB, designated eight institutions which are required to hold an O-SII buffer in 2018.

Buffer rates for systemically important institutions in Luxembourg

Denomination	Buffer rate as of January 2016	Buffer rate as of January 2017	Buffer rate as of January 2018	Buffer rate as of January 2019
Banque et Caisse d'Épargne de l'État, Luxembourg	0.125%	0.25%	0.375%	0.50%
Banque Internationale à Luxembourg	0.125%	0.25%	0.375%	0.50%
BGL BNP Paribas	0.125%	0.25%	0.375%	0.50%
Deutsche Bank Luxembourg S.A.	0.25%	0.50%	0.375%	0.50%
Société Générale Bank & Trust	0.25%	0.50%	0.75%	1.0%
Clearstream Banking S.A.	-	-	0.375%	0.50%
J.P. Morgan Bank Luxembourg S.A.	-	-	0.375%	0.50%
RBC Investor Services Bank S.A.	-	-	0.375%	0.50%

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

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 2017, the CSSF did not apply any reciprocity measures in the sense that no measures to be reciprocated by the ESRB had been issued.

Nevertheless, in May 2017, the Belgian measure taken in accordance with Article 458 of the CRR which consists in adding five basis points to risk weights on Belgian residential real estate property exposures had expired, and also its reciprocation by the Luxembourg authorities. The reciprocation of an Estonian measure stemming from 2016 is still applicable. In 2016, the CSSF had reciprocated the systemic risk buffer rate of 1% adopted by the Central Bank of Estonia (Eesti Pank) and applied to national exposures of all credit institutions authorized in Estonia. The CSSF requested its application with immediate effect to the concerned Luxembourg credit institutions.

2.5. Shadow banking and interconnectedness between banks and investment funds

Shadow banking is gaining attention at the international level since the financial crisis and the subsequent tightening of bank regulation. The term describes credit intermediation that takes place outside of the regulated banking system. Over the past few years, an enhanced supervision of shadow banking activities has been put in place. Several international institutions including the ESRB at European level and the Financial Stability Board (FSB) investigate this sector and provide an overview at the global level. This is necessary given the international scope of global finance.

The CSSF closely follows and contributes to the ESRB analyses on parallel banking. In May 2017, the second edition of the report "EU Shadow Banking Monitor" jointly prepared by the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC) was published[6]. 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.

In 2017, Luxembourg also participated in the FSB Global Shadow Banking Monitoring Exercise. In the context of this exercise, the authorities reported detailed data on shadow banking and interconnectedness between financial sectors. To this end, the "FSB Global Shadow Banking Monitoring Report" was published in March 2018[7]. The report presents the results of the FSB's seventh annual monitoring exercise, covering data up to end-2016 from 29 jurisdictions, including Luxembourg. The report compares the size and trends of financial sectors across jurisdictions based on sector balance sheet data. It then narrows the focus to those parts of non-bank credit intermediation that may pose financial stability risks (the "narrow measure of shadow banking") based on FSB's methodology.

Finally, considering the importance of the subject for Luxembourg, and given the size of the investment fund industry and the relatively important role of the OFI (Other Financial Institutions) sector, the SRB decided to create two working groups mandated with understanding and quantifying the activities of non-bank financial entities. The BCL chaired the first working group related to assessing the activities of OFIs. The main objective of this work was to improve the quality of data collection related to OFIs and to provide an overview of their activities and any potential risks. In April 2017, a report was published in this context[8]. The second group, related to assessing the linkages between the investment fund sector and the banking sector in Luxembourg, is chaired by the CSSF. The results of this group's work include a first quantification of the shadow banking content of the Luxembourg investment fund sector, which was completed in the context of Luxembourg's first participation in the FSB's global shadow banking monitoring exercise in 2017.

[6] https://www.esrb.europa.eu/news/pr/date/2017/html/esrb.pr170529.en.html.

[7] http://www.fsb.org/2018/03/global-shadow-banking-monitoring-report-2017/.

[8] http://www.bcl.lu/fr/stabilite_surveillance/CRS/Shadow-Banking_CRS-report.pdf.

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 2017, the Basel Committee reached an agreement on the so-called "Basel III" reforms initiated by the G20 as a response to the 2008 financial crisis. The agreement takes into account the public's feedback on the various consultations and the results from the impact studies that the Basel Committee performed over the last years. On 7 December 2017, the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee, approved the proposed reforms. The main point of contention was the floor which limits the benefits that a bank can derive from the use of its own internal risk management models instead of standard methods defined by the regulator. In fine, this disagreement was resolved by meeting halfway. The consensus provides for a maximum benefit of 27.5% at midway between those that asked that advantages do not exceed 25% and those that wanted to allow 30% at least. As a consequence, for banks that obtain the authorisation to use their own risk calculation methods, the necessary own funds to support these risks may not be lower than 72.5% of the risk amount determined in accordance with the standard regulatory approaches.

For Luxembourg banks, which are generally well capitalised, the new rules should not raise any compliance issue. Moreover, the agreement provides that banks have a long transition period until 1 January 2027.

However, the other major project concerning the review of prudential rules, i.e. the treatment of sovereign exposures, did not succeed. Given the lack of consensus on a tightening of the current rules, which are rather favourable for banks, the existing rules will continue to apply.

As regards other regulatory developments with a marked interest for Luxembourg banks, there is the publication on 25 October 2017 of final rules on the identification and measurement of step-in risk. Moreover, in the area of sound practices, the document "Implications of fintech developments for banks and bank supervisors", which is the first publication of the Basel Committee in this fast-developing area, was published on 19 February 2018. Finally, following the public consultation launched on 20 December 2017, the Basel Committee is moving towards an update of its guidelines on stress testing.

In conjunction with its regulatory work, the Basel Committee continued its monitoring and assessment programme for the implementation of the agreed reforms (RCAP programme). Thus, in 2017, it published its RCAP assessments on the LCR liquidity regime implemented by Brazil, China, Switzerland and the United States of America. For Luxembourg, which is host to many banks from these jurisdictions, the RCAP is a useful source of information which helps to assess the regulatory framework applying to the parent banks.

All the publications by the Basel Committee and information on its mission and organisational structure are available on the website www.bis.org, including the documents "Finalising Basel III – in brief" and "High-level summary of Basel III reforms" which present the changes brought about by the Basel III framework.

2. INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

2.1. 42nd 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 Montego Bay from 14 to 15 May 2017, on the occasion of the 42nd Annual Conference of IOSCO.

The Presidents Committee approved a resolution to revise the IOSCO Principles and their methodology.

As regards asset management, the Board progressed its initiatives on liquidity risk management of investment funds, aimed at strengthening the resilience of this form of market-based finance. The work forms part of IOSCO´s efforts to take forward the relevant Financial Stability Board (FSB) recommendations to address potential structural vulnerabilities related to asset management activities.

Moreover, the Board discussed potential enhancements to the governance of the international audit standard-setting process that IOSCO helps to oversee.

In addition, the Board discussed again the systems helping to protect against cybercrime.

IOSCO continues to work in the area of regulatory capacity building of its members.

At the end of the Annual Conference, IOSCO's Multilateral Memorandum of Understanding (MMoU) counted 114 signatories.

Finally, it should be noted that the format of the Annual Conference and of its meetings has been slightly changed and will change further in the future.

2.2. Work of the IOSCO Committees

In 2017, IOSCO published the following documents, drafted by its Committee 5 on Investment Management:

- the report "Findings of the Survey on Loan Funds" (ref.: FR03/2017);
- the "Fourth IOSCO Hedge Funds Survey" which follows a survey in the participating Member States' industry (including Luxembourg) on data as at 30 September 2016 (ref.: FR22/2017);
- the final report on "Good Practices for the Termination of Investment Funds" (ref.: FR23/2017).

On 1 February 2018, IOSCO published recommendations and good practices as regards liquidity management for investment funds (ref.: FR01/2018 and FR02/2018), also prepared by Committee 5.

Based on the final recommendations of the Financial Stability Board (FSB) published on 12 January 2017, IOSCO continues to work on leverage measures until the end of 2018. In addition, IOSCO started working on stock-taking of ETFs in November 2017.

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 (IOSCO Principles) 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.

3. INTERNATIONAL MONETARY FUND (IMF)

- **Luxembourg 2017 FSAP**

The IMF Financial Sector Assessment Program (FSAP) provides an analysis of a country's financial sector vulnerabilities and financial sector development needs. The assessment focuses on the resilience of the sector, the policy and supervisory framework and practices, and the safety nets to manage and resolve a financial crisis.

In 2017, the IMF concluded the FSAP for Luxembourg with the publication of the Financial System Stability Assessment Report and seven Technical Notes on specific topics. The assessment was based largely on discussions held with the Luxembourg authorities and the private sector during the course of 2016. As the main financial sector supervisor, the CSSF contributed to these discussions and ensures the follow-up of the IMF's recommendations included in the published reports.

Agents hired in 2017 and 2018: Department "On-site inspection"

From left to right: Alix HAMMOND, Anthony EMMEL, Daniela CHIRU, Pierre LEGARDIEN, Stijn HUYSENTRUYT, Philippe LEDUR, Agnès OSVILLE, Marie LAFFONT, Mirjam ANDRES, Arnaud DENIS

Agents hired in 2017 and 2018: Department "On-site inspection"

From left to right: Armelle KOUOKAP YOUGANG, Maria MARTINS, Nicolas ROCHEFEUILLE, Isabelle KULCZYNSKI, Joachim SEIFER, Natacha SANTIN, Grégory BAYLE, Marie CHENOUR, Guillaume MARCHAL

CHAPTER V

FINANCIAL INNOVATION

The financial technologies, commonly called FinTech, affect all the financial sector activities. In order to best keep up-to-date with the financial sector developments and to have an insight into the challenges, the CSSF is in permanent contact with both existing and new market players.

In order to continue this proactive approach, the CSSF has taken different initiatives at national level.

• Identification through video chat

Under certain conditions, the CSSF allows professionals of the financial sector to identify/verify the identity of their customer through video conference. The purpose of using such services is to enable professionals to fulfil, in compliance with the regulation and taking, at the same time, into account the new financial technologies, certain tasks regarding the identification and identity verification obligations, as laid down in the Law of 12 November 2004 on the fight against money laundering and terrorist financing.

Following the discussions with the main market players, the CSSF has amended and supplemented the FAQs detailing the conditions for the use of services for the identification through on-line video.

• Permanent contact with market players

The CSSF established a constructive and open dialogue with the FinTech industry by making itself available for all entities wishing to present an innovative project. During these meetings, the CSSF provides the entities with advice and guidelines on the applicable regulatory framework in order to ensure that the project is developed in compliance with the regulations in force. In order to remain reactive, the CSSF is open to consultation regarding the future development of the regulation given the market's expectation.

By enhancing the communication with market players, the CSSF thus offers itself a means to ensure appropriate information from the market players regarding regulation, whilst remaining immersed in market evolution in order to anticipate challenges.

• FinTech Working Group

The CSSF created a working group dedicated to the FinTech sector which is composed of financial sector and CSSF experts in this 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 associated regulation. Thanks to this initiative, the CSSF is able to understand the most innovative business models due to an extensive knowledge of the associated risks and advantages.

In 2017, the FinTech Working Group continued working and concentrated on topics such as robo-advice, blockchain or crowdfunding as well as the outsourcing of cloud services and KYC utilities (know-your-customer utilities), in order to determine whether the current regulation is adapted to the development of the market or whether additional regulation is needed.

Thus, the CSSF carried out, closely with the market players, important work in order to propose a viable regulatory framework for the outsourcing by regulated entities using public clouds. This is also the backdrop to the publication, on 17 May 2017, of Circular CSSF 17/654 on IT outsourcing relying on a cloud computing infrastructure.

• International working groups

Today, FinTech has, more than ever, a very strong international dimension which requires a common and harmonised response from the regulators of the financial 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. The CSSF works with its European and international counterparts on the preparation of European and international standards for managing FinTech players.

At European level, the CSSF is involved in a certain number of working groups organised by the EBA on issues related to the transposition of Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (PSD2) and on a European regulation on financial innovation. The CSSF also participates in the working group focussed on the European regulation of Big Data, jointly organised by the EBA, ESMA and EIOPA. Moreover, the CSSF takes part in working groups organised by ESMA, notably, on the Distributed Ledger Technology, still with a view to finding a common response to the expectations of the financial sector, or by the ECB, in particular on the impact of FinTech on credit institutions.

At international level, the CSSF participates in the SIG Task Force on Financial Technology of the Basel Committee on Banking Supervision in order to study the financial innovations and the views of the foreign authorities in this area. In the context of these exchanges, the CSSF strives to best adapt its actions to the expectations of the financial sector.

It is important to point out that all these thoughts and openings continue to factor in any possible risks arising from the new technologies, whether these risks relate to consumer protection or to the stability of the financial sector. The CSSF's mission is to mitigate the risks at best and to consider adapting the existing financial regulation in accordance with the development of the financial markets.

With a view to enhancing communication, the CSSF encourages the FinTech players to contact the division "Innovation and payments" of the department "Innovation, payments, market infrastructures and governance" or to send an email to innovation@cssf.lu in order to either present an innovative project or request information on the regulatory framework applicable to a project.

CHAPTER VI

SUPERVISION OF BANKS

1. DEVELOPMENTS IN THE BANKING SECTOR IN 2017

1.1. Characteristics of the Luxembourg banking sector

The Luxembourg banking legislation provides for two types of banking licences, namely that of universal banks (135 institutions had this status on 31 December 2017) and that of banks issuing covered bonds (four institutions had this status on 31 December 2017). The main characteristics of the banks issuing covered bonds are the monopoly of covered bonds 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 (94 on 31 December 2017);
- branches of banks incorporated in an EU Member State or assimilated (32 on 31 December 2017);
- branches of banks incorporated in a non-EU Member State (13 on 31 December 2017).

Furthermore, there is one special case: the *caisses rurales* (13 on 31 December 2017) 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 139 entities authorised at the end of the financial year 2017, the number of banks dropped by two entities as compared to 31 December 2016 when 141 entities were active.

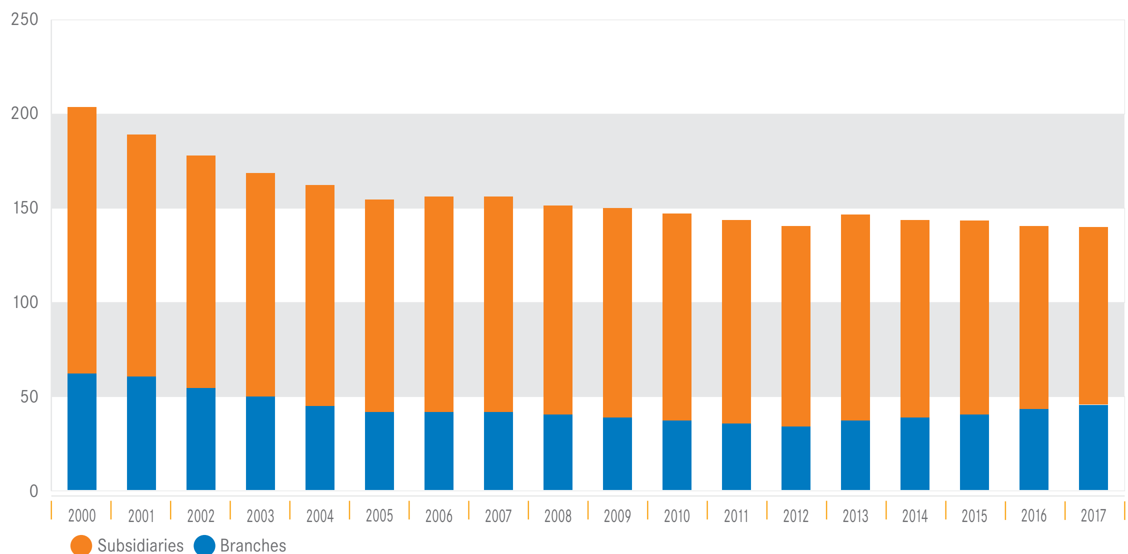
Seven banks were deregistered from the official list during 2017:

• La Française Bank S.A.	2 March 2017: Transfer of the registered office to France and change of business purpose.
• The Bank of New York Mellon (Luxembourg) S.A.	1 April 2017: Cross-border merger by takeover by The Bank of New York Mellon SA/NV and transfer of the activities to The Bank of New York Mellon SA/NV, Luxembourg Branch.
• BSI Europe S.A.	1 May 2017: Merger by takeover by EFG Bank (Luxembourg) S.A.
• Garanti Bank (Luxembourg Branch)	1 July 2017: Cessation of activities.
• Banque Havilland Institutional Services S.A.	1 October 2017: Merger by takeover by Banque Havilland S.A.
• AS Expobank Luxembourg Branch	15 December 2017: Cessation of activities.
• UBI Banca International S.A.	29 December 2017: Merger by takeover by EFG Bank (Luxembourg) S.A.

Five banks started their activities in 2017:

• AS Expobank Luxembourg Branch	9 January 2017: the bank is of Latvian origin and active in corporate banking.
• The Royal Bank of Scotland International Limited, Luxembourg Branch	13 March 2017: the bank originating from Jersey is active in transactional banking.
• RiverBank S.A.	30 March 2017: the bank carries out corporate lending.
• China Everbright Bank (Europe) S.A.	31 July 2017: the bank carries out corporate banking.
• China Everbright Bank Co. Ltd, Luxembourg Branch	22 August 2017: the bank is of Chinese origin and active in corporate banking.

Development in the number of banks established in Luxembourg



The total number of branches established in other EU/EEA Member States amounted to 68 entities as at 31 December 2017. On the same date, the number of branches set up in Luxembourg by credit institutions originating from another EU/EEA Member State totalled 32 entities.

Branches established in the EU/EEA as at 31 December 2017 broken down by Member State

Member State	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	1	-
France	8	4
Germany	3	14
Greece	1	-
Ireland	3	1
Italy	9	-
Netherlands	6	1
Poland	3	-
Portugal	3	2
Spain	9	1
Sweden	2	2
United Kingdom	9	5
Total	**68**	**32**

1.3. Development in banking employment

As at 31 December 2017, the number of employees in Luxembourg credit institutions amounted to 26,149, compared to 26,060 as at 31 December 2016, representing an increase of 89 people on an annual basis.

Whereas employment remained stable in 19% of the banks, the staff increase in 40% of the banks offset the reduction in staff numbers recorded in 41% of the financial centre's banks.

Compared to the figures of December 2016, 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+3" (bachelor) degree was noticeable (+8.2%), whereas employees whose education is equivalent or below the "BAC" degree declined (-3.6%).

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

1.4.1. Balance sheet total of credit institutions

In 2017, the banking sector registered its first decline in activity, as measured by the balance sheet total, in the last four years. This 2.3% decline of the balance sheet total is attributable to 48% of the financial centre's banks, representing 50% of the balance sheet total at the end of 2017.

The banking market concentration as measured by the balance sheet total per bank remained weak at the end of 2017 and stable compared to the index of 2016.

1.4.2. Development of the aggregated balance sheet structure

The trend of 2016 consisting in a redeployment of loans and advances to credit institutions into **loans and advances to central banks and central governments**, in order to comply with the Liquidity Coverage Requirement (LCR) at a sub-consolidated level, slowed down throughout 2017. Consequently, loans and advances to central banks grew by 2.5% in 2017, against +55.9% in 2016.

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 make more use of deposits with central banks deemed as high quality liquid assets eligible for the calculation of the LCR. Even though the use of deposits with central banks slowed down in 2017, this trend led to a greater fragmentation of financial flows within the euro area. This fragmentation also appeared in the liabilities of the Luxembourg banks, especially in **amounts owed to credit institutions**, which decreased by 8.1% year-on-year.

Fixed-income transferable securities recorded a net decrease of 12.9% over a year. This decrease in holdings of debt instruments was noted in every category of counterparties, i.e. central administrations, credit institutions as well as financial and non-financial undertakings. **Variable-yield transferable securities** also recorded a downward trend. All in all, the portfolios of equity instruments and debt instruments have been decreasing since 2015.

Finally, **amounts owed to customers**, consisting of deposits made by undertakings, private customers and/or retail customers, as well as of current accounts of investment funds, continued rising in 2017 (+2.6%). Although the automatic exchange of financial account information between Member States was introduced in January 2015, this source of financing of Luxembourg credit institutions kept developing positively.

Aggregate balance sheet total – in million EUR

ASSETS	2016	2017[1]	Variation	LIABILITIES	2016	2017[1]	Variation
Loans and advances to central banks and central governments	114,535[2]	116,447	1.7%	Amounts owed to central banks	10,834	8,537	-21.2%
Loans and advances to credit institutions	268,030[2]	266,680	-0.5%	Amounts owed to credit institutions	253,581	232,965	-8.1%
Loans and advances to customers	215,515	223,113	3.5%	Amounts owed to customers	352,778	362,031	2.6%
Financial assets held for trading	9,308	7,029	-24.5%	Amounts owed represented by securities	59,312	62,065	4.6%
Fixed-income securities	137,158	119,460	-12.9%	Liabilities (other than deposits) held for trading	8,783	4,944	-43.7%
Variable-yield securities	9,786	7,684	-21.5%	Provisions	3,578	3,381	-5.5%
Fixed assets and other assets	15,650	11,489	-26.6%	Subordinated liabilities	4,411	4,117	-6.7%
				Other liabilities	15,386	13,349	-13.2%
				Capital and reserves	61,319	60,513	-1.3%
Total	**769,982**	**751,902**	**-2.3%**	**Total**	**769,982**	**751,902**	**-2.3%**

[1] Preliminary figures.

[2] Restatement of the 2016 figures of loans and advances to central banks and central governments and loans and advances to credit institutions as presented in the Annual Report 2016. The increased granularity on the banks' current accounts initiated by the new FINREP reporting, submitted for the first time by all the Luxembourg banks for the financial year 2017, induced the necessity to reclassify this item between loans and advances to central banks and central governments and loans and advances to credit institutions.

Structure of the aggregated balance sheet

ASSETS	2016	2017[3]	LIABILITIES	2016	2017[3]
Loans and advances to central banks and central governments	14.87%[4]	15.49%	Amounts owed to central banks	1.41%	1.14%
Loans and advances to credit institutions	34.81%[4]	35.47%	Amounts owed to credit institutions	32.93%	30.98%
Loans and advances to customers	27.99%	29.67%	Amounts owed to customers	45.82%	48.15%
Financial assets held for trading	1.21%	0.93%	Amounts owed represented by securities	7.70%	8.25%
Fixed-income securities	17.81%	15.89%	Liabilities (other than deposits) held for trading	1.14%	0.66%
Variable-yield securities	1.27%	1.02%	Provisions	0.46%	0.45%
Fixed assets and other assets	2.03%	1.53%	Subordinated liabilities	0.57%	0.55%
			Other liabilities	2.00%	1.78%
			Capital and reserves	7.96%	8.05%
Total	**100.00%**	**100.00%**	**Total**	**100.00%**	**100.00%**

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)*	2016	2017[5]	Variation		Structure	
			in volume	in %	2016	2017[5]
Interest rate derivatives	167.9	173.7	5.8	3.5%	22.3%	24.3%
Equity derivatives	18.6	18.2	-0.4	-2.0%	2.5%	2.6%
Foreign exchange derivatives	559.2	510.0	-49.3	-8.8%	74.4%	71.4%
Credit derivatives	6.1	12.0	5.9	97.4%	0.8%	1.7%
Total	**751.8**	**713.8**	**-37.9**	**-5.0%**	**100.0%**	**100.0%**

1.4.4. Off-balance sheet

As at 31 December 2017, the contingent exposures of the Luxembourg banking sector through loan commitments and financial guarantees amounted to EUR 167.6 billion, against EUR 171.9 billion at the end of 2016, representing a 2.5% fall over one year.

1.5. Development in the profit and loss account

Net profit for the year 2017 substantially dropped (-20.1%) compared to the financial year 2016. Despite the positive development of income generated by the main businesses of the credit institutions (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 this negative result at aggregated level.

[3] Preliminary figures.

[4] Restatement of the 2016 figures of loans and advances to central banks and central governments and loans and advances to credit institutions as presented in the Annual Report 2016. The increased granularity on the banks' current accounts initiated by the new FINREP reporting, submitted for the first time by all the Luxembourg banks for the financial year 2017, induced the necessity to reclassify this item between loans and advances to central banks and central governments and loans and advances to credit institutions.

[5] Preliminary figures.

Development in the profit and loss account – in million EUR

	2016	Relative share	2017[6]	Relative share	Variation	
					in volume	in %
Net interest income	4,717	38%	4,877	42%	160	3.4%
Net fee and commission income	4,602	37%	4,727	41%	125	2.7%
Other net income	3,038	25%	1,974	17%	-1,064	-35.0%
Banking income	**12,357**	**100%**	**11,578**	**100%**	**-779**	**-6.3%**
General expenses	-6,040	-49%	-6,233	-54%	193	3.2%
of which: staff costs	*-3,109*	*-25%*	*-3,157*	*-27%*	*48*	*1.5%*
of which: general administrative expenses	*-2,931*	*-24%*	*-3,076*	*-27%*	*145*	*4.9%*
Profit before provisions	**6,317**	**51%**	**5,345**	**46%**	**-972**	**-15.4%**
Net creation of provisions	-757	-6%	-727	-6%	-30	-4.0%
Taxes	-820	-7%	-830	-7%	10	1.3%
Net profit for the year	**4,740**	**38%**	**3,788**	**33%**	**-952**	**-20.1%**

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. Over a year, the substantial decrease of 35% recorded during 2017 stemmed to 70% from the gain realised following an exceptional transaction by one bank of the financial sector in 2016. Excluding this exceptional element, other net income only fell by 14% and banking income only recorded a slight contraction of 0.3% year-on-year (against an actual decline of 6.3%).

Besides other net income, **general expenses**, which grew by 3.2%, greatly contributed to the negative development of the net profit for the year 2017. Among general expenses, general administrative expenses registered the most significant increase with 4.9% during 2017. The ongoing rise of general expenses was a phenomenon observed for the last three years and impacted the majority of the financial centre's credit institutions (64%). 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 brought about a lack in profitability outlook for a number of banks of the financial centre. In fact, in addition to cases specific to each bank, the lack of economies of scale as well as the weakness of targeted business models represented the main difficulties of these credit institutions to make their operations profitable. The number of banks recording a cost-to-income ratio exceeding 100% and active for at least three years amounted to 18, representing about 4% of the balance sheet total of the financial centre and 3% of overall employment in the banking sector. Despite the lack of profitability of these credit institutions, the Luxembourg banking sector showed a solid aggregated profitability as evidenced by the cost-to-income ratio of 54% during 2017.

1.5.2. Positive developments of the profit and loss account

In 2017, **net interest income** (+3.4%) continued its favourable development observed in the last years. The increase of this item was shared by 59% of the credit institutions, representing 60% of the aggregated banking income of the financial centre. For these banks, several major factors explain individually or collectively the improvement of the net interest income recorded in 2017. Thus, 59% of these credit institutions recorded a growth in the volume of activities and 67% managed to improve their average return on assets. 33% of these banks experienced a joint effect of both factors. Some banks also started passing through negative interest

[6] Preliminary figures.

rates to their institutional customers. Hence, despite the persistence of extremely low interest rates, the positive development of net interest income in the last years resulted from growth in the volume of activities for most of the banks and the implementation of exceptional measures such as the application of negative interest rates. 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 2.7% year-on-year. This growth was shared by 58% of Luxembourg banks which could benefit from a favourable stock exchange market throughout 2017.

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

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017[7]
Net interest income	5,792	5,807	4,761	4,960	4,671	4,281	4,066	4,496	4,717	4,877
Net fee and commission income	3,644	3,132	3,587	3,832	3,727	3,962	4,101	4,720	4,602	4,727
Other net income	1,001	1,614	1,201	76	1,401	2,213	2,217	2,262	3,038	1,974
Banking income	**10,437**	**10,553**	**9,549**	**8,868**	**9,800**	**10,455**	**10,384**	**11,477**	**12,357**	**11,578**
General expenses	-4,560	-4,451	-4,609	-4,789	-4,994	-5,198	-5,005	-5,942	-6,040	-6,233
of which: staff costs	*-2,461*	*-2,449*	*-2,497*	*-2,535*	*-2,622*	*-2,745*	*-2,624*	*-3,065*	*-3,109*	*-3,157*
of which: general administrative expenses	*-2,099*	*-2,002*	*-2,112*	*-2,253*	*-2,372*	*-2,453*	*-2,381*	*-2,878*	*-2,931*	*-3,076*
Profit before provisions	**5,877**	**6,102**	**4,939**	**4,080**	**4,806**	**5,258**	**5,379**	**5,535**	**6,317**	**5,345**
Net creation of provisions	-5,399	-3,242	-498	-1,572	-765	-865	-327	-577	-757	-727
Tax[8]	-259	-804	-625	-18	-503	-762	-799	-888	-820	-830
Net profit for the year	**218**	**2,056**	**3,817**	**2,490**	**3,538**	**3,631**	**4,253**	**4,070**	**4,740**	**3,788**

1.6. Prudential ratios

1.6.1. Solvency ratios

• Regulatory framework and calculation approaches implemented

In accordance with Article 92(1) of Regulation (EU) No 575/2013 (CRR), 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 (net of deductions) in the numerator and the total risk exposure amount in the denominator as defined in Article 92(3) of the CRR.

Besides the minimum requirements as laid down in Article 92 of the CRR and the specific capital requirements pursuant to Article 53-1 of the Law of 5 April 1993 on the financial sector, Luxembourg banks must hold capital buffers in accordance with Chapter 5 of Part III of the above-mentioned law. Therefore, based on Article 59-5 of the Law of 5 April 1993, the banks must hold a Common Equity Tier 1 capital conservation buffer equal to 2.5% of the total amount of their risk exposures. As a result, the above-mentioned three ratios that the credit institutions must comply with equal 7%, 8.5% and 10.5% respectively.

[7] Preliminary figures.

[8] As from 1 January 2008, the prudential reporting is based on the IFRS standards. These standards allow, in particular, activating future tax charges by crediting the tax charges account. Due to these positive tax charges, there are, depending on the year, material deviations from the «real» tax burden which, based on the LUX-GAAP standards, is used to determine the basis for the calculation of the taxes due to the tax administration. This was especially the case during 2009 and 2012.

In addition, pursuant to CSSF Regulation N° 16-08 and the opinion of the Systemic Risk Board, the CSSF designated six credit institutions (among which one credit institution transformed into a branch originating from an EU Member State) as other systemically important institutions within the meaning of Article 59-3 of the above-mentioned law during a period running from 1 January 2017 to 31 December 2017. 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 three years as from 1 January 2016. Pursuant to CSSF Regulation N° 17-04 and the opinion of the Systemic Risk Board, the CSSF designated eight credit institutions as other systemically important institutions within the meaning of Article 59-3 of the above-mentioned law for the period running from 1 January 2018 to 31 December 2018.

Moreover, in accordance with Article 59-6 of the Law of 5 April 1993, 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 2017 in CSSF Regulation N° 17-03. Finally, reference is made to point 2.3.2. which describes Pillar 2 capital requirements that the banks must comply with aside from those of Pillar 1 described above.

As at 31 December 2017, 10 banks were authorised to use the internal ratings-based approach regarding credit risk, seven of which 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 were exclusively significant banks within the meaning of the SSM. They represented 32.5% of the aggregate balance sheet total of the financial centre as at 31 December 2017.

As regards operational risk, nine banks (among which seven significant banks within the meaning of the SSM) had an authorisation to use the AMA approaches. The other banks used the basic indicator approach (65 banks) and the standardised approach (20 banks) to determine the capital requirements for operational risk.

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

Information of the internal models used by banks are also available under "Review of the approaches used to calculate the risk exposure amounts" hereunder.

• Solvency ratios

At aggregate level, the total weighted average capital ratio for the financial centre was 25.9% as at 31 December 2017, representing an increase compared to the weighted average ratio of 24.8% as at 31 December 2016. 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 25.1% as at 31 December 2017 (a rise compared to 24.1% at the end of 2016). The Common Equity Tier 1 capital ratio (CET1 ratio) was 24.5% as at 31 December 2017 (a rise compared to 24.0% at the end of 2016). 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.

The high level of capitalisation was also reflected at disaggregated 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 2017. However, it should be remembered that for banks whose ratio falls below 10.5%, restrictions in terms of bonus and dividend payments apply (Article 59-13 of the Law of 5 April 1993 on the financial sector).

Distribution of the solvency 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%	0
10%-12%	6	9%-10%	0	11%-12%	3
12%-15%	6	10%-11%	0	12%-13%	2
>15%	82	>11%	94	>13%	89
Total	**94**		**94**		**94**

• Elements of own funds

Aggregated own funds, eligible for the purpose of complying with prudential standards in terms of solvency, amounted to EUR 51,542.9 million as at 31 December 2017, i.e. an increase of 2.8% compared to 31 December 2016.

Elements of own funds

	2016		2017	
	Amount *(in million EUR)*	Relative share	Amount[9] *(in million EUR)*	Relative share
Own funds	**50,120.4**	**100.0%**	**51,542.9**	**100.0%**
Tier 1 capital	**48,693.1**	**97.2%**	**49,990.5**	**97.0%**
Common Equity Tier 1 capital (CET1)	**48,533.8**	**96.8%**	**48,831.9**	**94.7%**
Capital instruments that qualify as CET1 capital	27,748.5		27,009.8	
Retained earnings, other reserves, funds for general banking risks	24,449.1		25,357.4	
Other accumulated comprehensive income	1,426.9		1,164.5	
Minority interests	0.1		8.3	
Adjustments of CET1 deriving from prudential filters	-153.6		-106.3	
(-) Intangible assets, goodwill and differed tax assets	-1,925.2		-2,127.6	
(-) Holdings in financial instruments of financial sector entities	-328.7		-328.7	
(-) Other deductions	-2,683.3		-2,241.4	
Additional Tier 1 capital (AT1)	**159.3**	**0.3%**	**1,158.6**	**2.2%**
Capital instruments that qualify as AT1 capital	159.2		1,158.6	
Other items that qualify as AT1 capital	0.0		0.0	
(-) Deductions from AT1 capital	0.1		0.0	
Tier 2 capital (T2)	**1,427.3**	**2.8%**	**1,552.3**	**3.0%**
Capital instruments and subordinated loans that qualify as T2 capital	1,407.5		1,544.7	
Other items that qualify as T2 capital	94.2		81.7	
(-) Deductions from T2 capital	-74.4		-74.1	

[9] Preliminary figures.

• Risk-weighted exposure amounts

The risk-weighted exposure amounts recorded a slight decrease of EUR 3,175.5 million (i.e. -1.6%) between the end of 2016 and the end of 2017 to stand at EUR 199,189.6 million. This development was almost entirely due to the reduction of risk-weighted exposure amounts for credit risk which dropped by EUR 3,675.7 million. Credit risk remained the most important type of risk for the financial centre's credit institutions with 86.8% of the risk-weighted exposure amounts, followed by operational risk with 11.1%.

As at 31 December 2017, the average credit risk weight of banks in the financial centre amounted to 28%. This reflects the fact that the banks had exposures to obligors which benefited from a good credit assessment (mainly to rated institutions, rated corporations and central administrations) 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) of 1.7% at the end of December 2017.

Risk exposure amounts

(in million EUR)	2016	in %	2017[10]	in %
Total risk-weighted exposure amount	**202,365.1**	**100.0%**	**199,189.6**	**100.0%**
Risk-weighted exposure amounts for credit risk, counterparty risk and dilution risks and free deliveries	176,566.2	87.3%	172,890.5	86.8%
of which: Standardised Approach (STA)	*131,705.8*	*65.1%*	*125,810.7*	*63.2%*
of which: Internal ratings-based approach (IRB)	*44,859.5*	*22.2%*	*47,078.9*	*23.6%*
Total clearing/settlement risk exposure amount	0.5	0.0%	1.2	0.0%
Total position risk, foreign-exchange risk and commodity risk exposure amount	2,446.5	1.2%	1,800.0	0.9%
Total operational risk exposure amount	21,763.9	10.8%	22,072.2	11.1%
Total credit valuation adjustment risk exposure amount	1,047.5	0.5%	1,101.4	0.6%
Other risk exposure amount	540.6	0.3%	1,324.2	0.7%

• Review of the approaches used to calculate the risk exposure amounts

The internal ratings-based approaches used by banks to determine the risk 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 in Luxembourg 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 mainly 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 undue variability of risk weights that these internal models can achieve as well as the harmonisation of the 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 monitoring process for internal models, including relevant supervisory measures. In the context of its prudential supervision, the CSSF analysed in 2017, among others, the adequacy of the internal model validation as well as the EBA benchmarking results for Luxembourg significant banks whose group head was domiciled in Luxembourg.

Regarding credit risk, the ECB had three on-site inspections carried out at Luxembourg banks using the internal ratings-based approach in 2017. Two of these inspections were under the authority of a CSSF head of mission and all inspections included, among other people, CSSF agents. These inspections were linked to requests for the 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.

[10] Preliminary figures.

In addition to the inspections described above, the ECB continued working on the TRIM project (Targeted Review of Internal Models) which aims to restore confidence in the internal ratings-based approaches as well as their credibility. This major project, which spans over a period of several years, mobilises significant resources, including at the CSSF. In 2017, two on-site inspection missions, which were under the authority of a CSSF head of mission, were carried out in the framework of this project. They concerned internal models of credit risk relating to retail mortgage loans of banks whose group head was domiciled in Luxembourg.

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, this ratio is not yet binding. However, it is used as an instrument to monitor liquidity.

• Liquidity Coverage Requirement (LCR)

As at 31 December 2017, the weighted average of the LCR of Luxembourg banks and Luxembourg branches of banks that have their registered office outside the EU amounted to 236% as compared to 230% at the end of December 2016. The regulatory minimum to be observed amounted to 80% at the end of December 2017.

On the aggregated 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 2017, the CSSF was confronted with a very small number of breaches of the minimum regulatory threshold of 80%. After analysis, these breaches were explained by involuntary negligence rather than real liquidity insufficiencies. Every breach led to a monitoring of the swift restoration of the compliance with the regulatory minimum as well as to an examination of the appropriate measures to avoid repetition. As at 31 December 2017, no breach was noted.

As regards reporting, Commission Implementing Regulation (EU) 2017/2114 of 9 November 2017 supplements the reports on additional monitoring elements regarding liquidity with a maturity ladder. This new reporting table, which is applicable as from March 2018, will allow capturing maturity mismatch 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 179% in December 2017, as against 130% at the end of December 2016. 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 risk ratio

Luxembourg banks have a low asset encumbrance risk ratio. As at 31 December 2017, this ratio amounted to 9.07% on weighted and aggregated basis, showing that most of the Luxembourg banks' assets were unencumbered. Only nine banks had an asset encumbrance risk 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 2017 did not witness any particular event leading to liquidity strains for banks.

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 often covered using resources of the group. The management of liquidity 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, 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 shall take measures at least in the case of CRR institutions whose economic value declines by more than 20% of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or equivalent as given in the EBA guidelines. The review and evaluation are 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 2017, the Luxembourg banking sector as a whole was only moderately exposed to structural interest rate risk. Indeed, the average of regulatory ratios (reporting simulated losses following a scenario of changes in the interest rates over eligible own funds) amounted to -4.1%. In other words, the impact of an immediate 2% rise in overall interest rates would have cut the intrinsic value of the financial centre's banks only by about 4.1% of their own funds.

As far as dispersion of results is concerned, 67% of the banks of the financial centre had a ratio higher than or equal to -5% and only 2% of the banks had a ratio of less than -15%. In 2017, the CSSF identified two banks whose regulatory ratios were less than -20%, a threshold which requires the authorities to take measures pursuant to CRD IV. Hence, the CSSF entered into contact with these banks to receive supplementary information. After analysis, it was decided that an on-site inspection would be carried out at one of these banks in 2018.

Supervision of the interest rate risk according to Circular CSSF 08/338 did not lead the CSSF to adopt other specific measures in 2017. Given the current context of historically low interest rates and the concomitant pressure on income, the CSSF continues to closely monitor the taking of structural interest rate risk. In general, the CSSF reminds banks of their obligation to manage interest rate risks in a prudent and sound 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 December 2017, the EBA published a consultation paper on new rules regarding management of interest rate risk arising from non-trading book activities 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 to the term structure of interest rates. Moreover, the reference threshold under CRD IV, set at 20% of total own funds, remains in force.

2. PRUDENTIAL SUPERVISORY PRACTICE

2.1. Organisation of the supervision

Since the introduction of the Single Supervisory Mechanism (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 directly authorises any new bank which intends to be established in Luxembourg, any acquisition of qualifying holdings in banks established in Luxembourg, as well as all the withdrawals of banking licenses. The ECB also authorises the managers and directors of significant banks.

At the end of 2017, 56 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 69.5% of the total assets of the Luxembourg banks.

Seventy banks were considered as less significant institutions (LSIs) and 13 banks 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. In 2017, 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. 28 supervisors and eight experts.

Banks established in Luxembourg by category

SSM status	Number of banks	In % of assets
Significant institutions - SIs	38	51.9%
Branches of an SI	18	17.5%
High-priority less significant institutions - High-priority LSIs	7	7.1%
Less significant institutions - LSIs	56	13.3%
Branches of an LSI	7	1.4%
Outside the scope of SSM	13	8.7%
Total	**139**	**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 endeavours to increasingly harmonise the supervision of less significant banks.

The SSM's supervisory approach is described in detail in the document "Guide to banking supervision"[11].

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 authorisation of new credit institutions in all euro area countries is granted exclusively by the ECB. The CSSF remains competent for the authorisation of branches of non-EU credit institutions.

[11] Weblink: 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.

However, the CSSF is still the entry point for the submission of all the authorisation files. Upon reception of an application, the CSSF first informs the ECB thereof and then analyses the file in order to verify compliance with the legal and regulatory requirements. 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 2017, the CSSF worked on 10 authorisation requests for new credit institutions and branches of non-EU banks. Three authorisations were granted to credit institutions by the ECB in 2017. One authorisation request for a branch of a non-EU bank was approved by the Minister of Finance. One credit institution gave up its license granted by the ECB and six files are still being examined in 2018. Moreover, the CSSF met with 15 entities which were interested in opening a bank in Luxembourg.

2.2.2. Authorisation for acquisitions of qualifying holdings

Like the authorisation of a new institution which requires prior examination of the file by the CSSF, including the authorisation of its shareholders, the subsequent acquisition of holdings that reach or exceed 10% of the capital (known as qualifying holdings) must also be examined by the CSSF and authorised by the ECB. In 2017, the CSSF examined 18 files regarding acquisitions of qualifying holdings, 15 of which were authorised by the ECB during the year.

2.2.3. Authorisation of directors and managers of banks

In 2017, the CSSF dealt with 213 files regarding the nomination of new directors and authorised managers in Luxembourg credit institutions. The nominations in 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 LSIs 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, evaluate 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; and
- 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 reports[12].

The CSSF requires, on a yearly basis, a long form report from every Luxembourg credit institution as well as from Luxembourg branches of non-EU 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* (statutory auditors) 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, when need be 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 about the business strategy 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 transparency of the prudential supervision.

[12] 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 the banks under standard supervision. Moreover, individual meetings regarding banks under enhanced supervision are organised with the *réviseurs d'entreprises* agréés every year.

Number of meetings

	2015	2016	2017
Meetings with the senior management of banks or persons responsible for the control functions	185	273	399
Meetings with other stakeholders (including other supervisors or external auditors)	44	50	78

• 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, 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.

As regards the SREP 2017, 2% of the less significant institutions remaining under the direct supervision of the CSSF received an overall score of 1, 67% of them received a score of 2 and 31% of them received a score of 3. No bank received a score of 4. Based on the outcome of the SREP, the CSSF decided to require additional own funds for half 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%, as against 8.3% in 2016. 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 199 observation letters to banks during 2017.

2.4. Supervision on a consolidated basis

As at 31 December 2017, 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 were banks incorporated under Luxembourg law (19 in 2016), three were financial holding companies incorporated under Luxembourg law (idem in 2016) and one was a financial holding company incorporated under foreign law established in another EU Member State (idem in 2016).

Ten (13 in 2016) 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 control 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, the scope, content and means of supervision on a consolidated basis are specified in Chapter 2, Title II of Part I of Regulation (EU) No 575/2013.

In accordance with the European regulations, the main prudential standards and norms to be complied with by an institution or a financial holding company at a consolidated level concern:

- consolidated own funds;
- observance of the consolidated solvency ratios;
- large exposure limits on a consolidated basis;
- arrangements concerning exposures to transferred credit risk;
- consolidated liquidity;
- consolidated leverage ratio;
- information to be published (Pillar 3).

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 company communicates its policies and strategies to its subsidiaries as well as in the controls set up at the Luxembourg parent undertaking 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 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 2017, 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 of supervisory authorities set up for these banking groups. In 2017, the CSSF participated in 30 meetings of supervisory colleges, among which four supervisory colleges organised by the supervisory authorities from non-EEA countries, which concerned in total 22 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 2017, 33 MoUs were in force and the CSSF was party to eight WCCAs. Some MoUs were or will be replaced by MoUs signed by the ECB instead of the CSSF, thus reflecting the new organisation of the banking supervision within the euro area.

The 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 imposes capital surcharges 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 joint missions carried out by the authorities from different countries participating in the colleges and the delegation of work between authorities.

2.5.2. Cooperation with other authorities

Besides the institutionalised cooperation in JSTs and colleges, the CSSF works closely with the foreign supervisory authorities within the context of the consultations provided for by the European directives and in all circumstances in which cooperation is needed. Cooperation generally takes place in the form of requests for advice, information or assistance initiated or received by the CSSF. In this context, the CSSF sent 114 letters to supervisory authorities in 2017.

An annual meeting takes place between the CSSF and the FINMA (Swiss supervisory authority) in order to exchange information on banking groups established in both countries.

In 2017, the CSSF visited for the first time the China Banking Regulatory Commission and both agreed on annual meetings to be held in the years to come.

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, within the context of the assessment of the professional standing conditions to be complied with by the persons called upon to form part of the authorised management or the Board of Directors of a bank, the CSSF refers to the State Prosecutor's office of the *Tribunal d'arrondissement* (District Court) of Luxembourg and to the Grand-ducal Police.

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:

- comprehensive and effective 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 2017, the CSSF received 44 recovery plans (including three group recovery plans) of which it assessed the comprehensiveness, the quality and the general credibility. As the host authority, the CSSF participated in 15 joint decisions on group recovery plans. It also contributed to the assessment of recovery plans of significant institutions consolidating in Luxembourg. 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. Risk-based approach in relation to the fight against money laundering and terrorist financing (AML/CFT)

The CSSF is the competent authority to ensure compliance with the professional obligations in relation to AML/CFT by all the persons subject to its supervision.

Within the Luxembourg banking sector, the monitoring of the compliance with these obligations is fully integrated in the banking supervision framework described under point 2.3. Thus, the supervision of ML/FT risks is subject to a multiannual control programme which combines off-site and on-site supervision. Off-site supervision includes among other the analysis of the work carried out by the *réviseur d'entreprises agréé* (approved statutory auditor) with respect to ML/FT risks, the analysis of the reports from the Compliance function and, where applicable, the internal audit as well as annual meetings with the Compliance officers and internal auditors in order 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 of the CSSF described below. On-site supervision consists mainly of on-site inspections. The final assessment resulting from the analyses and inspections is reflected in the RAS[13], in the sub-categories of the internal governance and operational risks. In case of non-compliance with the professional obligations, the legal sanctions regime is applied.

These last years, the business profile of private banking in Luxembourg significantly changed with more international, less EU-based and wealthier customers who seek tailored solutions. As these changes came to coincide with more political and geopolitical uncertainty, the ML/FT profile of private banking got riskier. As a result, in 2017, the department "Supervision of banks" revised its assessment method for ML/FT banking risks. Based at first on essentially qualitative information, like the report from the Compliance function or the long form report of the *réviseur d'entreprises agréé*, the assessment of the ML/FT risk includes henceforth an annual collection of quantitative and qualitative data 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 bank an ML/FT risk rating. This automatic rating may be adjusted at the margin following expert judgement, based on qualitative considerations. The final product is a global rating of the ML/FT risk. These global ratings serve to prepare the control programme of the CSSF. They are used to allocate the available resources (on- and off-site) to the AML/CFT controls in accordance with the basic principle of risk-based supervision. In addition, the collected data allow digging into 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 still higher level of granularity, the inherent risk may be analysed in terms of the origin of the clients and the funds ("geographical risk"), the different activities of the bank or the products and services offered by the bank. By aggregating the information according to these perspectives, the CSSF obtains sectoral information which serves to prepare more global analyses, like the ML/FT risk assessment on a national or European level.

[13] Cf. point 2.3.

2.8. Financial Sector Assessment Program (FSAP)

During the last quarter of 2016, the International Monetary Fund (IMF) carried out an in-depth analysis of the Luxembourg financial sector under its Financial Sector Assessment Program. This analysis follows those performed in 2001 and 2010. The work resulted in a series of publications, among which two technical notes ("Selected Issues in Banking Supervision" and "Risk Analysis") which are directly linked to the prudential supervision of banks established in Luxembourg[14].

The main recommendations of the IMF are summarised on page 9 of the consolidated document "Financial System Stability Assessment"[15] (FSSA) published in May 2017. The category "Banking Regulation and Supervision" contains the following four recommendations:

1. increase the intensity of supervision over intra-group exposures, with banks required to demonstrate continued eligibility in their use of large exposure limit waivers;
2. continue monitoring ability of banks to absorb a real estate market price decline;
3. increase frequency of on-site inspections of subsidiaries of significant banks within the meaning of the SSM[16];
4. harmonise data reporting standards for loan-to-value and debt-to-income ratios with respect to mortgages.

Point 4, directly linked to Recommendation 2016/14 of the European Systemic Risk Board on closing real estate data gaps, is subject to a follow-up by the CSSF's macroprudential team. Point 3 is directly addressed to the ECB since the Luxembourg subsidiaries of significant banks are directly supervised by the ECB.

The first two points underwent continuous improvements these last three years. These developments were shared with the IMF which, following its 2018 mission under Article IV of its Articles of Agreement, noted that the implemented measures were appropriate. The concluding statement of the mission, published on 9 February 2018, only restates that "rigorous supervision of the waivers for large exposure limits of internationally-oriented banks is important".

Moreover, the FSSA certifies good resilience of the Luxembourg banking sector. Based on the stress tests applied to a representative sample of 16 banks, the IMF notes a good deal of resilience in the face of severe shocks affecting solvency and a sound liquidity situation in the Luxembourg banking sector[17]. These elements confirm the recurring analyses carried out by the CSSF which show that the Luxembourg banking sector is resilient when faced with adverse developments with respect to solvency and liquidity and that contagion effects inside the Luxembourg financial sector are limited.

2.9. Supervision of central securities depositaries having banking status

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

In Luxembourg, one bank currently exercises an activity which requires the 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 a customised link (Article 19 of the CSDR);
- the authorisation to provide, under the banking licence, ancillary banking 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, some of them several times, during the handling of the authorisation files.

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[14] The publications are available on the IMF's website at http://www.imf.org/en/countries#L.

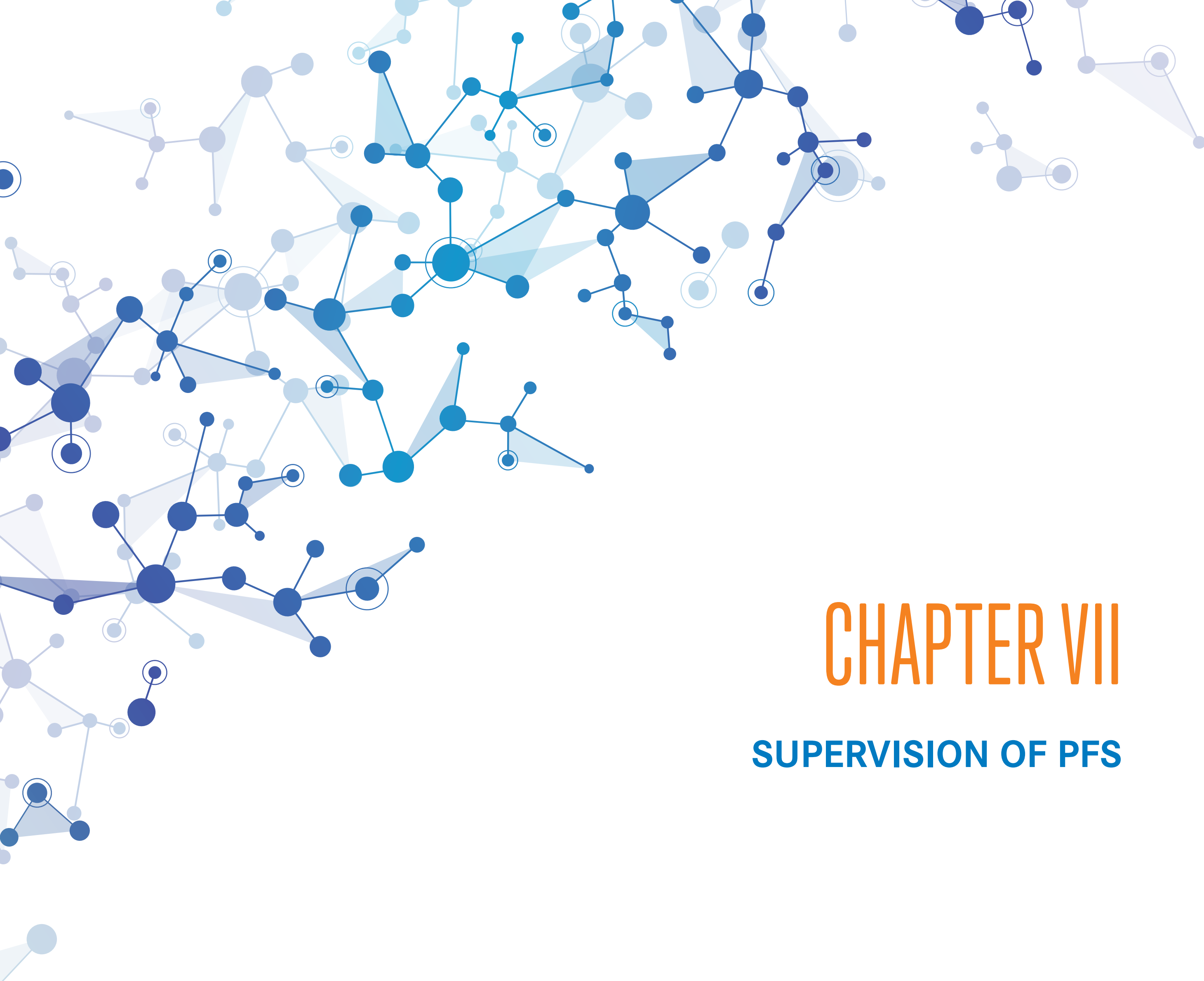
[15] The "IMF Country Report No. 17/122" is available on the IMF's website.

[16] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

[17] Paragraphs 14 and 17 of the FSSA.

After finalising the authorisation process, the CSSF will be in charge of supervising the entity concerned as a CSD. In the framework of this supervision, which will be time- and resource-consuming, the CSSF will cooperate with a lot of authorities concerned and competent authorities, as defined in the CSDR and the relevant technical standards and guidelines.

Simultaneously to the CSDR, the supervision of the entity as a bank will continue. As in the past, this supervision will be based on procedures and standard approaches for banking supervision which will undergo adaptations, where necessary, based on the expert opinion with respect to the business model of the entity in question.



CHAPTER VII

SUPERVISION OF PFS

1. INVESTMENT FIRMS

1.1. Development of investment firms in 2017

1.1.1. Development in the number of investment firms

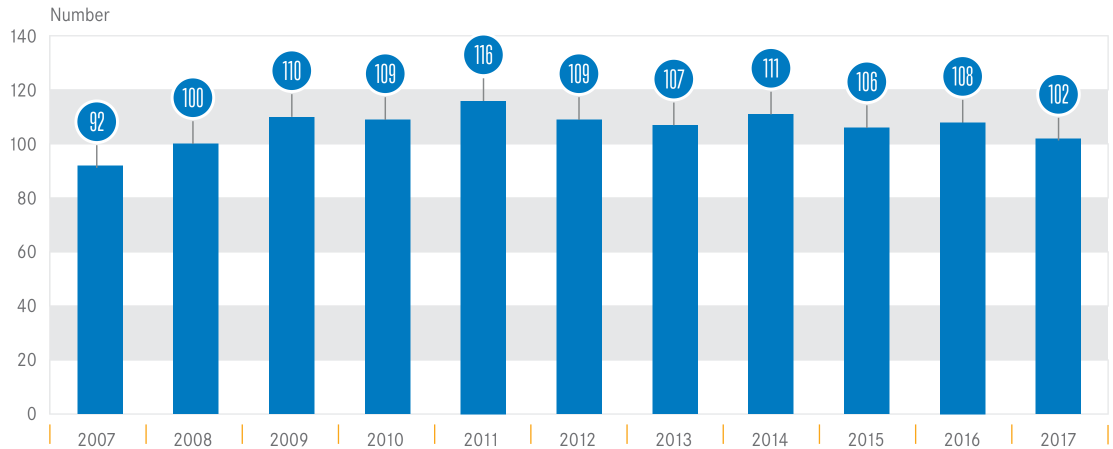
The slight increase in the number of investment firms supervised by the CSSF in 2016 was followed by a drop of six entities during 2017, resulting in a total number of 102 investment firms at the end of 2017, compared to 108 entities as at 31 December 2016.

Three entities were authorised as investment firms in 2017, against nine new entities in 2016.

Nine entities gave up their investment firm status during the year under review, compared to seven in 2016. These nine entities gave up their investment firm status for the following reasons:

- change or cessation of activities, implying that the entity no longer required an authorisation as investment firm, as it no longer fell within the scope of the Law of 5 April 1993 on the financial sector (one entity);
- judicial liquidation (one entity);
- voluntary liquidation (one entity);
- merger (one entity);
- change into a management company (one entity);
- closing of EU/EEA investment firm branches established in Luxembourg (four entities).

Development in the number of investment firms



Among the investment firms, the activity of private portfolio manager was the most widespread with 83 entities authorised in this respect as at 31 December 2017. It is worth mentioning that two out of the three 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 remained unchanged compared to the previous year and amounted to 30 entities as at 31 December 2017. It should be noted that one of the three investment firms authorised in 2017 falls within the scope of the CRR.

1.1.3. Development in employment

Employment in investment firms remained stable in 2017, as was already the case in the previous year. Indeed, the total number of staff for all investment firms decreased only slightly (-0.61%) and amounted to 2,271 people as at 31 December 2017, against 2,285 people at the end of December 2016.

The upward variations a certain number of players recorded in 2017 and the staff variations related to new authorisations as investment firms virtually counteracted the downward trend in the total staff figures deriving from the deregistration of nine investment firms from the official list and the staff reduction at 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

It should be noted that the deregistrations in 2017, in particular the merger by takeover of one entity by a credit institution of the financial centre and the change of an investment firm into a management company, do not necessarily reflect a loss of jobs in the financial sector. These transfers of activities do not impact employment in the financial sector as a whole, but only affect the breakdown between the different categories of financial players.

It should also be noted that, as at 31 December 2017, about half of the investment firms had eight or less 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 1,966 million[1] as at 31 December 2017, against EUR 3,174 million as at 31 December 2016, i.e. a substantial decrease of 38.05%. This decline is mainly attributable to one investment firm with a significant balance sheet total which recorded a considerable decline of the balance sheet total on 31 December 2017 compared to the end of December 2016.

Investment firms recorded a positive development in their net results. Indeed, provisional net results amounted to EUR 142.7 million[2] as at 31 December 2017, against EUR 131.0 million as at 31 December 2016, representing an increase by 8.95%.

It should also be noted that a little more than one fourth of the investment firms, including notably several entities authorised during the last three years, registered negative results as at 31 December 2017.

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

(in million EUR)	2016	2017	Variation in %
Balance sheet total	3,174	1,966	-38.05%
Net results	131.0	142.7	+8.95%

1.1.5. International expansion of investment firms

- **Subsidiaries created and acquired abroad during 2017**

In 2017, the CSSF has not received any request from an investment firm incorporated under Luxembourg law to open a subsidiary abroad.

[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.

• **Freedom of establishment**

In 2017, four branches were established in other EU/EEA Member States by investment firms incorporated under Luxembourg law. Moreover, following the deregistration from the official list of one investment firm, its branch is no longer registered on the list of investment firm branches established in other EU/EEA countries at the end of 2017. The total number of branches of Luxembourg investment firms in other EU/EEA Member States amounted to 31 entities as at 31 December 2017, compared to 28 entities as at 31 December 2016.

Following the closure of three branches originating from the United Kingdom and of one branch originating from the Netherlands, the number of branches established in Luxembourg by investment firms originating from other EU/EEA Member States totalled six entities as at 31 December 2017.

One investment firm incorporated under Luxembourg law established a branch in a country outside the EU/EEA in 2017, resulting in a total of one branch established in a country outside the EU/EEA as at 31 December 2017.

• **Freedom to provide services**

In 2017, 12 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 82 entities as at 31 December 2017 (78 in 2016). 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 24-9 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 minimal 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.

The CSSF reminds 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 sector[3].

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 compliance of investment firms with the minimal capital base conditions. In 2017, the CSSF intervened at four investment firms for non-compliance with the legal provisions relating to capital base.

• **Capital ratio**

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 CRR[4] must permanently fulfil the capital ratio requirements.

In 2017, 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

[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) on capital ratios and large exposure limits.

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 in one of the aforementioned cases. The CSSF attaches utmost importance to permanent compliance with the structural 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 limits[5], the applicable limits were not exceeded in 2017, so that the CSSF did not have to intervene.

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 has formally made use of this right once in 2017.

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 basis[6]. 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 2017, 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.

2. SPECIALISED PFS

2.1. Development of specialised PFS in 2017

2.1.1. Development in the number of specialised PFS

During the year 2017, the number of specialised PFS continued to decrease to reach 108 entities (against 119 entities at the end of 2016).

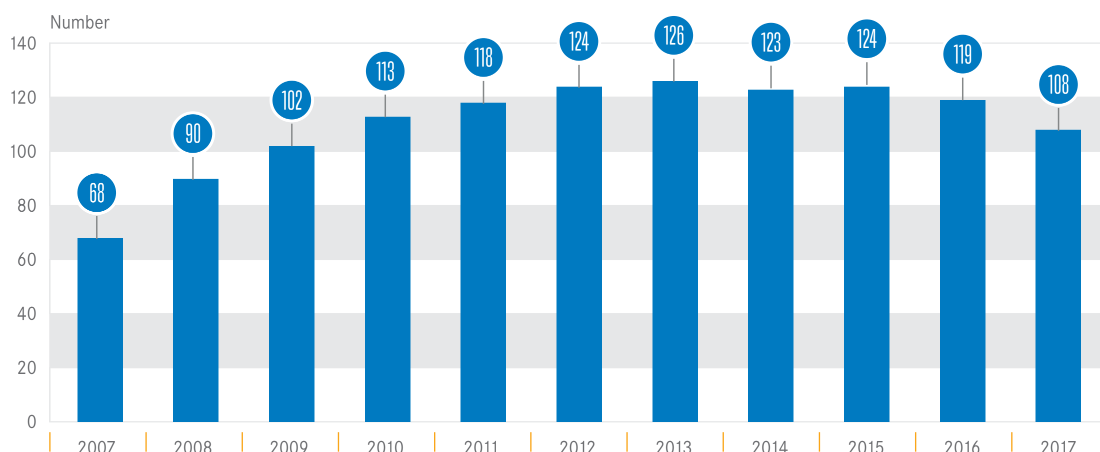
In 2017, two entities were authorised as specialised PFS (against five in 2016). Thirteen entities gave up their status as specialised PFS during the year (against 10 in 2016), six of them having been absorbed by other specialised PFS in the context of mergers.

[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.

Development in the number of specialised PFS



Among the specialised PFS, the statuses of corporate domiciliation agent and of 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 2017 (2016: 94 and 99 entities, respectively), followed by the status of registrar agent with 58 entities authorised at the same date (2016: 60 entities).

Breakdown of specialised PFS according to status

Professionals providing company incorporation and management services	92
Corporate domiciliation agents	86
Registrar agents	58
Family Offices[8]	31
Professional depositaries of assets other than financial instruments	13
Professionals performing lending operations	5
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

One of the two entities registered on the official list of specialised PFS in 2017 obtained the authorisation as professional providing company incorporation and management services and as Family Office, and the other one requested the statuses of corporate domiciliation agent, professional providing company incorporation and management services and registrar agent.

2.1.2. Development in employment

During 2017, the number of staff employed by all specialised PFS rose by 36 people, representing a minor increase of 0.9% as compared to the end of the financial year 2016.

When disregarding the transfer of activities of one PFS to a credit institution in the last quarter of 2017, implying a transfer of 163 people, the employment figures show an increase by 5.0% (against 4.9% in 2016). It should also be noted that a decrease in staff numbers by 33 people is attributable to specialised PFS which returned their authorisation in 2017 (other than PFS having been absorbed in the context of a merger with another PFS).

[8] The section “Family Office” only includes the entities authorised and carrying out this activity.

As at 31 December 2017, 11 specialised PFS employed more than 100 people (against 12 at the end of 2016) and 47 specialised PFS employed 10 or less people (against 55 at the end of 2016).

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

2.1.3. Development of balance sheets and profit and loss accounts

The decrease of the provisional balance sheet total of all specialised PFS by EUR 1,543.1 million as compared to 2016 (-23.1%) is mainly attributable to three entities, one of which voluntarily renounced its authorisation in 2017. With the exception of these three entities and the other entities created or closed during the financial year, the balance sheet total of the other specialised PFS rose by EUR 193.4 million over one year (+7.0%).

Over a one-year period, the specialised PFS show an overall rise in their net results of EUR 30.3 million (+9.5%). With the exception of the entities created or closed during the financial year, the net results of the other entities rose by EUR 42.6 million over one year (+13.9%).

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

(in million EUR)	2016	2017	Variation in %
Balance sheet total	6,672.4	5,129.3	-23.1%
Net results	318.4	348.7	+9.5%

2.1.4. International expansion of specialised PFS

In 2017, specialised PFS recorded no branch opening or closing. Thus, as at 31 December 2017, two specialised PFS (idem in 2016) 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 2017, the CSSF registered cases of non-compliance with the legal provisions in this respect by five entities (against 11 entities in 2016). 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 2017, the CSSF intervened twice (against three times in 2016) 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.

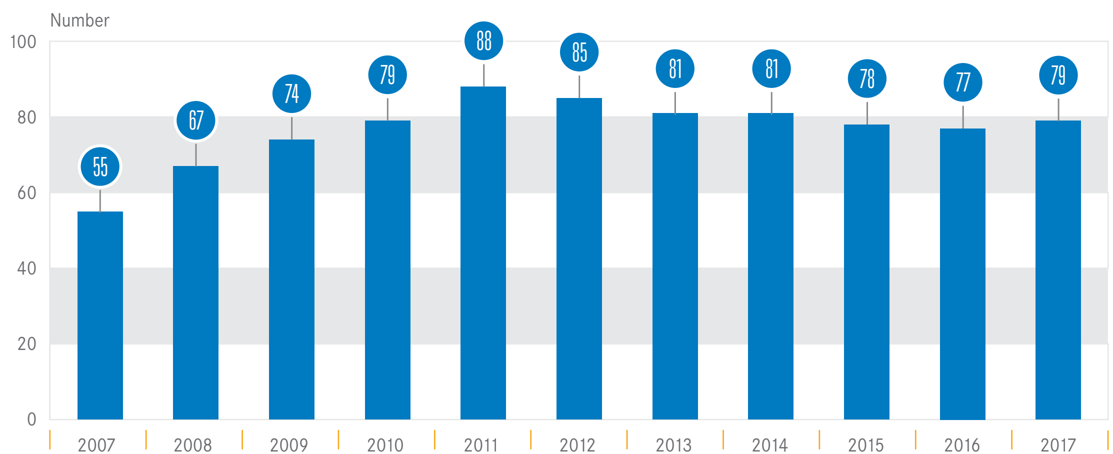
3. SUPPORT PFS

3.1. Development of support PFS in 2017

3.1.1. Development in the number of support PFS

In 2017, the number of support PFS increased by two entities to reach 79 entities as at 31 December 2017, against 77 entities at the end of 2016.

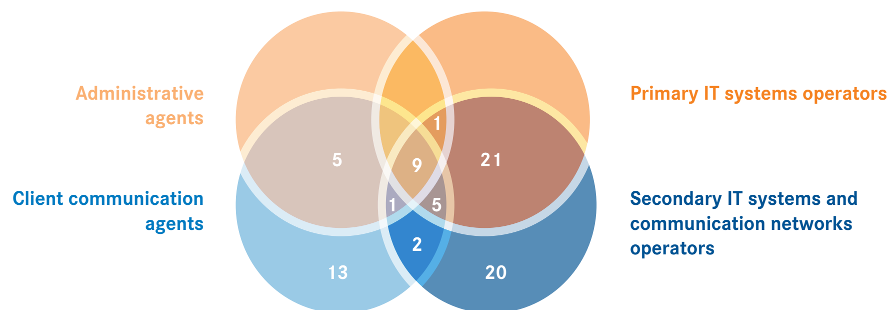
Development in the number of support PFS



In 2017, three support PFS were authorised, two of which as secondary IT systems and communication networks operators of the financial sector and one as support PFS cumulating the statuses of administrative agent and secondary IT systems and communication networks operator of the financial sector.

One support PFS was deregistered from the official list following a merger.

Breakdown of support PFS according to status



Administrative agent + primary IT systems operator: 1 entity

Administrative agent + secondary IT systems and communication networks operator of the financial sector: 1 entity

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. Development in employment

The number of staff of support PFS rose from 9,185 people as at 31 December 2016 (77 active entities) to 9,656 people as at 31 December 2017 (79 active entities), representing an annual increase of 471 positions (+5.13%).

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

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 1,234.3 million as at 31 December 2017, against EUR 1,127.8 million as at 31 December 2016, i.e. an increase of 9.44%.

Over one year, support PFS show an increase in their net results from EUR 66.5 million as at 31 December 2016 to EUR 80.4 million as at 31 December 2017 (+20.90%).

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 2017. 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.

SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

1. REGULATORY FRAMEWORK

The Law of 10 November 2009 on payment services (hereinafter LPS) transposed Directive 2007/64/EC of 13 November 2007 on payment services in the internal market into national law. The LPS imposes authorisation, exercise and supervisory conditions on the payment institutions and electronic money institutions that provide payment services. The relevant payment services are specifically listed in the annexe to the LPS.

Since then, the retail payments market has experienced significant technical innovation, with rapid growth in the number of electronic and mobile payments and the emergence of new types of payment services in the market place, which challenges the current framework[1].

Many innovative payment products or services do not fall, entirely or in large part, within the scope of Directive 2007/64/EC[2].

As a consequence, Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market and repealing Directive 2007/64/EC (PDS2) aims at ensuring continuity in the market, enabling existing and new service providers to offer their services with a clear and harmonised regulatory framework[3]. The relevant payment services listed in the appendix to the LPS will be modified accordingly.

The draft bill that transposes PSD2 into Luxembourg law was submitted to the Chambre des Députés in October 2017. The Law of 10 November 2009 on payment services is expected to be amended in the course of 2018.

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[1] Recital 3 of PSD2.

[2] Recital 4 of PSD2.

[3] Recital 33 of PSD2.

2. PAYMENT INSTITUTIONS

Following the authorisation of one new payment institution and the cessation of activities of one entity in 2017, nine Luxembourg payment institutions were listed in the public register of payment institutions established in Luxembourg as at 31 December 2017. Moreover, there were five branches established in other EU Member States by two of these nine institutions.

It should also be noted that a branch of a UK payment institution started its activities in Luxembourg in 2017.

The balance sheet total of payment institutions amounted to EUR 594.6 million as at 31 December 2017, representing a 42.24% increase compared to the end of 2016 when the balance sheet total reached EUR 418.0 million.

In 2017, two payment institutions infringed the provisions regarding own funds laid down in Article 16(1) of the LPS. Following the CSSF's intervention, these institutions took appropriate measures in order to rectify their capital situation.

3. ELECTRONIC MONEY INSTITUTIONS

Following the authorisation of one new electronic money institution, five electronic money institutions were listed in the public register of electronic money institutions authorised in Luxembourg as at 31 December 2017. In addition, one institution authorised in Luxembourg established a branch in France.

The balance sheet total of electronic money institutions amounted to EUR 1.8 billion as at 31 December 2017, representing a 130.72% increase compared to the end of 2016 when the balance sheet total reached EUR 794.6 million.

In 2017, two electronic money institutions infringed the provisions regarding own funds laid down in Article 24-12(1) of the LPS. Following the CSSF's intervention, these institutions took appropriate measures in order to rectify their capital situation.

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

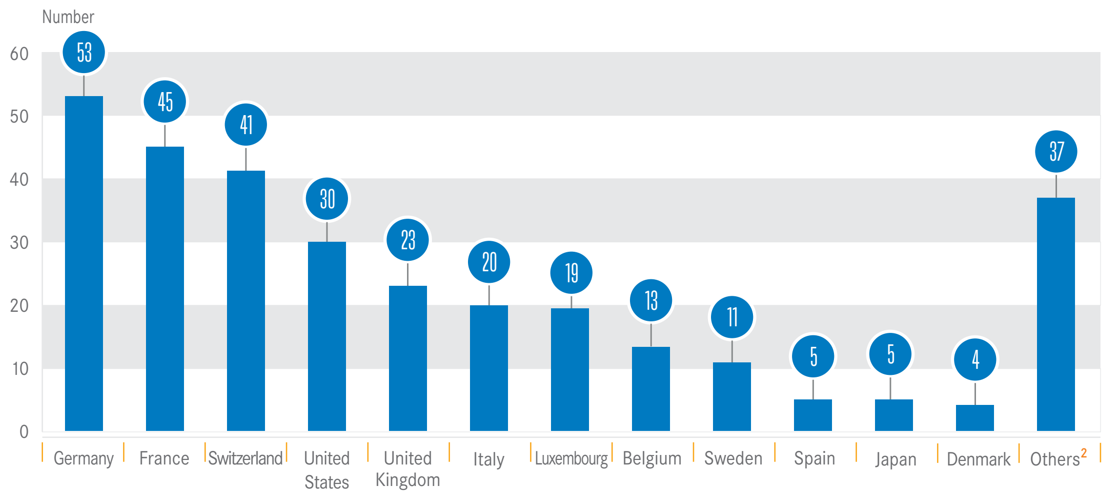
The total number of authorised IFMs amounted to 306 as at 31 December 2017, compared to 296 as at 31 December 2016. This net increase of 10 entities is the result of 15 registrations and five withdrawals in 2017. Among the new registrations, two entities exercise activities in the investment funds sector in Luxembourg for the first time.

[1] It should be noted that this section's statistics do not include the 34 internally authorised managers, namely 22 SICAVs which did not designate a management company under Article 27(1) of the Law of 17 December 2010 relating to undertakings for collective investment and 12 internally managed alternative investment funds (AIFs), as laid down in Article 4(1)(b) of the Law of 12 July 2013 on alternative investment fund managers.

1.2. Geographical origin

As in previous years, the main countries of origin of authorised IFMs are Germany, France, the United States of America and Switzerland. It should be pointed out that most managers registered in 2017 are of German, British, Swiss or French origin.

Geographical origin of authorised IFMs



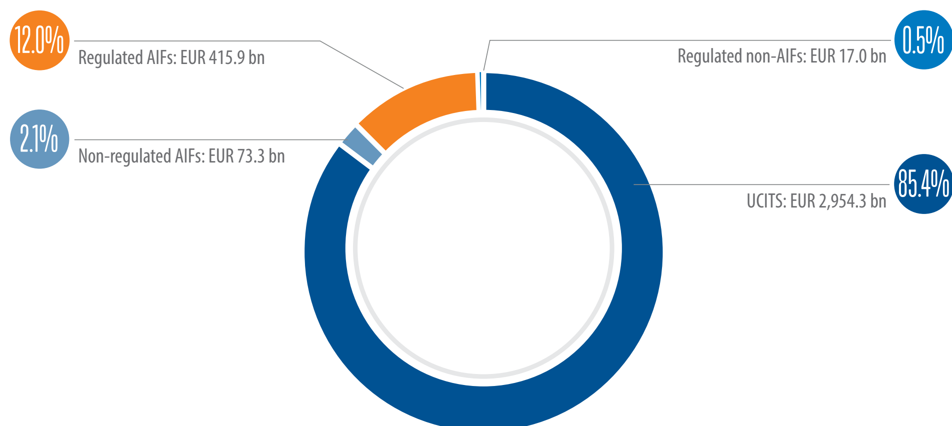
1.3. Development in employment

As at 31 December 2017, total staff of authorised IFMs amounted to 4,969 employees, as against 4,513 employees as at 31 December 2016, i.e. an increase of 456 employees. This rise results from a general increase of the number of employees within the existing authorised IFMs and from the arrival of new entities in 2017.

1.4. Assets under management

As at 31 December 2017, authorised IFMs managed assets of EUR 3,460.5 billion.

Breakdown of assets under management according to type of product



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

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 should be noted that the 50 most significant authorised IFMs in terms of assets under management manage 83% 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	35.7%	2.5%	0.0%	38.2%
Variable-yield transferable securities	29.1%	1.2%	0.0%	30.3%
Mixed transferable securities	17.6%	3.3%	0.0%	20.9%
Funds of funds	2.7%	2.2%	0.4%	5.3%
Real estate funds	0.0%	1.4%	0.3%	1.7%
Capital investment funds	0.0%	1.0%	0.4%	1.4%
Speculative funds	0.0%	0.0%	0.1%	0.1%
Others	0.3%	0.9%	0.9%	2.1%
Total	**85.4%**	**12.5%**	**2.1%**	**100.0%**

With respect to all the funds managed by authorised IFMs, a high concentration of investment strategies relating to fixed-income transferable securities and variable-yield transferable securities (diversified 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 the provision of discretionary management services. As at 31 December 2017, 46 authorised IFMs (42 in 2016) provided this service for a total of EUR 59.9 billion of assets under management (compared to EUR 42.5 billion in 2016).

1.7. Financial situation

The provisional balance sheet total of all authorised IFMs, including their branches, reached EUR 14.7 billion as at 31 December 2017, as against EUR 14.5 billion as at 31 December 2016, i.e. a slight increase of 1.4%. This positive development is due to an increase of the items "loans and advances" and "amounts owed", respectively, correlated with an increase of assets under management.

Provisional net results amounted to EUR 3.1 billion as at 31 December 2017, as against EUR 2.6 billion as at 31 December 2016, representing a rise of 18.6%. Finally, from the 306 authorised IFMs, 249 recorded a net profit and 57 a net loss. Among the authorised IFMs that recorded a loss, seven are newly created authorised IFMs.

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

(in bn EUR)	2016	2017	Variation in %
Balance sheet total	14.5	14.7	1.4%
Net results	2.6	3.1	18.6%

The financial data of authorised IFMs also shows that:

- liquidities held by the authorised IFMs cover 119% of their own funds, showing a sound and prudent management;
- staff costs increased by 39.02%, due mainly to the strengthening of the presence of authorised IFMs.

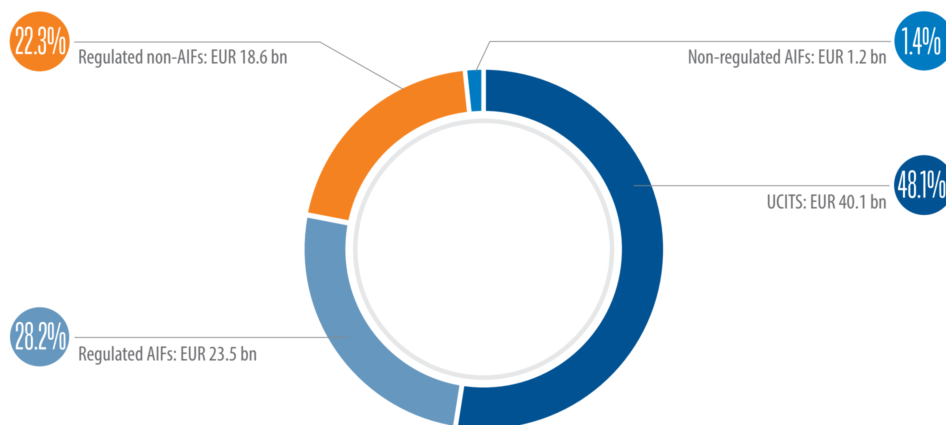
2. OTHER INVESTMENT FUND MANAGERS

The following other investment fund managers are present in Luxembourg:

- 600 registered investment fund managers (registered IFMs);
- 71 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 derogation or transitory provisions of the 2013 Law;
- 22 self-managed UCITS investment companies (SIAGs);
- 12 internally managed alternative investment fund managers;
- one management company set up under Chapter 18 of the 2010 Law.

At EUR 83.4 billion, the share of the assets under management of these other IFMs[3] remains moderate compared to the authorised IFMs.

Breakdown of assets under management of other IFMs according to type of product[4]



[3] The regulated AIFs and non-AIFs, which are not attached to an authorised or registered manager pursuant to the transitional provisions of Article 58 of the 2013 Law and representing EUR 78.6 billion of assets, are excluded from this category.

[4] Excluding the regulated AIFs and non-AIFs (cf. footnote 3 above).

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	16.1%	4.2%	0.0%	20.3%
Variable-yield transferable securities	9.7%	3.3%	0.0%	13.0%
Mixed transferable securities	17.1%	12.6%	0.0%	29.7%
Funds of funds	5.1%	13.9%	0.4%	19.4%
Real estate funds	0.0%	3.1%	0.1%	3.2%
Capital investment funds	0.0%	11.4%	0.1%	11.5%
Speculative funds	0.0%	0.1%	0.0%	0.1%
Others	0.1%	1.9%	0.8%	2.8%
Total	**48.1%**	**50.5%**	**1.4%**	**100.0%**

With respect to all the funds managed by the other IFMs and similarly to authorised IFMs, the most representative UCITS strategies are investment strategies relating to fixed-income transferable securities and variable-yield transferable securities (diversified 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 fund strategies represent a significant proportion along with the above-mentioned strategies.

- **EuVECA and EuSEF**

In 2017, one EuVECA registration request under Regulation (EU) No 345/2013 of 17 April 2013 on European venture capital funds was submitted to the CSSF. This entity has not yet been registered. However, two entities which submitted their registration request in 2016 were registered by the CSSF in 2017 and can use the denomination EuVECA, which brings the total number of registered EuVECAs to nine as at 31 December 2017.

By contrast, no authorisation request for an EuSEF in accordance with Regulation (EU) No 346/2013 of 17 April 2013 on European social entrepreneurship funds was submitted to the CSSF.

As at 31 December 2017, 77 EuVECAs and two EuSEFs managed by a manager registered in another EU country are distributed in Luxembourg.

In this context, the CSSF draws the attention to the entry into force of Regulation (EU) No 2017/1991 of 25 October 2017 which amends certain provisions of the above-mentioned EuVECA and EuSEF regulations and which has applied since 1 March 2018. The CSSF encourages the EuVECA managers registered in Luxembourg to review the legal texts in order to ensure their regulatory compliance and to submit the required reports to the CSSF.

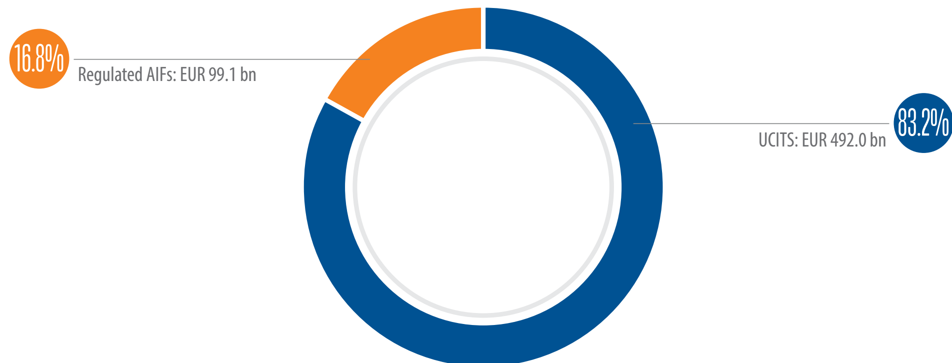
3. CROSS-BORDER ACTIVITIES[5]

3.1. IFMs established in another EU Member State

IFMs established in another EU Member State and carrying out the management of Luxembourg UCITS or AIFs under Article 119 of the 2010 Law and/or Article 33 of the 2013 Law manage EUR 591.1 billion of assets.

[5] 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 20.6 billion of assets, are excluded.

Breakdown of products managed on a cross-border basis[6]



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

- 78 managers manage UCITS;
- 135 managers manage regulated AIFs;
- six managers manage both UCITS and regulated AIFs.

Among these 219 IFMs, five managers originating from Germany, France, Malta and Sweden provide management services for UCITS and AIFs via a branch in Luxembourg as at 31 December 2017.

3.2. IFMs established in Luxembourg

3.2.1. Freedom to provide services under the UCITS Directive

In 2017, nine authorised IFMs (compared to seven in 2016) 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 Germany, France, Ireland, the Netherlands and the United Kingdom.

3.2.2. Freedom to provide services under the AIFMD

In 2017, 15 authorised IFMs (compared to 13 in 2016) 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 Germany, Belgium, France, Ireland, Italy, Malta, the Netherlands and the United Kingdom.

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

As at 31 December 2017, 39 authorised IFMs (compared to 28 in 2016) 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 76 branches (compared to 60 in 2016).

4. EVOLUTION OF THE UCI SECTOR IN 2017

As at 31 December 2017, 4,044 UCIs were registered on the official list, compared to 4,144 UCIs at the end of the previous year (-2.4%). This decrease is linked to a consolidation trend in the UCI sector, combined with a preference to create umbrella structures.

[6] Data not available for non-regulated AIFs.

From the 4,044 UCIs, 2,603 had adopted an umbrella structure, representing a decline of 53 entities compared to the previous year. Traditionally structured UCIs decreased by 47 entities.

The total number of fund units rose from 14,595 as at 31 December 2016 to 14,728 as at 31 December 2017. This rise results from the net creation of 180 sub-funds within UCIs with an umbrella structure.

Through the inflow of new capital and the positive developments in the financial markets, total net assets of Luxembourg UCIs grew by EUR 418.3 billion over one year to reach EUR 4,159.6 billion as at 31 December 2017 (+11.2%). This increase originates for 73.7% from net subscriptions and for 26.3% from a positive impact of the financial markets. Net capital investments in Luxembourg UCIs amounted to EUR 308.4 billion in 2017, which provides evidence of investors' confidence in the financial markets.

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)*
2007	3,050	11,297	2,076.8
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

Similarly to preceding years, the Luxembourg UCITS sector benefited from a positive balance between mergers in which the receiving UCITS is domiciled in Luxembourg (168 projects) and those in which the receiving UCITS is domiciled in another EU Member State (13 projects).

5. PRUDENTIAL SUPERVISORY PRACTICE

5.1. Prudential supervision

The CSSF's prudential supervision aims to ensure 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 reports with due care so that they are accurate in form and content.

The CSSF carries out quality and coherence controls over 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 based on annual and half-yearly reports, management letters and long form reports of the UCI activity

In the framework of the review of annual and half-yearly reports, management letters and long form reports[7], the CSSF had to take decisions in the form of injunctions, formal requests and recommendations regarding the *dirigeants* (directors) of some UCIs. These decisions were designed to remedy organisational deficiencies noted by the *réviseurs d'entreprises agréés* in their reports or management letters.

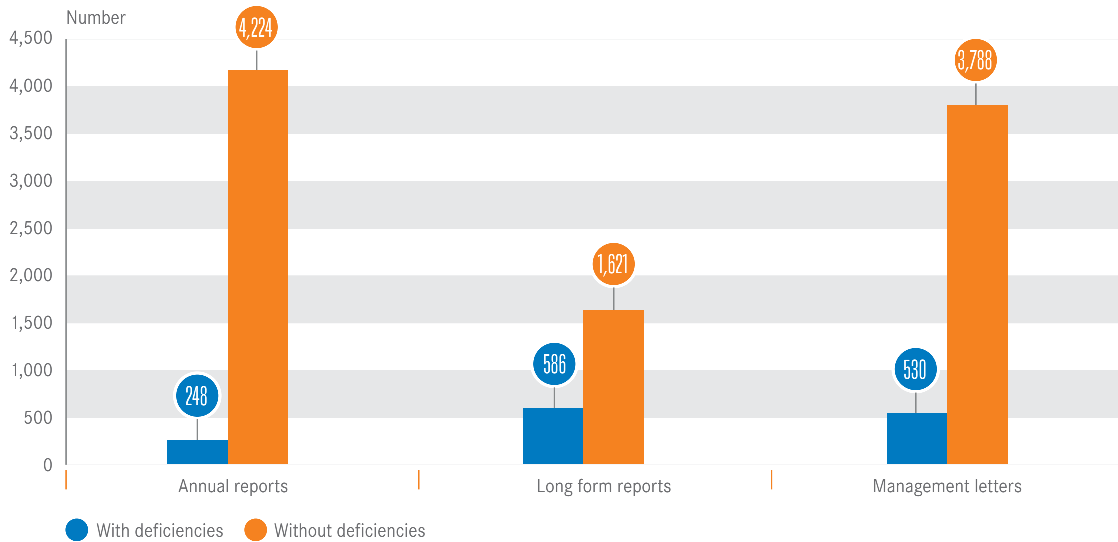
In 2017, the CSSF sent 87 letters to require corrective measures in order to remedy more serious deficiencies identified during the review of the above-mentioned documents. The CSSF also intervened pursuant to the risk-based supervision to clarify issues or deal with less critical deficiencies by sending letters or emails or via telephone.

The following chart highlights, per type of report, the number and proportion of reports in which one or several deficiencies were noted by the *réviseur d'entreprises agréé* and which were subject to a review by the CSSF[8].

[7] 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.

[8] It should be noted that the reports and management letters received in 2017 mostly concerned the year 2016.

Number and proportion of reports with or without deficiencies noted



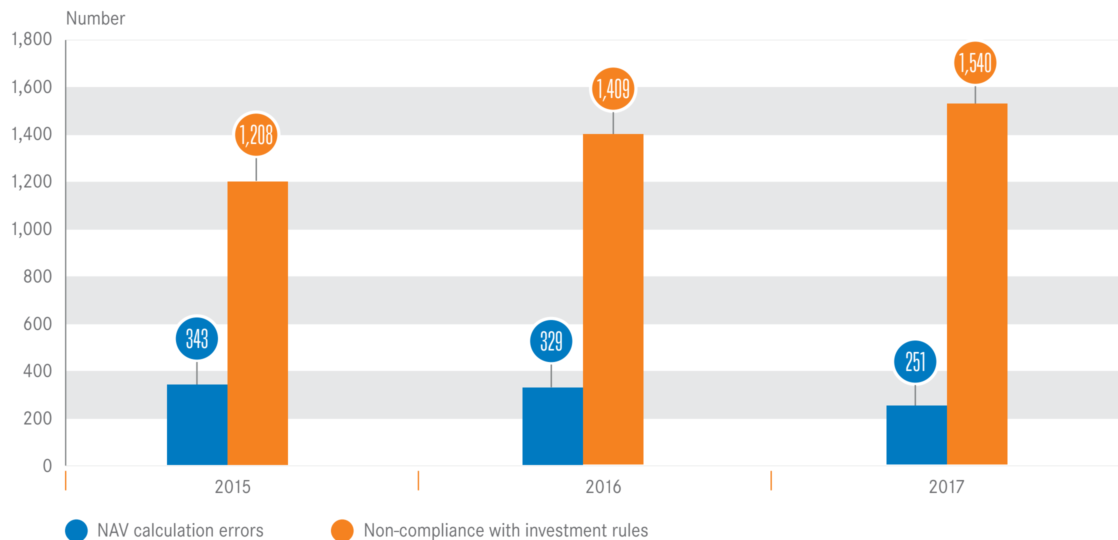
In 2017, the CSSF's interventions via letter, addressed mostly to UCITS, mainly concerned Circular CSSF 02/77 as well as the fight against money laundering and terrorist financing. The deficiencies noted in relation to the fight against money laundering and terrorist financing concerned, in particular, incomplete customer documentation.

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

- **Declarations made in 2017**

In 2017, the CSSF received 1,791 declarations on the basis of Circular CSSF 02/77[9], compared to 1,738 declarations in 2016, representing an increase of 3.05% that is entirely attributable to non-compliance with investment rules (+9.3%).

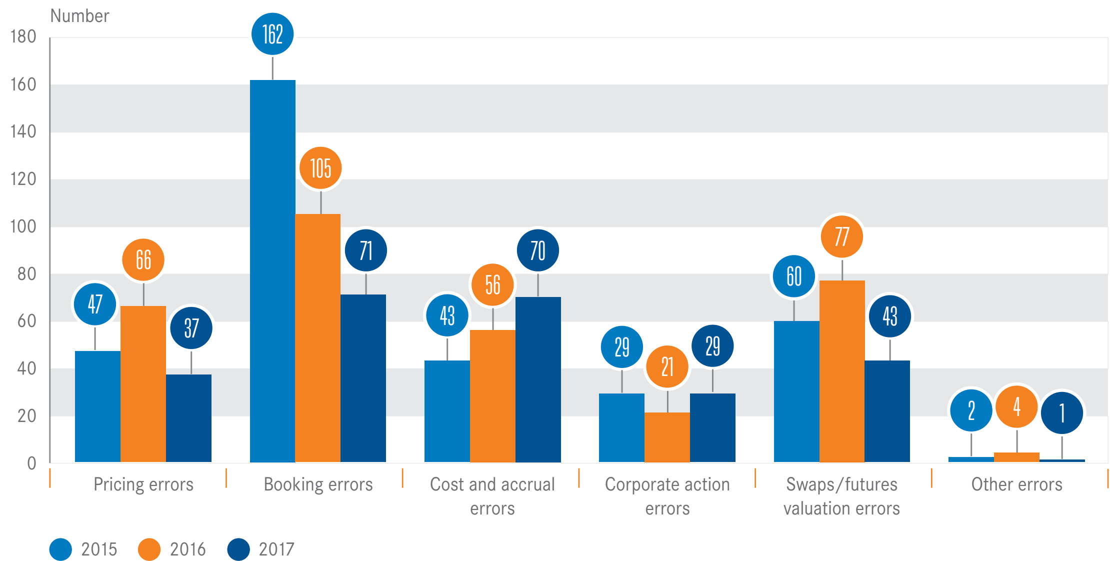
Evolution of the number of NAV calculation errors and instances of non-compliance with investment rules reported to the CSSF over the last three years



[9] Even if Circular CSSF 02/77 does not automatically apply to SIFs, the CSSF, nevertheless, considers that SIFs may either opt for the application of Circular CSSF 02/77 or set other internal rules that must remain within reasonable limits with respect to the SIF's investment policy. In this context, the CSSF considers that SIFs that have not set specific internal rules must apply Circular CSSF 02/77.

As in previous years, the simplified procedure 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

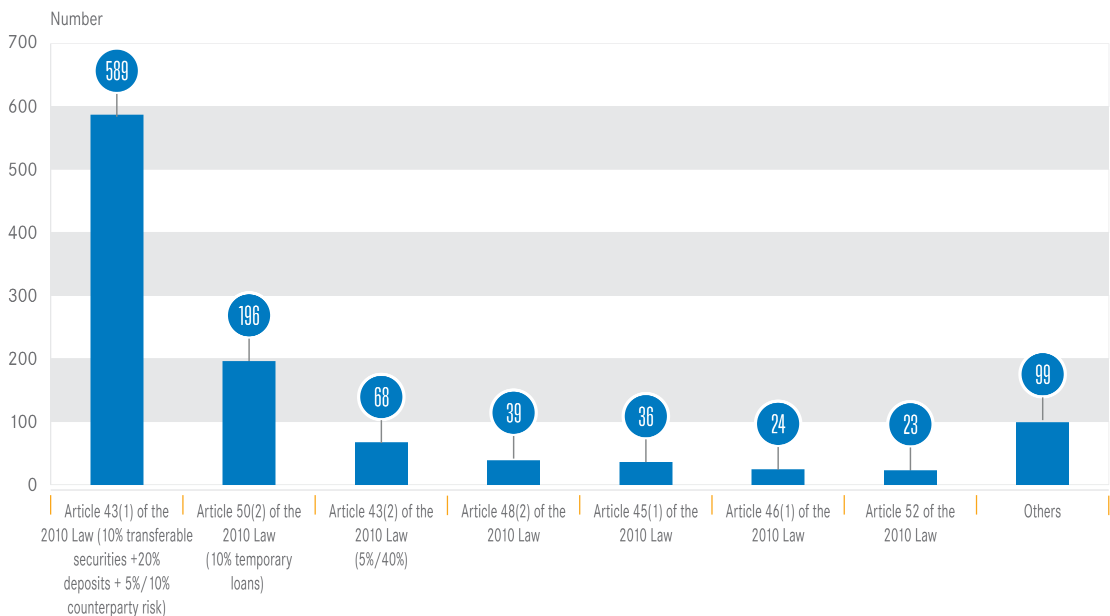


Although the number of booking errors is declining, they remain the main cause of NAV calculation errors. Cost and accrual errors, which have been on the rise these past years, result mainly from deficiencies relating to the calculation of performance fees.

Failure to observe legal limits of diversification, holding and borrowing remains the main source of non-compliance with investment rules with 1,074 cases (987 cases in 2016, i.e. +8.81%). This was followed by 306 cases of exceeding internal limits defined in sales documents (317 cases in 2016, i.e. -3.47%) and 160 cases of legal constraints breaches as regards asset eligibility (105 cases in 2016, i.e. +52.38%).

Cases of failure to observe legal limits of diversification, holding and borrowing increased compared to 2016, except for notifications regarding the 5%/40% limits as provided for in Article 43(2) of the 2010 Law.

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 2016 and 2017[10]

	Investors			UCI/Sub-fund		
	2016	2017	Variation in %	2016	2017	Variation in %
Total amount of compensation following NAV calculation errors	3,150,381.34	8,522,213.29	171%	5,748,612.81	2,571,664.39	-55%
Total amount of compensation following non-compliance with investment rules	338,411.11	2,067.46	-99%	1,914,231.14	1,630,269.21	-15%

In 2017, the amounts of compensation paid declined aside from amounts of compensation paid to investors as a result of NAV calculation errors which significantly increased due to some isolated cases requiring higher compensation. Overall, the total amount of compensation remains moderate as compared to the amount of assets under management.

- **Form file for notifications**

At the beginning of 2017, the CSSF introduced a form file for the transmission to the CSSF of information relating to non-compliance with investment rules or NAV calculation errors.

In this context, the CSSF reiterates that all fields of the form file must be filled in for the notification to be processed. The notifying person must ensure to include all relevant information in the form file in order to allow the CSSF to understand the notified incident, its origins and the calculations made for the compensation required under Circular CSSF 02/77. In addition, the person must also provide a complete description of the organisational measures or any other measures taken to avoid henceforth such incident.

5.3. On-site supervision

The "UCI on-site inspection" department continued to increase its staff. As at 1 April 2018, it was composed of 13 agents, against seven as at 31 December 2016. It is planned to substantially increase the number of agents over the next months. The team carries out on-site inspections consisting of an in-depth review of the business model and the governance of IFMs.

Since 1 July 2017, the department has also been performing thematic on-site inspections in relation to the fight against money laundering and terrorist financing (AML/CFT).

The "Prudential supervision and risk management" department performs thematic on-site inspections in relation to risk management, procedures linked to Circular CSSF 02/77 and money market UCIs.

Moreover, the "On-site inspection" department of the CSSF may perform thematic inspections in relation to central administration and MiFID regulations at IFMs.

5.3.1. Statistics

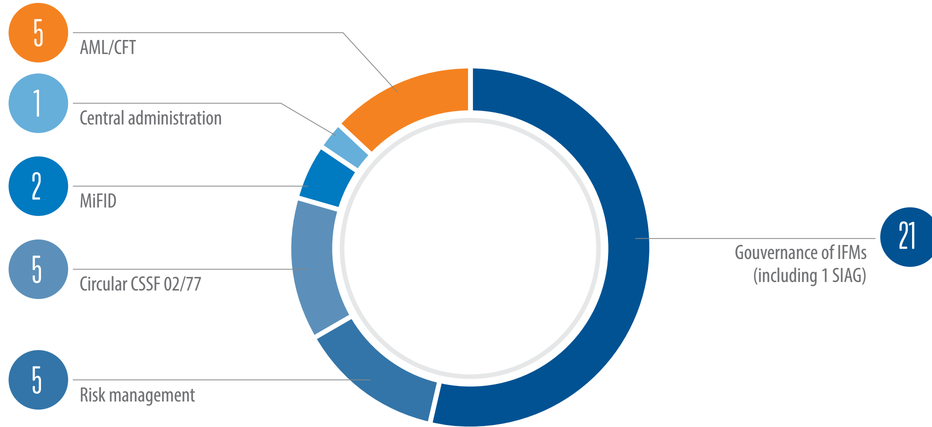
In 2017, the CSSF carried out 39 on-site inspections at IFMs[11] based on a long-term inspection plan using a risk-based approach.

Authorised IFMs inspected represent about 17% in terms of assets under management of these IFMs. Moreover, the inspections concerned 13 authorised IFMs whose assets under management exceed EUR 10 billion.

[10] The data as at 31 December 2017 are incomplete as the final compensation amounts had not yet been finalised for some files.

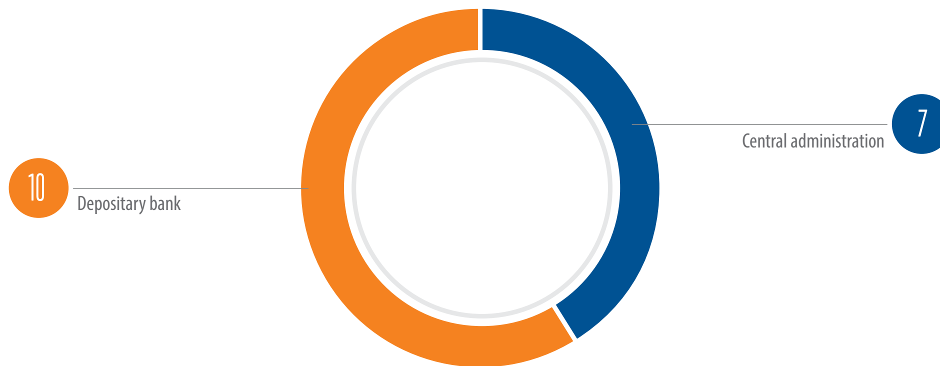
[11] Including one SIAG.

Thematic on-site inspections performed in 2017 at IFMs (including SIAGs)



The CSSF also performed 17 on-site inspections at depositary banks and central administrations.

Thematic on-site inspections performed in 2017 at UCI service providers[12]



5.3.2. Main findings

In the context of the on-site inspections relating to governance of IFMs, the CSSF continued to pay particular attention to the follow-up of delegated activities, a topic which was subject again to deficiencies during the 2017 inspections. In particular, some due diligences (initial and continuous) are not sufficiently substantiated to allow appropriate identification and assessment of the risks related to the use of delegation.

Among the other most recurring observations, the CSSF noted that the Executive Board and Board of Directors of IFMs did not always have the information required to monitor all the activities of the IFMs as well as those of their delegates. Furthermore, the CSSF noticed different shortcomings relating to the control of compliance with the investment policies and restrictions as well as several cases where the risk profiles were not approved by the Board of Directors.

In addition, a non-litigious administrative procedure has been initiated against an IFM. The deficiencies noted mainly concerned the internal organisation of the company, the arrangements for the ongoing monitoring of the delegates and compliance with the rules of conduct.

During the thematic on-site inspections relating to AML/CFT, the CSSF noted that the risk analysis had not yet been performed in accordance with the provisions of CSSF Regulation N° 12-02. Moreover, deficiencies

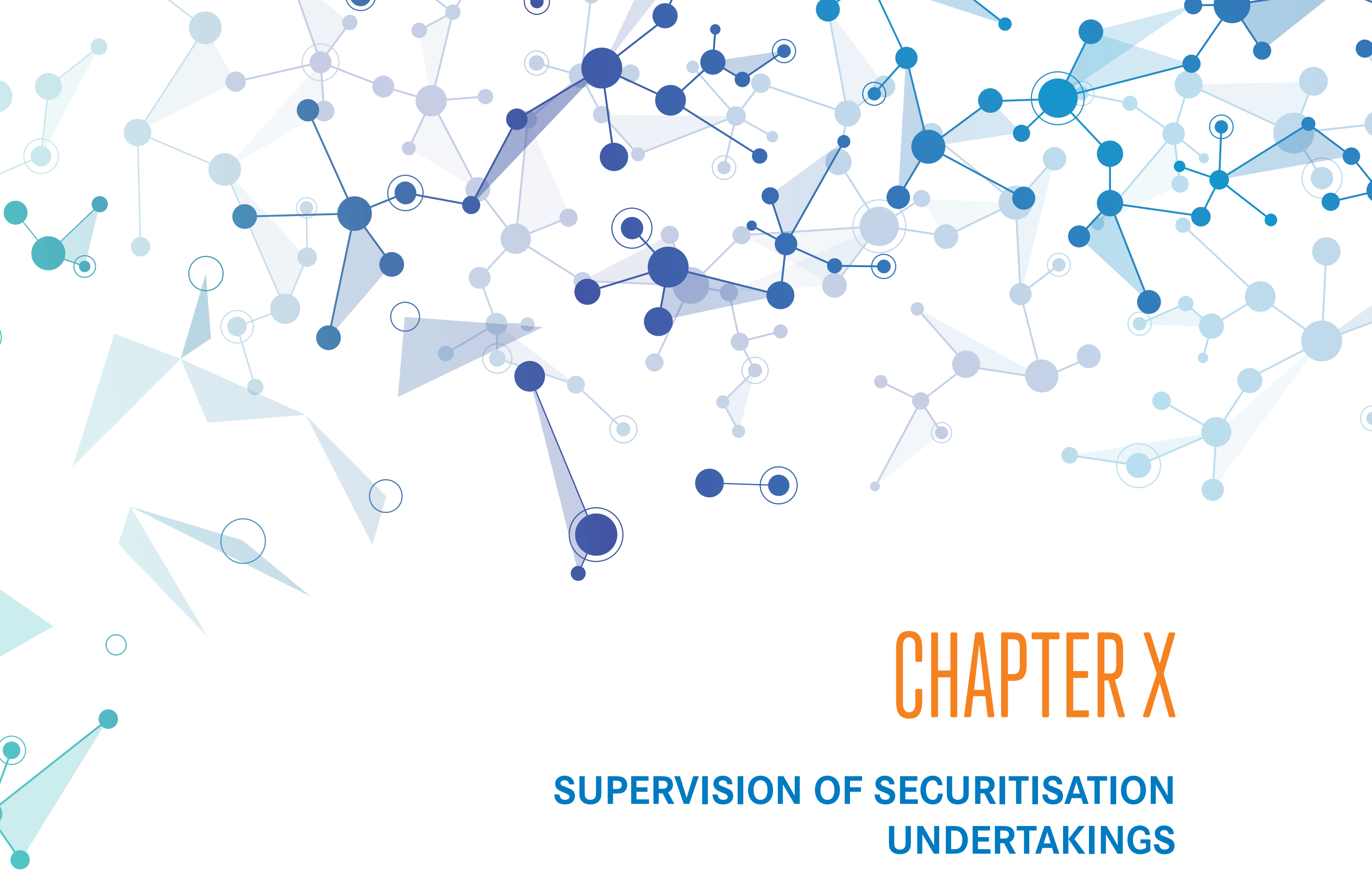
[12] These on-site inspections were carried out at credit institutions, investment firms and specialised PFS.

in the diligence concerning business relationships of IFMs (initiators, distributors, business providers) were observed. The CSSF also noted that AML/CFT diligences were often focussed on investors and omitted to take into account the AML/CFT risks arising from the assets of the funds under management. Finally, many deficiencies in the verifications of the business relationships of IFMs vis-à-vis the lists of sanctions and the lists of politically exposed persons were observed.

Agents hired in 2017 and 2018: Departments "Authorisation and supervision of UCITS and pension funds" and "Prudential supervision and risk management"

From left to right: Cédric LEROY, Amra DZOGOVIC, Frédéric NEY, Shaneera RASQUÉ, Serigne LÔ, Paul BRACK, Maximilien SAGRILLO, Christophe EISCHEN, Eric THEISEN, Jeff BREUSKIN

Absent: Cynthia CUESTA



CHAPTER X

SUPERVISION OF SECURITISATION UNDERTAKINGS

1. DEVELOPMENTS OF AUTHORISED SECURITISATION UNDERTAKINGS

During 2017, the CSSF received one application for registration on the official list of authorised securitisation undertakings subject to the Law of 22 March 2004 on securitisation.

Following the deregistration of one securitisation undertaking from the official list of authorised securitisation undertakings during the year, 33 securitisation companies were registered on the official list of authorised securitisation undertakings as at 31 December 2017, against 34 entities at the end of 2016. The balance sheet total of authorised securitisation undertakings amounted to EUR 42.4 billion at the end of 2017, representing an increase of EUR 7.2 billion against 2016.

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 undertakings for collective investment, 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 2017, 12 of the 33 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.

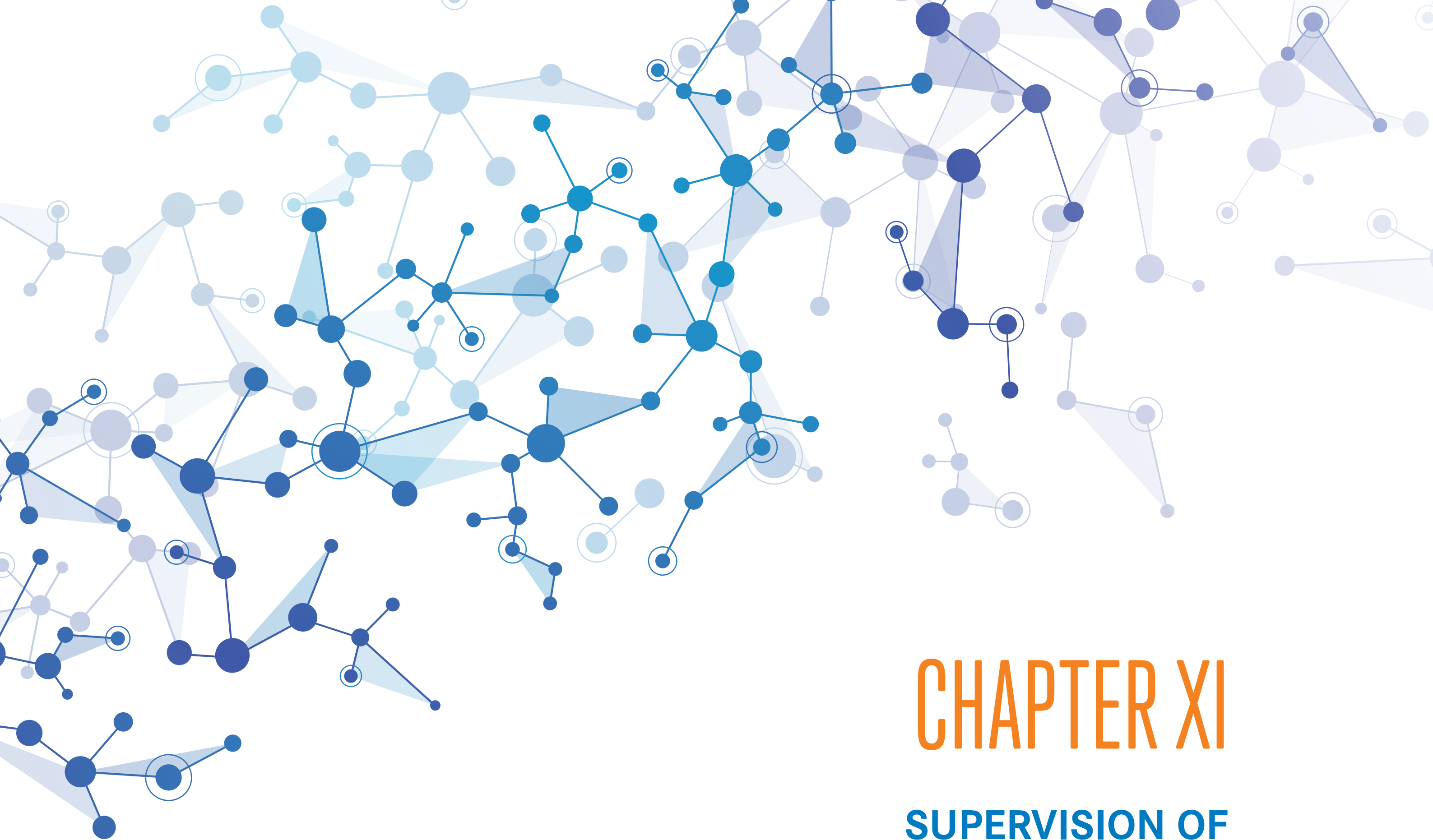
On 19 December 2017, ESMA launched three consultations on draft technical standards implementing the Securitisation Regulation. These consultations, which were closed on 19 March 2018, focussed on:

- the content and format of the STS notification under the Securitisation Regulation (ref.: ESMA33-128-33);
- disclosure requirements, operational standards and access conditions under the Securitisation Regulation (ref.: ESMA33-128-107);
- requirements relating to third-party firms providing STS verification services (ref.: ESMA33-128-108).

On 15 December 2017, the EBA also launched two consultations on draft technical standards which focussed on:

- homogeneity of underlying exposures in securitisation (ref.: EBA/CP/2017/21);
- risk retention (ref.: EBA/CP/2017/22).

These consultations were closed on 15 March 2018.



CHAPTER XI

SUPERVISION OF PENSION FUNDS

1. DEVELOPMENT OF PENSION FUNDS IN 2017

1.1. Major events and trends observed in 2017

As at 31 December 2017, 13 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.

During the year, one pension fund was withdrawn from the official list following the decision to transfer its liabilities to insurance contracts.

The year 2017 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, three notifications were sent by the CSSF to the competent authorities acting as host Member State and four pension schemes have been approved by the CSSF.

1.2. Pension fund activities

The majority of the pension funds in Luxembourg manage one or several pension schemes set up by Luxembourg or foreign companies for their employees.

As at 31 December 2017, 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.

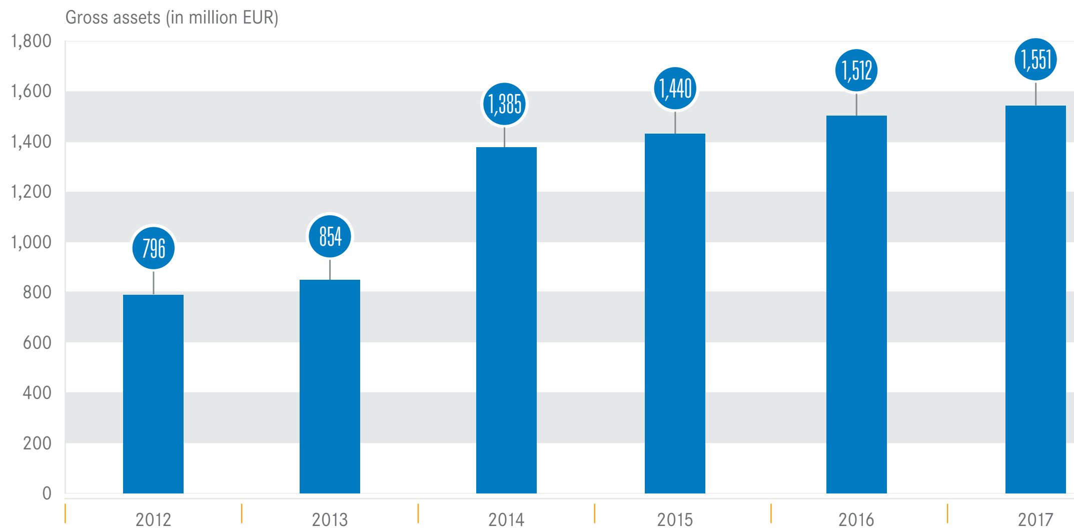
Out of the 13 pension funds registered on the official list, 11 have adopted the legal form of a pension savings association and two have adopted the legal form of a pension savings company with variable capital.

1.3. Development of pension fund assets

At the end of 2017, gross assets of pension funds amounted to EUR 1,551 million against EUR 1,512 million as at 31 December 2016, representing a 2% growth.

The assets of cross-border pension schemes amounted to EUR 473 million as at 31 December 2017 against EUR 463 million at the end of the previous year.

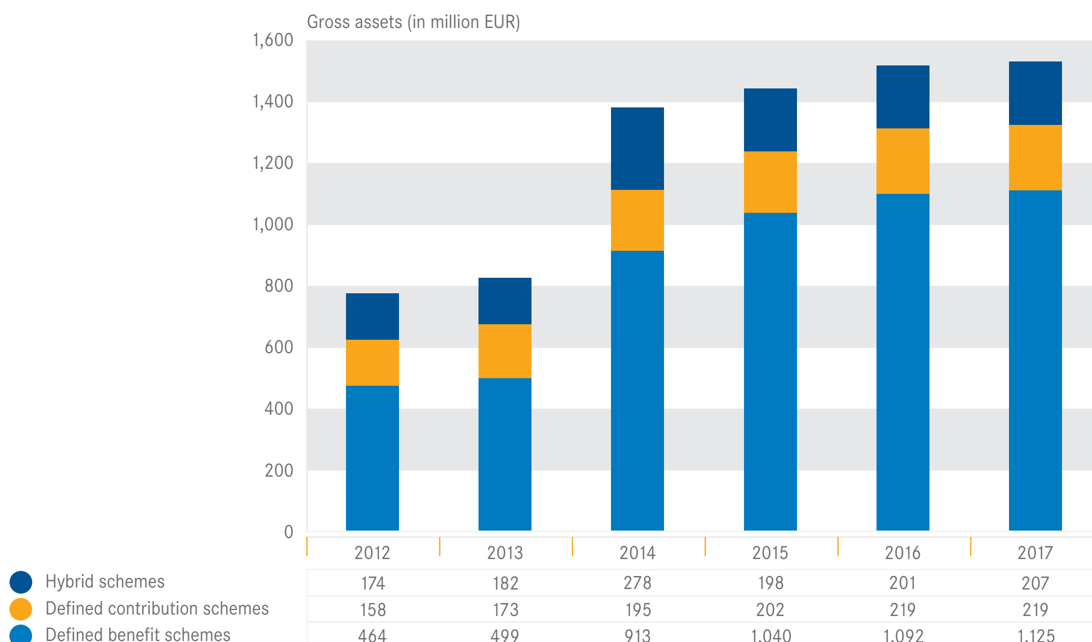
Development of pension fund assets



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

At the end of 2017, gross assets of the defined benefit schemes amounted to EUR 1,125 million and represented 72.5% of overall gross assets of pension funds. The assets of defined contribution schemes amounted to EUR 219 million as at 31 December 2017.

Developments of assets according to the type of pension scheme



	2012	2013	2014	2015	2016	2017
Hybrid schemes	174	182	278	198	201	207
Defined contribution schemes	158	173	195	202	219	219
Defined benefit schemes	464	499	913	1,040	1,092	1,125

1.5. Allocation of pension fund assets

In 2017, pension funds invested mainly in investment funds, amounting to EUR 796 million, 49.12% (EUR 391 million) of which were exposed on the equity market and 44.59% (EUR 355 million) on the bond market. The remaining 6.28% (EUR 50 million) were invested in mixed funds, monetary funds and alternative investment funds.

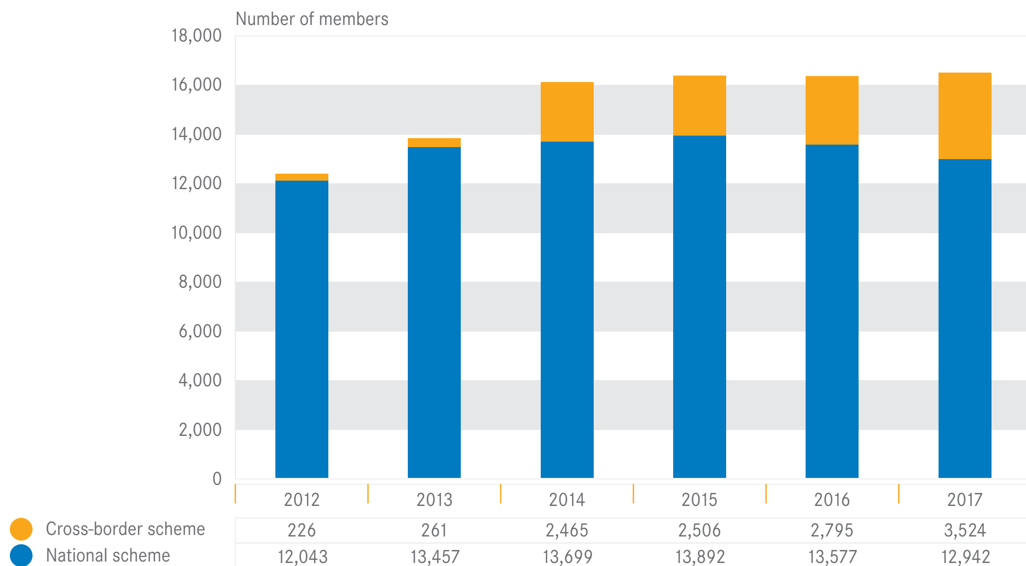
Total investment of pension funds in bonds represented EUR 630 million, i.e. 40.6% of total gross assets of pension funds.

1.6. Development in the number of pension fund members

At the end of 2017, the pension funds had 16,466 members against 16,372 as at 31 December 2016.

Analysing the population of members of pension funds supervised by the CSSF shows that the proportion of international members (3,524 members as at 31 December 2017) is rising compared to the previous years, resulting from a growing globalisation of certain pension funds via schemes offered in multiple host countries. Four new pension schemes with foreign sponsoring undertakings were approved in 2017.

Development in the number of pension fund members



	2012	2013	2014	2015	2016	2017
Cross-border scheme	226	261	2,465	2,506	2,795	3,524
National scheme	12,043	13,457	13,699	13,892	13,577	12,942

2. DEVELOPMENT OF LIABILITY MANAGERS IN 2017

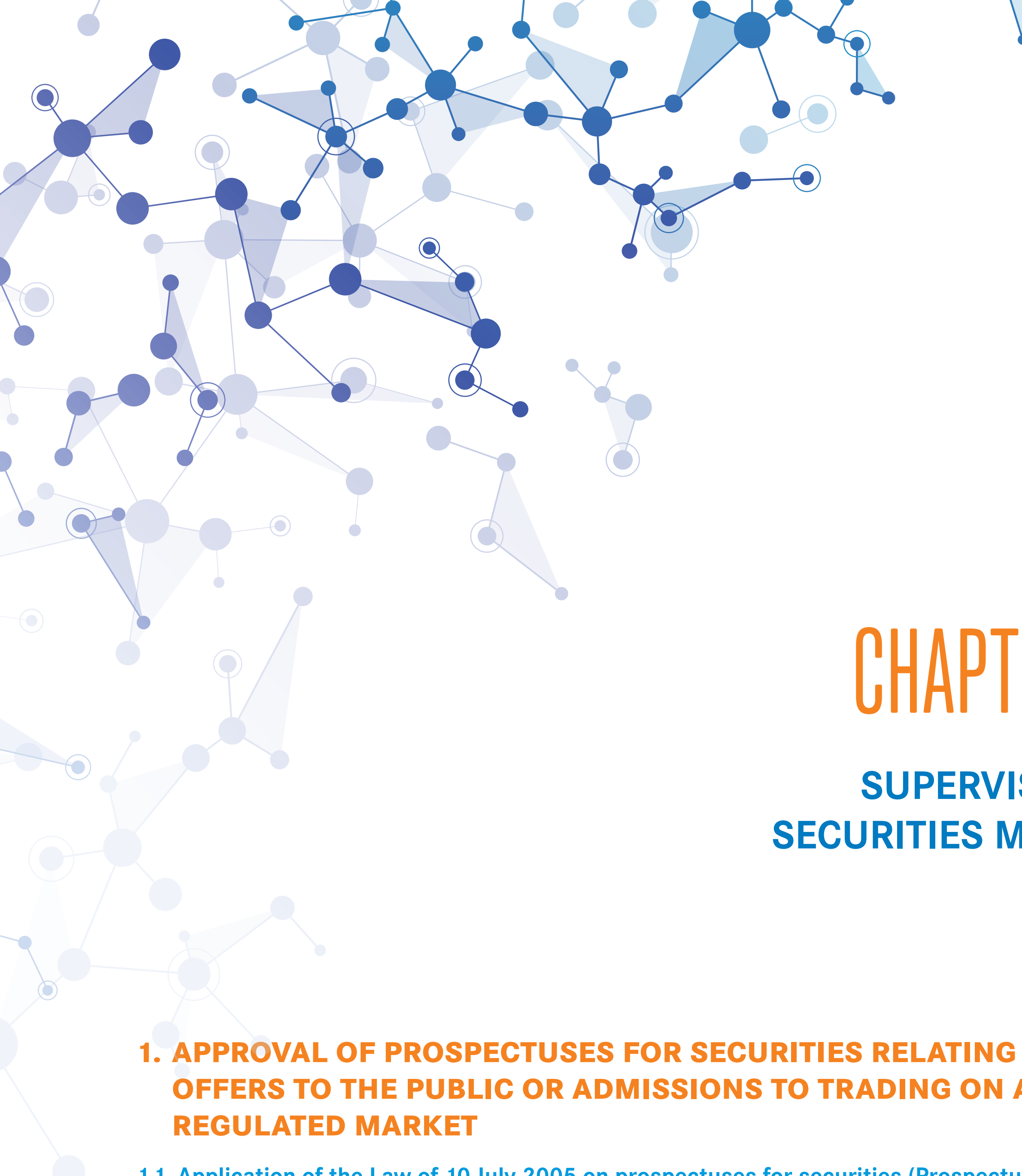
In 2017, no new liability manager has been registered on the official list of professionals authorised to act as liability managers for pension funds subject to the Law of 13 July 2005.

The number of liability managers for pension funds authorised by the CSSF amounted to 18 as at 31 December 2017.

Agents hired in 2017 and 2018: Departments "Authorisation and supervision of investment fund managers and securitisation undertakings", "Authorisation and supervision of alternative investment funds" and "UCI on-site inspections"

From left to right: Mathieu JIMENEZ, Jérôme DRACA, Kaloyan KOSTOV, Jean-François DELOOZ, Anila ALIJAJ, Robert STAUTER, Jean-François STOFFEN, Engin IRCAG, Laura DE CARVALHO, Daniel SCHONS, Marc NEUBERT

Absent : Caroline BIECHEL, Malgorzata MARCISZEWSKA



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 Law of 10 July 2005 on prospectuses for securities (Prospectus Law)

There has been no regulatory change to the Prospectus Law in 2017. However, European Commission's consultation papers and the work undertaken in 2015 and 2016 with respect to the review of the regulations governing prospectuses led to the adoption of Regulation (EU) 2017/1129 of 14 June 2017 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).

The New Regulation entered into force on 20 July 2017 and most provisions will be applicable as from 21 July 2019, with the exception of three articles. One of these articles applies as from 20 July 2017 and the other two as from 20 July 2018.

This regulation will facilitate, among others and under certain conditions, access to capital markets for small enterprises at lower costs through the introduction of a simplified prospectus called "EU Growth prospectus". It also aims at simplifying access to capital markets for frequent issuers by introducing simplified schedules for secondary issuances and will allow retail investors to use a summary adapted to their needs.

In this context, the CSSF is currently making appropriate arrangements that allow agents in charge of the review of the files of securities prospectuses to become acquainted with the innovations introduced by this regulation.

Regarding the review of prospectuses, the CSSF continued to strive to meet, as far as possible, the timetable established by the issuers. Indeed, some of them need to access to the markets very quickly, while others have longer-term projects. Thus, in most instances, the files are distributed among the file reviewers according to

the established timetable, thereby allowing projects to be accomplished within requested deadlines. The CSSF therefore encourages the filing entities to provide, if possible, a timetable with the filing of the prospectus, in order to enable the CSSF to deploy, from the beginning of the review, the necessary means to approve the documentation at the desired date, while ensuring a high level of quality.

In 2017, it took 4.95 business days on average to dispatch the final comments and about 23.23 business days on average to process a file.

In regard to the questions sent to prospectus.help@cssf.lu before the actual filing of documents to be approved, the CSSF notes that the number of requests for advice was, with 123 requests in 2017, higher than in the previous year. Most of these requests concerned questions on financial statements relating to the issuer or guarantor, the presentation of the draft prospectus before the official filing or the filing of the final terms.

The CSSF strongly recommends this approach which consists in contacting it before the official filing. In many cases, upstream reflections allow clearing up doubts of the persons in charge of the prospectus drafting and gaining precious time for the preparation of the files in question as well as the review process of the files by the CSSF agents.

In 2017, the CSSF approved two prospectuses each with an omission of information due to non-pertinence in accordance with Article 23(4) of the Prospectus Regulation.

In the year under review, the CSSF received and accepted only one request for omission of information pursuant to Article 10 of the Prospectus Law.

1.2. Approvals and notifications in 2017

1.2.1. Documents approved by the CSSF in 2017

In 2017, the number of documents approved by the CSSF decreased marginally compared to 2016, with a total of 1,508 documents approved (of which 324 prospectuses, 310 base prospectuses, eight registration documents and 866 supplements) against 1,560 in the previous year (-3.33%). The number of base prospectuses approved in 2017 remained stable compared to the preceding year, whereas the number of approved prospectuses decreased by 5.54%. There has been a 3.99% fall in the number of approved supplements.

1.2.2. Documents drawn up under the European passport regime in 2017

In 2017, the CSSF received 1,124 notifications (relating to 267 prospectuses and base prospectuses and to 857 supplements) from the competent authorities of several EEA Member States, against 1,296 notifications (relating to 254 prospectuses and base prospectuses and to 1,042 supplements) in 2016 (-13.27%). Between 2016 and 2017, there has been a 5.12% growth in the number of received notifications relating to prospectuses and base prospectuses. The number of notifications relating to supplements however dropped by 17.75% over this period.

In 2017, the CSSF sent notifications for 935 CSSF-approved documents (318 prospectuses and base prospectuses and 617 supplements) to the competent authorities of the EEA Member States, against 892 documents (283 prospectuses and base prospectuses and 609 supplements) in 2016. Thus, there has been a growth of 12.37% over the year for prospectuses and base prospectuses while supplements remained almost stable (+1.31%).

1.2.3. ESMA statistics

In July 2017, ESMA published its statistics relating to prospectus activity in 2016. These statistics show that Luxembourg still ranks first with respect to the number of approved documents by the competent authorities of the EEA Member States. The CSSF approved 18.7% of the approved documents in the EEA, i.e. 649 prospectuses and base prospectuses.

1.2.4. Approvals

In the first five months of the year 2017, the number of prospectus approvals remained fairly stable compared to the same period of 2016. Thereafter, differences were much greater, up to 30% in October for instance. Despite these gaps, the teams in charge of reviewing the prospectuses remained very flexible which allowed managing these fluctuations and respecting the timetables established by the issuers.

It can be noted in this context that base prospectus approvals remained stable, as already observed in 2016. Indeed, 310 base prospectuses have been approved in 2017, against 309 in 2016.

Moreover, 83 prospectuses were approved in the framework of issues of asset-backed securities, which is a slight drop against the preceding year during which the CSSF approved 97 prospectuses of this category.

This year again, the CSSF observed great diversity in the geographical origin of the issuers, whether in relation to prospectuses or base prospectuses. Indeed, the top three geographical origins are Germany (19.71%), the United Kingdom (17.19%) and Luxembourg (15.30%). As far as the other issuers are concerned, 33.60% come from EEA Member States other than the above-mentioned ones and 14.20% from third countries.

The CSSF approved 206 files relating to Luxembourg issuers, including 55 prospectuses, 42 base prospectuses, three registration documents and 106 supplements.

Along with approving prospectuses, the CSSF started reviewing the Final Terms which are submitted to the CSSF throughout the year, more than 12 months ago. Most of the issuers seem to appreciate this "free" control which allows them to improve the quality of their future Final Terms or to take into account the CSSF's remarks in order to make certain clarifications in their base prospectuses in a future update.

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 2014 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.

2.1. Files for which the CSSF was competent as the authority of the Member State where the company concerned has its registered office and where the regulated market on which the securities of the company concerned are admitted to trading is located

On 8 June 2016, CPI Property Group S.A. (CPI) acting on behalf of its wholly-owned subsidiary Nukasso Holdings Limited (Nukasso) announced the launch of a mandatory takeover bid on the shares of the company Orco Property Group S.A. (OPG) as the control threshold provided for in the Law on Takeover Bids had been exceeded. Since OPG had its registered office in Luxembourg and its shares admitted to trading on the regulated market of the Luxembourg Stock Exchange, the CSSF was the competent authority under the Law on Takeover Bids for the supervision of the bid[1].

In the context of its investigation, the CSSF found, in December 2017, the existence of an undisclosed concert action with respect to OPG in breach of Article 3(a) and (d) and Article 5(1) and (3) of the Law on Takeover Bids among certain main and secondary concert parties. As a consequence, the CSSF decided not to approve the offer document in the context of the mandatory bid on OPG shares considering it as null and void in accordance with the provisions of Article 13(a) of the Law on Takeover Bids.

Please refer to the CSSF's press releases of 16 February 2017, 8 December 2017 and 15 March 2018 for further information. The CSSF's decisions communicated in the CSSF press releases of 8 December 2017 have been challenged.

[1] Cf. CSSF Annual Report 2016 (pp. 105-106).

2.2. Files for which the CSSF was competent as the authority of the Member State where the company concerned has its registered office whereas its securities are admitted to trading on a regulated market situated in another Member State

• Voluntary takeover bid on the shares of the company Pegas Nonwovens S.A.

On 17 July 2017, the Czech company R2G Rohan Czech s.r.o. (the Offeror) announced a voluntary takeover bid on all the shares of the company Pegas Nonwovens S.A. (Pegas) which has its registered office in Luxembourg. At the announcement of this bid, the shares of Pegas were admitted to trading on the regulated markets of the Prague stock exchange and the Warsaw stock exchange. The CSSF cooperated with the competent authority of the Czech Republic, namely the Czech National Bank, for the review of the offer document which was published on 25 August 2017 by the Offeror after being approved by the Czech regulator.

The acceptance period ran from 25 August to 25 September 2017. After the voluntary takeover bid, the Offeror held 7,755,476 Pegas shares, representing 88.49% of the voting rights and of the share capital of Pegas.

This voluntary takeover bid was not followed by a mandatory squeeze-out or sell-out under Articles 15 or 16 of the Law on Takeover Bids, as the thresholds allowing to request such a squeeze-out or sell-out had not been reached at the end of the bid.

• Voluntary takeover bid on the shares of the company exceet Group SE

On 18 September 2017, White Elephant S.à r.l. (the Offeror), a company indirectly controlled by the investment fund Active Ownership Fund SICAV-FIS SCS, publicly announced its decision to submit a voluntary takeover bid to the shareholders of exceet Group SE, a company with its registered office in Luxembourg and whose shares are admitted to trading on the regulated market of the Frankfurt stock exchange. The CSSF cooperated with the competent authority of Germany, namely BaFin, for the review of the offer document which was published on 23 October 2017 by the Offeror after being approved by BaFin.

The acceptance period ran from 23 October to 20 November 2017. On 6 November 2017, the Board of Directors of exceet Group SE published a detailed opinion on the bid, by which the Board of Directors recommended the shareholders not to accept the offer on the grounds that the price offered by the Offeror was not financially adequate (*finanziell nicht angemessen*). At the expiry of the acceptance period, the bid was accepted for 5,708,427 shares (i.e. the 27.81% equity interest held by Wendel SE in the target company which Wendel SE had contractually committed to tender). Together with the shares held by the Offeror at the publication of the offer document (5,800,000 shares, i.e. about 28.26% of the share capital and voting rights of the target company), the latter held shares representing about 56.07% of the share capital and voting rights of the target company at the end of the bid.

This voluntary takeover bid was not followed by a mandatory squeeze-out or sell-out under Articles 15 or 16 of the Law on Takeover Bids, as the thresholds allowing to request such a squeeze-out or sell-out had not been reached at the end of the bid. Moreover, the Offeror had stated in the offer document its intention not to perform a mandatory squeeze-out, either under the Law on Takeover Bids or 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.

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

In 2017, the CSSF did not grant any derogation under Article 4(5) of the Law on Takeover Bids.

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

In 2017, the CSSF did not have to deal with any case not falling within the scope of the Law on Takeover Bids.

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

In 2017, the CSSF did not have to deal with any procedures governed by 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. There has not been any majority shareholder notification, provided for under Article 3 of the aforementioned law, to the CSSF in 2017.

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 22 February 2018, 564 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 substantially as compared to March 2017, notably due to the fact that most of the 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 2017, Luxembourg was confirmed as the home Member State of 31 issuers, whereas 113 issuers no longer fall 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 564 issuers supervised by the CSSF, 160 are Luxembourg issuers, of which 44 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, nine are banks, eight are securitisation undertakings authorised pursuant to the Law of 22 March 2004 on securitisation and two are UCIs.

196 issuers have their registered office in another EEA Member State and 208 issuers are established in a third country (outside the EEA).

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 2017 review campaign. The CSSF sent 42 reminders and imposed seven administrative fines pursuant to Article 25 of the Transparency Law related to annual and half-yearly financial reports. Though there is an increase in the number of reminders resulting from tighter deadlines, 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 2017, the CSSF continued its reviews of notifications relating to the acquisition or disposal of major holdings. In total, the CSSF received about 280 notifications relating to major holdings. The review of these notifications led the CSSF to issue six 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, 25 and 26 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 2017 amounted to 219 entities (2016: 224 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 of ESMA. 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 companies listed on a European regulated market.

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; and
- 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 2017

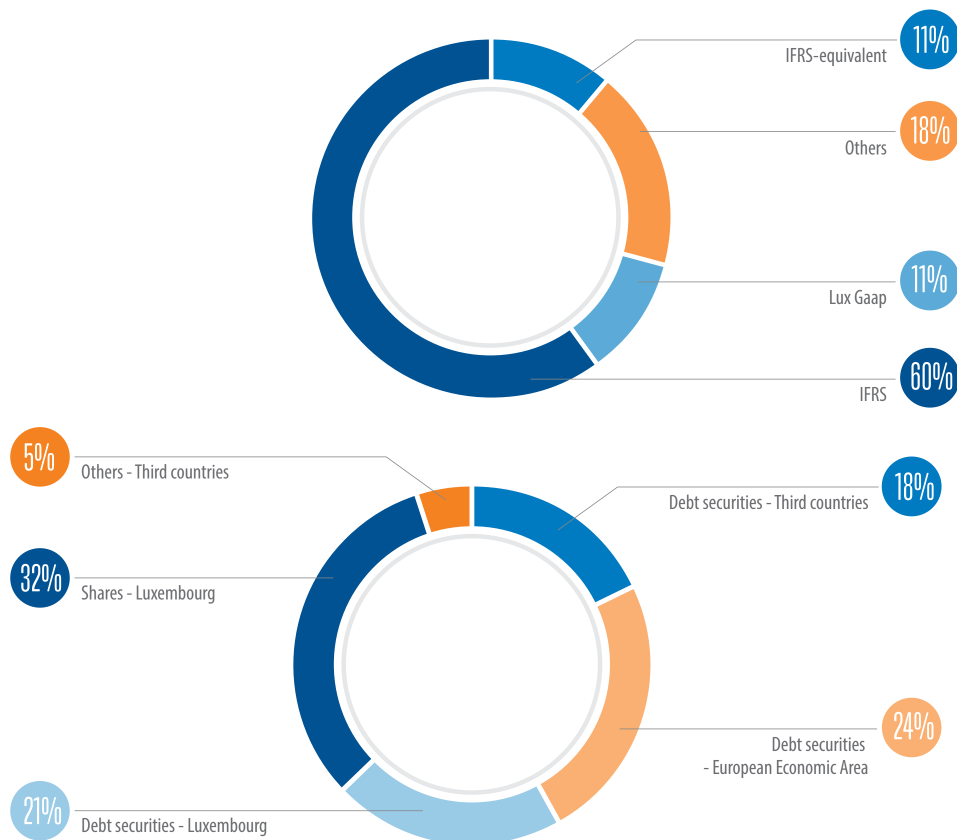
5.3.1. Summary of the enforcement activities in 2017

The examinations performed in 2017 covered more than 35% of the issuers falling within the scope of enforcement.

- **Unlimited scope examinations**

In 2017, the CSSF's unlimited scope examinations covered 17% of the issuers (against 16% in 2016 and 16% in 2015). As the tables below show, the unlimited scope examinations covered different categories of issuers and accounting standards, and thus a representative 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 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 2017 enforcement campaign, the CSSF notified on average 4.7 misstatements/irregularities per issuer (compared to 6.2 in 2016 and 4.2 in 2015).

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

Topic	2015	2016	2017
Disclosure of financial statements (IAS 1, IAS 34, IAS 7)	34%	20%	20%
Alternative performance measures	-	3%	20%
Fair value measurement (IFRS 13, IAS 40)	15%	13%	11%
Financial instruments (IAS 32, IAS 39, IFRS 7)	14%	9%	11%
Impairment of assets (IAS 36)	5%	19%	6%
Income taxes (IAS 12)	3%	8%	3%
Business combinations (IFRS 3)	1%	9%	1%
Consolidation standards (IFRS 10, IFRS 12)	4%	2%	1%
Other accounting standards and issues	24%	17%	27%

- **Focussed scope examinations**

Two focussed scope examinations were carried out on different samples of issuers during the 2017 campaign. The CSSF verified in this context that these issuers complied with the main requirements of IFRS 3 "Business Combinations", as well as with the ESMA Guidelines on alternative performance measures (APMs).

- **Follow-up examinations**

Issuers subject to an examination during the 2016 campaign, and whom the CSSF requested to modify or improve the 2016 financial statements concerned, 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 2017, 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, the preparation of consolidated financial statements as well as compliance with the ESMA Guidelines on APMs.

5.3.2. Main observations and recommendations issued in 2017

The findings and recommendations described below provide an indication of the CSSF's main observations made in 2017. The issues put forward relate in particular to the priorities identified during the 2017 campaign and described in Press release 17/03 published by the CSSF on 5 January 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.

- **Presentation of financial performance**

The presentation of an entity's financial information is a key driver to influence its users. To this end, the CSSF's examinations covered the main requirements of IAS 1 "Presentation of Financial Statements", and in particular how issuers present their performance in the primary financial statements.

Overall, the CSSF observed that the issuers stated their comprehensive income adequately and took into account the latest amendments to IAS 1 on information aggregation the purpose of which is to present comprehensible information which is not obscured by non material elements, including in the notes.

However, the CSSF intervened when it considered, for instance, that incomplete, misleading or irrelevant information was given notably due to aggregation, in the profit and loss account, of items of dissimilar nature, inadequate designation of certain subtotals used, or presentation of accounting methods that do not apply to the financial situation or to the operations of certain issuers.

The CSSF also emphasises the importance of taking into account the materiality as determining factor to present useful information to the users of financial statements. However, materiality shall be considered in view of the size or nature of the elements involved.

• Alternative performance measures (APMs)

APMs are measures that are not defined by the applicable accounting framework and also play a role in the presentation of the financial performance mentioned above. In general, they are used by issuers in their management report and/or press releases in order to shed additional light on the performance measure.

In 2015, ESMA published guidelines regarding these APMs in order to promote their usefulness and transparency. Complying with these guidelines improves their comparability, reliability and understanding.

In the context of focussed scope examinations, the CSSF had observed, as soon as 2016, some failures to comply with these guidelines that apply to issuers since 3 July 2016. That is why this subject was a focus of attention of the 2017 campaign.

While there has been significant improvement in compliance with the guidelines, deficiencies have nevertheless been observed for three out of eight requirements set out in the guidelines. Thus, as regards the presentation of APMs, the CSSF regrets that certain issuers do not clearly communicate the definitions of all the APMs used or do not use a sufficiently explicit denomination reflecting their content and their calculation method, which could harm the message transmitted to the users of such financial information.

APMs must be reconciled to the relevant line items of the financial statements of that period, unless they are directly identified in the financial statements. Indeed, it is important for users to be able to reconcile a measure used by the management to one or several figure(s) from the financial statements established according to an accounting framework.

Some issuers fail to provide an explanation regarding their reason to use these APMs in order to allow users to understand their relevance and reliability. Here again, the CSSF insists on the importance of this information which aims at clearly explaining the purpose of the use of APMs rather than presenting a series of standard and/or generic measures (EBIT, EBITDA, etc.) without explaining the link with the entity's performance.

• Information to be provided for the first application of a new standard

The new financial information standards IFRS 9 "Financial instruments" and IFRS 15 "Revenue from Contracts with Customers" entered into force on 1 January 2018 and IFRS 16 "Leases" will follow suit on 1 January 2019. In this context, the CSSF analysed the information presented by the issuers relating to the impact of these new standards, based on the application of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" in order to also assess, to a certain extent, their degree of preparation.

While IAS 8 requests issuers to provide known information or information that could be reasonably estimated concerning the assessment of the possible impact of a new standard, it has been observed that the information provided is all too often generic and does not sufficiently contain qualitative and quantitative data to allow readers to understand the expected impact of the transition on financial statements.

Therefore, the CSSF issued injunctions and recommendations in order to improve the quality of the information provided in the financial statements relating to the financial year 2017. The CSSF will continue, in its 2018 campaign, to verify, among other things, how this information on the impact of these new standards is communicated to the market.

• Business combinations

As regards the thematic review of different aspects of business combinations, the CSSF noted that the different stages of the application of the acquisition method are generally well accounted for. The issuers pay particular attention to the identification and the valuation of intangible assets not recognised before the acquisition. The examinations carried out demonstrated that the reviewed issuers analyse in detail the determination of these assets and that the assumptions inherent in their valuation are acceptable.

However, improvements as regards the information to be provided are still necessary. Paragraphs 59 and B64 of IFRS 3 "Business Combinations" provide an exhaustive list of information to be transmitted by every business combination that occurred during the reporting period of financial information presentations, except for those deemed insignificant.

• Other considerations

During the 2017 campaign, the CSSF took a certain number of decisions relating to impairment tests on assets and the presentation of quantitative and qualitative information in this context, as described by IAS 36 "Impairment of Assets", as well as the presentation of information on the fair value measurement methods and the assumptions used as required under IFRS 13 "Fair Value Measurement".

These subjects have already been attention points during the 2016 campaign and the main observations were broadly described in the CSSF Annual Report 2016. Nevertheless, the CSSF noted, once again, deficiencies relating to the methods used for the determination of the recoverable amount of a cash-generating unit, or the lack of a certain amount of data in the notes to the accounts.

5.4. Prospects for the 2018 campaign

The enforcement campaign for the financial year 2018 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 2017 closing of financial statements, the CSSF announced in Press release 17/43, published on 15 December 2017, a certain number of topics and issues that will be specifically monitored during the 2018 campaign of enforcement examination of issuers preparing their financial statements in accordance with the IFRS.

6. SUPERVISION OF MARKETS AND MARKET OPERATORS

6.1. Reporting of transactions in financial instruments

6.1.1. Obligation to report transactions in financial instruments

The reporting regime in respect of transactions in financial instruments is mainly set down in Article 28 of the Law of 13 July 2007 on markets in financial instruments (MiFID Law).

6.1.2. Credit institutions and investment firms concerned by the obligation to report transactions in financial instruments

As at 31 December 2017, 237 entities (credit institutions and investment firms incorporated under Luxembourg law and Luxembourg branches of credit institutions and investment firms incorporated under foreign law) fell within the scope of Article 28 of the MiFID Law and were potentially concerned by the transaction reporting regime (243 entities in 2016), including 139 credit institutions (141 in 2016) and 98 investment firms (102 in 2016). It should be noted that among the investment firms, only those authorised to carry out transactions in financial instruments, i.e. commission agents, private portfolio managers, professionals acting for their own account, market makers, underwriters of financial instruments and distributors of units/shares of UCIs, are subject to the reporting obligation.

As at 31 December 2017, 86 entities (88 in 2016), of which 76 credit institutions (77 in 2016) and 10 investment firms (11 in 2016), were required to send their transaction reports to the CSSF as their interventions are considered as "executions of transactions" within the meaning of the MiFID Law, as specified by Circular CSSF 07/302. The difference compared to the number of entities that are potentially concerned by the reporting regime results from the fact that, in practice, a certain number of entities, mainly investment firms, are not subject to the obligation to report transactions in financial instruments because they do not conclude immediate market facing transactions and do not execute transactions on own account.

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

In 2017, the number of transaction reports sent by the entities and accepted by the CSSF reached 667,911 (-0.69% compared to 2016).

Monthly breakdown of transactions by type of instrument in 2017

	Bonds	Shares	UCIs[2]	Futures	Options	Others	Rights	Monthly total
CFI Code	(Dxxxxx)	(Exxxxx)	(Cxxxxx)	(Fxxxxx)	(Oxxxxx)	(Mxxxxx)	(Rxxxxx)	
January	25,944	20,566	235	2,568	2,294	361	287	52,255
February	26,339	20,845	200	3,010	2,335	322	209	53,260
March	29,530	21,050	257	4,278	2,962	341	478	58,896
April	21,013	16,021	191	2,726	2,168	335	566	43,020
May	24,479	26,222	169	2,666	2,733	561	606	57,436
June	21,597	17,656	303	4,099	2,086	463	585	46,789
July	22,565	18,218	1,984	4,551	1,992	1,032	327	50,669
August	17,222	15,451	2,646	4,401	2,300	192	78	42,290
September	20,673	20,837	4,588	4,133	4,453	256	101	55,041
October	23,142	32,182	3,644	3,127	2,512	1,305	255	66,167
November	27,137	30,807	5,526	3,987	6,769	633	147	75,006
December	18,741	34,592	5,548	4,486	2,517	1,085	113	67,082
Annual total	**278,382**	**274,447**	**25,291**	**44,032**	**35,121**	**6,886**	**3,752**	**667,911**

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, enhance investor confidence in those markets and thereby ensure a level playing field for all market participants.

[2] This new classification of funds was introduced with the new CFI code (ISO 10962:2015) that the CSSF accepts since mid-November 2016 in the transaction reports. However, it needs to be noted that the majority of professionals still use the former version of the CFI code which categorised funds as "Shares".

In the context of its supervision of securities markets, the CSSF either initiates inquiries itself or conducts them following a request for assistance from a foreign administrative authority within the framework 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 are noted during the aforementioned investigations are also brought to the attention of the State Prosecutor.

7.1. Investigations initiated by the CSSF

In 2017, the CSSF did not open any investigation in terms of market abuse.

An investigation carried out by the CSSF led to the imposition of administrative fines on several persons who participated in an undisclosed concert action in breach of the provisions of the Law on Takeover Bids and to an administrative fine of EUR 1 million imposed on a natural person for market manipulations. The decisions have been challenged before the administrative jurisdictions.

Moreover, two investigations into insider dealing 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 2017, the CSSF received 74 cooperation requests from foreign authorities (idem in 2016) in relation to the following subjects.

Cooperation requests by subject[3]

Subject		2016	2017
Market abuse	Insider dealing	40	48
	Market manipulation	23	11
MiFID (markets in financial instruments)		4	3
Takeover bids		2	1
Transparency		4	2
Law of 5 April 1993 on the financial sector		-	4
Others		8	6

Nine 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 41 suspicious transaction and order reports in 2017 (28 in 2016).

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 2017, the CSSF also received 28 reports transmitted by foreign authorities (25 in 2016).

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

[3] 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 represents a common framework to ensure the accuracy and integrity of indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds in the EU and thereby contributes to the proper functioning of the internal market while achieving a high level of consumer and investor protection.

This regulation is fully applicable since 1 January 2018 and targets three types of market participants, namely benchmark administrators, contributors providing input data to a benchmark and supervised entities using a benchmark.

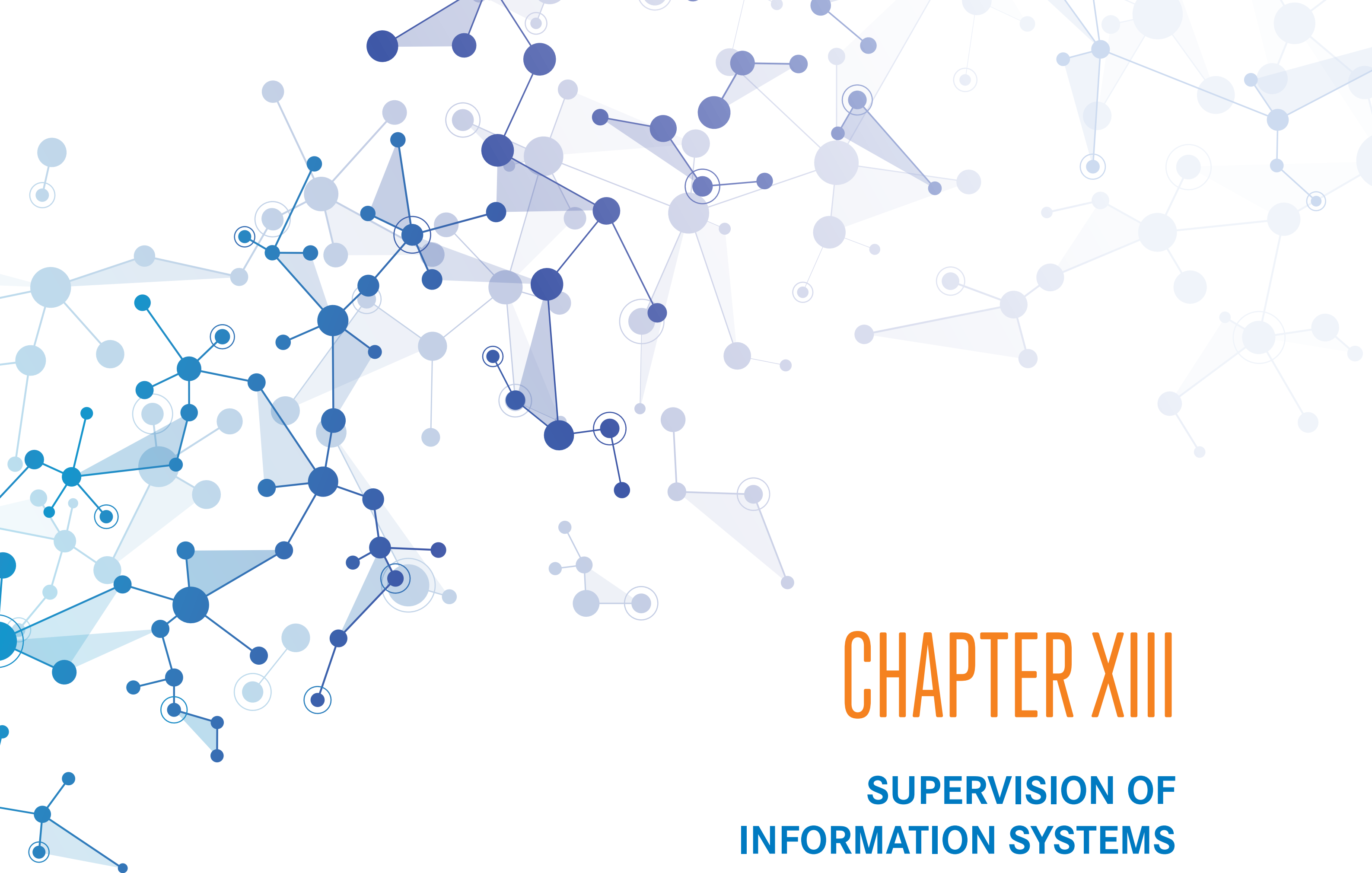
At the national level, the draft bill no 7164 implementing the aforementioned regulation designates the CSSF as the competent authority for the benchmark administrators and as the default competent authority for the supervised entities governed by the regulation. An exception applies however to this default competence for entities supervised by the Commissariat aux Assurances, as the latter is designated as competent authority for the purpose of the regulation for supervised entities under its supervision.

In 2017, the European Commission completed the list of critical benchmarks under the aforementioned regulation, which already included EURIBOR, by taking into account EONIA and LIBOR. It should be noted that the CSSF, in its capacity as authority supervising Banque et Caisse d'Épargne de l'État, contributor to EURIBOR and EONIA, is represented in the EURIBOR and the EONIA college.

As stated in Press release 17/36 of 30 October 2017, any question concerning the application of the regulation may be addressed to the CSSF by email to benchmarks@cssf.lu. The CSSF also created a subsection dedicated to benchmarks on its website (Supervision > Benchmarks).

Agents hired in 2017 and 2018: Departments "Information systems and supervision of support PFS", "Resolution" and "Innovation, payments, market infrastructures and governance"

From left to right: Églantine FLORI, Nicolas VETSUYPENS, Sabrina MEKHANE, Markus POKORNI, Alexandra KNYAZEVA, Maximilian WELSCH, Elvira JÖRG, Bastien RIO, Véronique POURTIER, Christophe DAUDRIX, Amélie SOMMEN, Jean-Pierre BORSA



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 2017

1.1. Modification of the regulatory framework relating to IT outsourcing

In the framework of the cloud computing project, initiated beginning of 2016, the CSSF performed a detailed analysis on the functioning and management of cloud computing service provisions of some major players in this area, including public cloud service providers. The aim of this work was to assess the risks which financial institutions face when subscribing to this type of outsourcing and, where necessary, to contribute to the development of the regulatory framework.

In general, the risks identified have shown that outsourcing to a cloud computing infrastructure requires particular attention, and it differs from traditional IT outsourcing, as governed by Circulars CSSF 12/552 and CSSF 05/178. Therefore, the modification of the regulatory framework appeared to be necessary in order to take into account these specificities while also considering the current thinking at European level as regards cloud computing.

Consequently, in May 2017, the regulatory framework for IT outsourcing has been amended by:

- a new Circular CSSF 17/654 on IT outsourcing relying on a cloud computing infrastructure;
- the amendments of the following circulars, relating to conventional IT outsourcing (as opposed to cloud), in particular to clarify their scope of application which was amended as a result of the new circular on cloud computing and to adjust certain texts which were drafted a number of years ago:
  - amendment to Circular CSSF 12/552 applicable to credit institutions, investment firms and professionals performing lending operations, by Circular CSSF 17/655;

- repeal of Circular CSSF 05/178 and replacement by a new Circular CSSF 17/656 applicable to payment institutions, electronic money institutions and PFS other than investment firms;
- amendment to Circular CSSF 06/240 applicable to all credit institutions and other professionals of the financial sector as well as payment institutions and electronic money institutions, by Circular CSSF 17/657.

1.2. National cooperation: working groups and conferences

In 2017, the CSSF worked, in particular, on the following topics:

- security and evolution of payment means by participating in the Payment Committee of the ABBL and in ALMUS (Association Luxembourgeoise des Membres et Utilisateurs SWIFT). In this context, and considering successful frauds which enabled to divert significant amounts, the CSSF supports SWIFT's initiative referred to as Customer Security Program (CSP) and encourages SWIFT users to join the programme.
- FinTech, by participating in the working group organised by the CSSF with market participants in order to evaluate the need to regulate certain activities and by participating in events organised, among others, by Luxembourg for Finance (LFF) and other organisations and associations involved in this area.

Conferences and events concerning new technologies or IT service offers represent interesting information and exchange platforms in order to stay abreast of the evolution of new technologies. In this regard, the CSSF took part in many events on topics such as e-payments, cybersecurity, blockchain or cloud organised in Luxembourg. Following the publication of Circular CSSF 17/654 relating to cloud computing, the CSSF organised several sessions for lawyers and entities concerned in order to explain the content of the circular and to answer questions, for the purpose of improving the understanding.

1.3. 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 2017, the annual meeting was held in Oslo under the aegis of Finanstilsynet, the Norwegian financial sector authority. The discussions concerned (1) FinTech (in particular, the impact of new technologies such as DLT, Robo Advisor, Biometrics, API, etc. on the business models and experience of regulatory sandboxes), (2) cybersecurity (exchange of information between supervisors and need in terms of training of supervisors), and (3) business continuity and IT disaster recovery plans (exchange on regulatory requirements in the various countries and on the technical and procedural solutions observed). The different round tables also enabled 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 (Forum SecuRe Pay), co-chaired by the EBA and the ECB. The SecuRe Pay Forum brings together the EU/EEA supervisory authorities and the national central banks. Its work 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 between the authorities of the challenges in this matter 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 in the ongoing risk assessment in the banking system, in the promotion of cooperation between authorities and the enhanced convergence of supervisory practices. With regard to IT risks and IT supervision, the SCOP draws on the work of this working group dedicated to the 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 includes IT supervisors from each country participating in the Single Supervisory Mechanism (SSM) of the ECB. In plenary sessions or through 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 2017, the three aforementioned working groups devoted most of their efforts on the following topics.

1.3.1. 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 2017, the SecuRe Pay Forum continued its preparation or finalisation of the regulatory texts.

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

The EBA published the final version of these technical standards in February 2017 but the European Commission announced, on 24 May 2017, its intention to amend the text of the EBA. In its reply, dated 29 June 2017, the EBA expressed its disagreement with three of the four proposed amendments. Finally, on 27 November 2017, the European Commission adopted by delegated act a revised version of these technical standards, leaving the Council and the European Parliament a period of three months until 27 February 2018 to adopt this text.

The standards will then enter into force 18 months after their adoption by the European Commission, i.e. presumably in 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, not prohibiting the development of user-friendly and innovative means of payment, and a level playing field for all payment service providers.

• Guidelines on the management of operational and security risks

The CSSF contributed to the drawing-up of the 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 market consultation took place during summer 2017 over a three-month period, prior to the publication of the final text on 12 December 2017. These guidelines have been applicable since 13 January 2018.

- **Guidelines on major incident reporting**

Please refer to point 1.3.4. below for further information.

- **Guidelines on the information to be provided for the authorisation of payment institutions and e-money institutions and for the registration of account information service providers**

The CSSF contributed to the drawing-up of these guidelines as regards the information to be provided on the IT organisation, IT systems as well as payment and data security. These guidelines were published on 11 July 2017 and have been applicable since 13 January 2018.

- **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 launched a market consultation on its draft guidelines on 2 August 2017 for a period of three months. The CSSF contributed to the analysis of the feedback received up to the finalisation of these guidelines.

1.3.2. Cloud computing IT outsourcing

In 2017, the EBA TFIT continued to draw up recommendations on the outsourcing to cloud service providers aiming at clarifying and harmonising the European regulators' expectations towards banks wishing to rely on a cloud computing IT outsourcing.

Following a market consultation on its draft recommendations, the EBA finalised and published, at the end of 2017, these recommendations which will be applicable as from 1 July 2018.

1.3.3. Assessment of IT risks in the banking supervisory process

- **Guidelines on the assessment of the risks related to information and communication technology (ICT) in the context of the supervisory review and evaluation process (SREP)**

IT risks are taken into account and assessed by banking supervisors as operational risks in the context of the supervisory review and evaluation process (SREP), in accordance with the EBA guidelines on SREP. However, the methodology available to them in this area is limited and harmonisation of these practices at European level is thus uncertain, whereas the importance of a correct evaluation of these risks in the current technological context is growing steadily.

Consequently, the EBA TFIT published, in 2017, guidelines addressed to the competent authorities, aiming at promoting common procedures and methodologies for the IT risk assessment in the SREP context. They have been applicable since 1 January 2018.

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

Following the assessment of IT risks within the SREP context, supervisors may start different actions and, in particular, plan an 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 feedbacks and the evolution of IT risk. In 2017, this working group notably focussed its efforts on the IT risk management framework.

- **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 SREP context, 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. These guidelines should be published, for market consultation, in summer 2018.

1.3.4. Security incident reporting

In order to allow supervisors to develop an improved appreciation of security risks and incidents, notably cyber risks and cyber incidents, to which the financial sector is exposed, two incident reporting obligation processes were finalised in 2017.

- **Guidelines on major incident reporting for payment service providers (under PSD2)**

In accordance with the mandate conferred upon it by Article 96 of PSD2, the EBA drafted, through the SecuRe Pay Forum, guidelines on the reporting of major operational and security incidents including cyber incidents, addressed to each of the following:

- payment service providers with respect to the classification of major incidents and the procedure for reporting them to the competent authority of the home Member State;
- competent authorities with respect to the criteria on how to assess the relevance and details of the incidents to be reported to other national authorities;
- competent authorities with respect to the notification process to the EBA and the ECB of relevant details of the reported incident to a national competent authority, the collective assessment by the EBA, the ECB and the national authority of the reported incident for other national and European authorities, and the process of notification by the EBA and the ECB to these other national authorities, where appropriate.

These guidelines were published on 27 July 2017 and have been applicable since 13 January 2018.

- **Decision of the ECB establishing compulsory reporting of major cyber incidents**

This notification requirement concerns significant banks (within the meaning of the SSM) and relates to cyber incidents. The reporting requirement entered into force in July 2017 and must take place according to the instructions and templates developed by the ECB.

1.3.5. Financial innovation

Within the scope of the EBA's FinTech working programme, the EBA TFIT has been entrusted with the task of identifying prudential risks and opportunities that FinTech may offer for 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 report is expected for mid-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 245 requests in 2017, i.e.:

- 41 applications for authorisation (IT-related part) for different types of entities (credit institutions, electronic money institutions, payment institutions, PFS);
- 204 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 most requests for advice or for authorisation originate from credit institutions.

As regards the on-site supervision of the information systems, the on-site inspections aiming to cover 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 2017, the CSSF continued to carry out examinations in order to ensure compliance with the legal and regulatory requirements applicable to remuneration policies and practices. It continued its review of the updates transmitted by the entities following the remuneration policy review campaign initiated in 2016.

Moreover, as announced in its Annual Report 2016, and for the second consecutive year, the CSSF carried out 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 31% of the fixed component of the remuneration (against 35% in 2016), that the proportion of the variable remuneration paid out in financial instruments amounted to 30% on average (against 32% in 2016) and that the deferred component of variable remuneration amounted to 29% of the granted variable remuneration (against 27% in 2016).

In 2017, 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%, were complied with by the entities concerned. To this end, the CSSF reiterates the need to comply with the notification procedure as described in Circular CSSF 15/622. Over the last three 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 will be 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. 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.

Moreover, the CSSF started analysing, based on a sample, the identification of material risk takers in accordance with Delegated Regulation (EU) No 604/2014.

It should also be noted that Circular CSSF 17/658 specifies the application and confirms the principle of proportionality as laid down in Circular CSSF 11/505 and that the EBA Guidelines of 13 December 2016 (ref.: EBA/GL/2016/06) on remuneration policies and practices related to the sale and provision of retail banking products and services apply as from 13 January 2018. These guidelines notably require credit institutions, payment institutions and electronic money institutions to comply with a certain number of provisions when establishing their remuneration policy.

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

A draft grand-ducal regulation has been drawn up in the context of the reform of the examination of professional competence. It will repeal 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).

1.2. Developments in audit standards

1.2.1. Adoption of Circular CSSF 17/662

Circular CSSF 17/662, adopted in July 2017, provides additional information to certain legal and regulatory texts applicable to the audit profession.

Moreover, it adopts the sections "Application and Other explanatory material" and, where necessary, the "Appendix" to the international auditing standards and to the International Standard on Quality Control which were adopted in 2016 via CSSF Regulation N° 16-12.

These "Application and Other explanatory material" and "Appendix" are also accompanied by Luxembourg supplements which include the provisions introduced by the Law of 23 July 2016 concerning the audit profession (Audit Law) and Regulation (EU) No 537/2014.

1.2.2. Draft CSSF regulation adopting professional standards on auditing, quality control and ethics

A draft CSSF regulation which will repeal CSSF Regulation N° 16-12 was submitted for opinion to the Consultative Committee for the Audit Profession in order to adopt:

- the international auditing standards and the International Standard on Quality Control as drawn up by the International Auditing and Assurance Standard Board (IAASB) in the published version of the "Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements - 2016-2017 Edition" by the International Federation of Accountants (IFAC); and
- the code of ethics for the audit profession in Luxembourg which corresponds to the 2016 version of the code of ethics issued by the International Ethics Standards Board for Accountants (IESBA), as amended and published on 21 September 2016.

The main changes introduced by this draft CSSF regulation concern:

- ISA 250 on the consideration of laws and regulations in an audit of financial statements; and
- the code of ethics, supplemented by two new sections (225 and 360) which introduce new requirements when professionals encounter cases of non-compliance with laws and regulations in the course of carrying out their activities.

These requirements apply to accounting periods beginning on or after 15 December 2017.

1.3. Standard-setting activities of the CEAOB (Committee of European Auditing Oversight Bodies)

Two comment letters have been issued in 2017:

- one letter for the attention of the IAASB relating to the draft revision of ISA 540 on auditing accounting estimates;
- the second letter is the response to a consultation on a proposal to reorganise the governance process, the oversight and the setting of professional and ethical standards applicable to the audit profession in order to increase independence and objectivity of standard setters by involving to a greater extent stakeholders in the setting of these standards.

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.

- **Population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* concerned by the quality assurance review**

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 2017:

- Number of approved audit firms: 55, 12 of which are firms auditing public-interest entities (PIEs);
- Number of approved independent *réviseurs* (auditors): four, none of whom audit PIEs.

Based on the data collected through the "Annual Annexes" for the year 2017, the audit engagements break down as follows between *cabinets de révision agréés* and independent *réviseurs d'entreprises agréés*:

- 83% of the audit engagements are carried out by the "Big 4"[1];
- 10% of the audit engagements are carried out by medium-sized audit firms[2]; and
- 7% of the audit engagements are carried out by the other audit firms and independent *réviseurs*.

2.2. Activity programme for 2017

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.

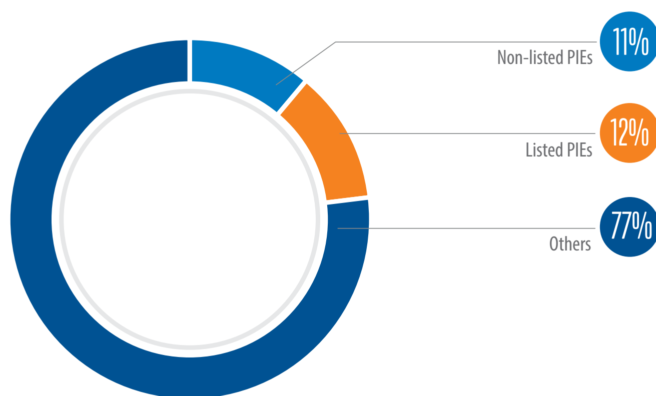
Under the 2017 programme, 13 firms were reviewed, eight of which audit PIEs and eight are members of an international network. The quality assurance reviews concerned:

- 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 (ISQC 1);
- the review of a sample of audit files relating to audit engagements of the financial year 2017 (one reviewed file) and 2016 (or 2015, where applicable); and
- the setting-up of a specific follow-up for professionals for which material weaknesses were noted in the previous financial years.

The 13 reviewed audit firms reported[3] a total of 8,751 audit engagements, including 608 in relation to PIEs. Under the 2017 review programme, 184 mandates were reviewed, 43 of which concerned PIEs.

The quality assurance reviews started in January 2017 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 7,923 hours.

Breakdown of audit files reviewed by the CSSF in 2017 per entity type

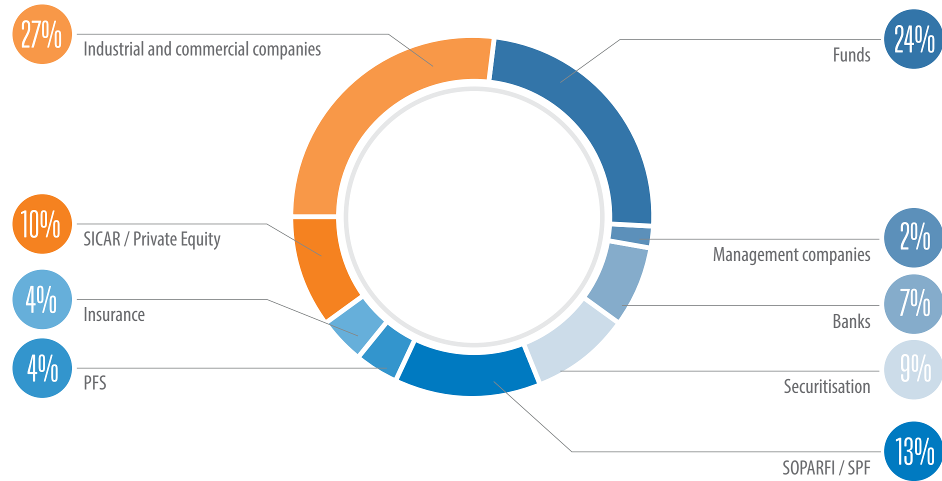


[1] PwC, KPMG, Deloitte, EY.

[2] Firms that carry out more than 100 audit engagements entrusted exclusively to *réviseurs d'entreprises agréés* and *cabinets de révision agréés* by law. As at 31 December 2017, three firms were concerned.

[3] Based on the statements of *cabinets de révision agréés* as at 31 December 2016.

Breakdown of audit files reviewed by the CSSF in 2017 per sector



2.3. Conclusions of the 2017 campaign of quality assurance reviews

Out of the 13 reviews carried out in 2017, 10 were subject to a report and three are in the finalisation process.

In particular, the CSSF carried out a specific follow-up of two firms and six *réviseurs d'entreprises agréés* due to previous campaign conclusions. The measures were terminated during the 2017 review, except for three *réviseurs d'entreprises agréés* who remained subject to the specific follow-up.

Based on the 10 finalised reviews, the following specific conclusions in relation to the 2017 campaign were transmitted to the *réviseurs d'entreprises agréés*:

- a training plan was given to two *réviseurs d'entreprises agréés*; and
- two *réviseurs d'entreprises agréés* were subject to a specific follow-up.

2.4. Major issues identified during the quality assurance reviews of 2017

2.4.1. Review of the quality control systems of *cabinets de révision agréés*

Based on the work carried out in 2017, the main observations in relation to the quality assurance systems of the *cabinets de révision agréés* concerned:

- the monitoring of the completeness of the information produced by the approved audit firm. Exceptions were identified notably with respect to the lists of audit engagements communicated to the CSSF;
- the perfectible character of several engagement quality control reviews implemented, which did not allow identifying significant deficiencies that the CSSF, on the opposite, noticed during its inspections of the same audit files;
- the fact that audit diligence had not been compiled in the audit files within the archiving deadlines or that this reason was used to perform audit diligence after the signature date of the report following the file review by the CSSF; and
- the insufficient promotion of an internal culture based on quality. On this subject, the CSSF reiterates that the management of the approved audit firm and the tone it sets have a significant influence on the internal culture.

2.4.2. Audit files

The findings following the 2017 quality control review are not very different from the ones identified in 2016, irrespective of the size of the reviewed *cabinet de révision agréé*.

Thus, the main observations in 2017 concern:

- the audit of accounting estimates;
- the reliability of the entity's information used by the auditor;
- the group audit and the use of another auditor's work; and
- the overall presentation of the financial statements, including the information disclosed.

• Audit of accounting estimates

The auditor continues to repeatedly lack professional scepticism in assessing the reasonableness of the assumptions retained by the management.

• Reliability of the entity's information used by the auditor

In an environment where information flows are increasingly automated with little or no manual intervention, the auditor must ensure that the information provided by the entity is sufficiently reliable to address the audit needs. The fact that this information was produced by a system does not necessarily mean that it is accurate and complete. Consequently, the CSSF encourages the *cabinets de révision agréés* to be particularly vigilant in this respect and underlines that the reliability of the evidence produced internally is enhanced when controls are implemented during their preparation and follow-up and that such controls operate effectively. Irrespective of the on-site inspections, the auditor may also decide to implement specific audit procedures to ensure that the information provided by the entity is reliable.

• Group audit and the use of another auditor's work

The quality inspections put into perspective some weaknesses concerning group audits, notably with respect to the assessment of the communications on significant components received from auditors and to the adequacy of their work. The quality of these communications raises sometimes legitimate questions as regards the sufficiency of the audit evidence gathered to support their conclusions. The files of the team assigned to the group audit do not always allow avoiding these doubts. In order to address appropriately this point, the group auditors should ensure to:

- be more involved in the risk assessment of significant components;
- communicate audit instructions that are suitable for the risks of material misstatements which are relevant to the group, highlighting, thus, the type of work to be carried out to address these risks;
- systematically discuss with the auditors of the significant components or the management of the components, and, where applicable, with the group management about the important questions resulting from the assessment of the communications received from the auditors of significant components; and
- determine objectively and in accordance with the facts and circumstances of the engagement, the appropriateness of reviewing other relevant parts of the audit documentation drawn up by the auditor of the component. If that is the case, this review and its conclusions should be documented in the group auditor's file.

• Overall presentation of the financial statements, including the information disclosed

If the responsibility of the preparation of the financial statements lies with the client, the auditor, however, must identify the misstatements which are not insignificant and communicate them to 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.

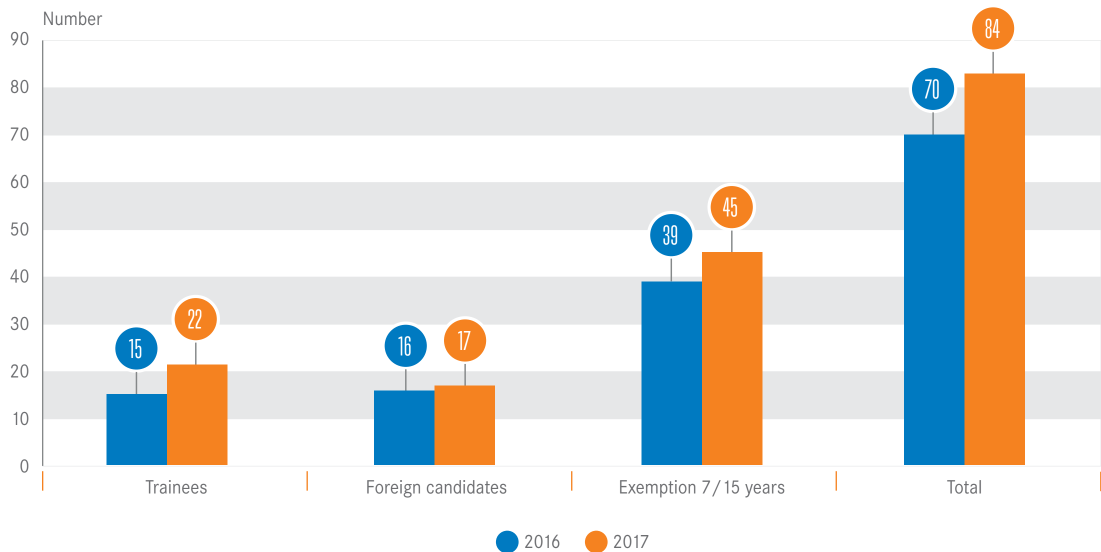
The Commission met seven times in 2017 and analysed the files of 84 candidates, against 70 in 2016, representing an increase of 20%.

In 2017, the access to training was refused to six candidates (7%) as the number of subjects to be completed based on their administrative certificate was greater than five.

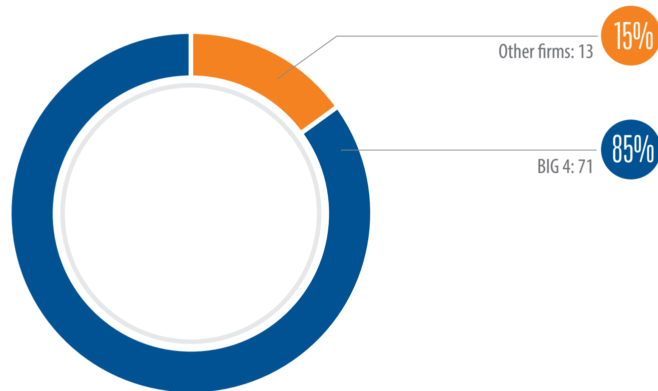
There are three categories of candidates:

- trainee *réviseurs d'entreprises*;
- foreign candidates;
- candidates applying for an exemption based on their professional experience of either 7 or 15 years.

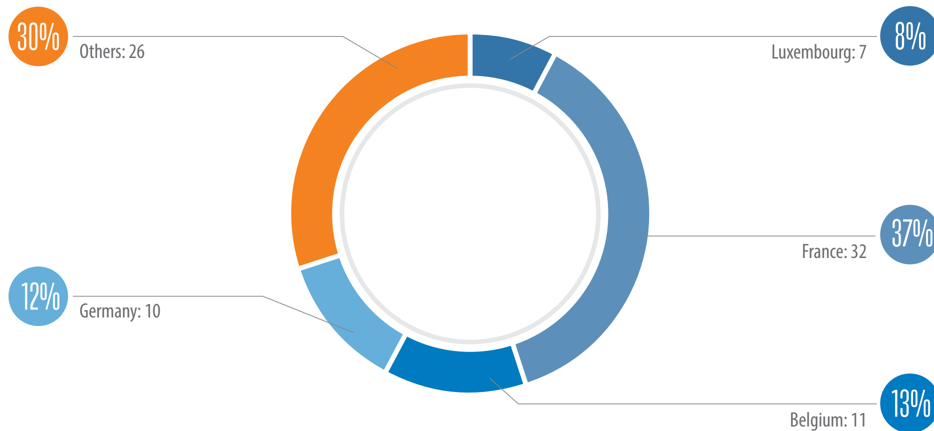
Development in the number of application files submitted to the Consultative Commission



Breakdown of candidates per firm



Breakdown of candidates per nationality



3.1.2. Examination of professional competence in 2017

The CSSF administrates the examination of professional competence in accordance with Articles 5 and 6 of 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 32 candidates registered for the 2017 examination of professional competence to the CSSF:

- Ordinary session: 32 candidates took the written exam, 12 of whom were admitted to the oral exam. In total, eight passed the exam and four were subject to partial referral.
- Extraordinary session: four candidates took the written exam, three of whom were admitted to the oral exam. In total, three passed the exam of the extraordinary session.

Thus, all sessions included, 11 candidates passed the examination of professional competence in 2017 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 14 March 2018 in the presence of the Minister of Finance Mr Pierre Gramegna.

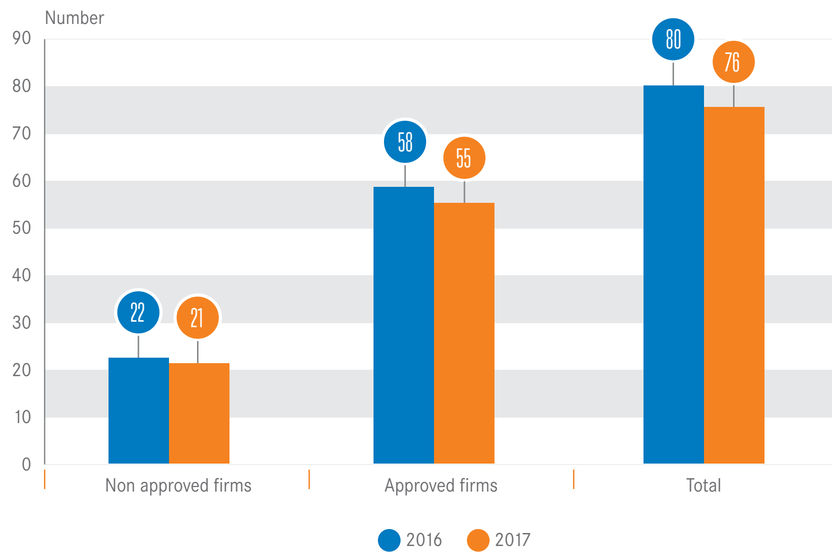
3.2. Public register

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 2017

- **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 76 as at 31 December 2017, against 80 as at 31 December 2016.



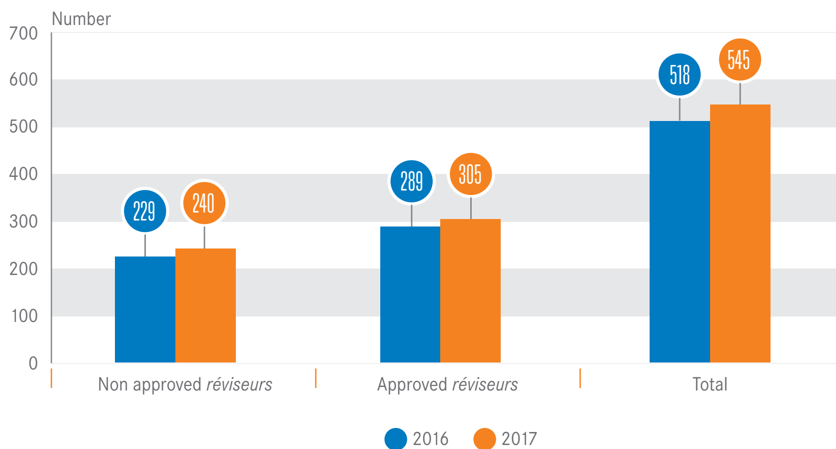
The following firms were approved in 2017:

- Pro Fiduciaire Auditing & Accounting;
- HACA Partners.

In 2017, four firms gave up their approval, three of which have also abandoned the title of "*cabinet de révision*" and two *cabinets de révision agréés* have merged.

- **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 545 as at 31 December 2017, against 518 as at 31 December 2016, representing a 5% increase.



In 2017, the CSSF granted the title of "*réviseur d'entreprises*" to 31 persons and approved 29 *réviseurs d'entreprises*.

During the year under review, 13 *réviseurs d'entreprises* gave up their approval.

The population consists of 68% men and 32% women. The average age of the *réviseurs* is 42.4 years for women and 46.0 years for men.

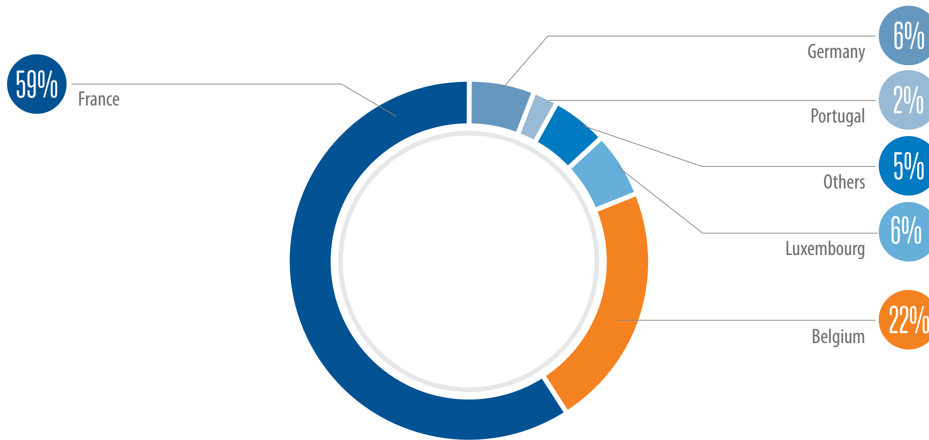
• Development in the number of trainee *réviseurs d'entreprises*

The total number of trainee *réviseurs d'entreprises* amounted to 113 as at 31 December 2017, against 164 as at 31 December 2016, which represents a 31% decrease.

The population consists of 73% men and 27% women. The average age of trainees is 31.6 years for women and 31.4 years for men.

It should be pointed out that 89% of the population of trainees come from the "Big 4" firms.

Breakdown of trainees per nationality



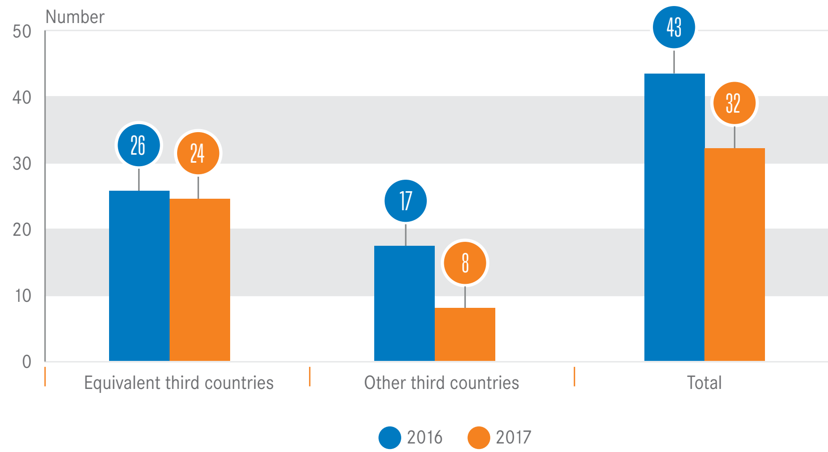
3.2.2. Third-country auditors and audit firms

The registration procedure for third-country auditors and audit entities that provide an auditor's report on the annual or consolidated accounts of a company incorporated outside EU Member States, whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange, continued in 2017.

Thus, the CSSF accepted one new application for registration from an audit entity located in a third country which has public oversight, quality assurance, investigation and penalty systems which are considered as equivalent to the systems in place in the EU.

At the same time, 12 third-country audit entities whose activities no longer fall within the scope of the amended Directive 2006/43/EC 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 2017.

The agreements previously concluded are available on the CSSF's website.

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 banks[1], 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 three on-site inspections of European significant banks abroad.

The OSI department's staff increased to 59 people as at 31 December 2017 in order to fulfil all its tasks. The OSI department's teams are expected to be strengthened in 2018 by way of the recruitment of 20 additional agents.

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. 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 inspections[2] 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 Single Supervisory Mechanism (SSM) as well as "AML/CFT", "MiFID", "Depositary bank" and "Central administration function" 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.

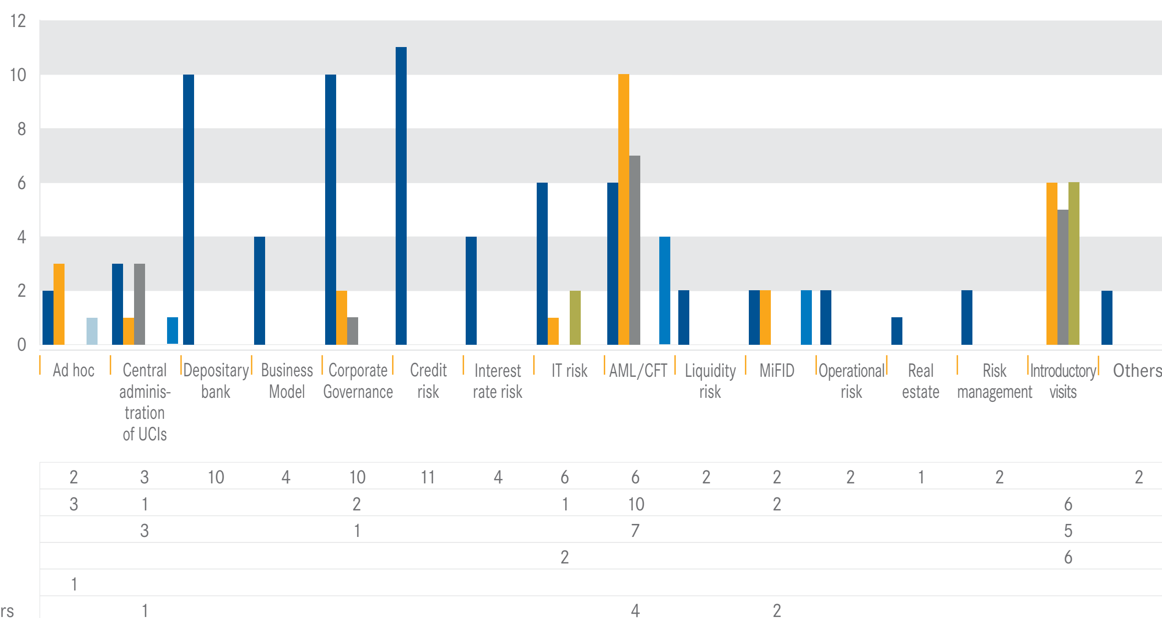
After each on-site inspection, the team in charge of the mission draws up an internal report indicating any flaws and weaknesses identified during the mission. Generally, on-site inspections are followed by an observation letter that is sent to the inspected professional. In the event of more serious 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.

With the entry into force of Grand-ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF, a lump sum will henceforth be 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.

As from 2018, the CSSF adapted its definition of on-site inspection so that on-site visits, during which only management interviews are carried out, will no longer be considered as on-site inspections as their duration is short (cf. in particular introductory visits). Hence, as from 2018, this type of intervention will no longer be included in the statistics of on-site inspections. The CSSF thus aligned its definition of on-site inspection with the definition provided at EU level.

In 2017, a total of 158 on-site inspections were conducted by the CSSF departments or with their participation. Thirty-four of these 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". The other 124 missions concerned the following topics.

Breakdown of the on-site inspections carried out in 2017 by topic and type of entity (excluding UCI departments)



	Ad hoc	Central adminis-tration of UCIs	Depositary bank	Business Model	Corporate Governance	Credit risk	Interest rate risk	IT risk	AML/CFT	Liquidity risk	MiFID	Operational risk	Real estate	Risk management	Introductory visits	Others
Banks	2	3	10	4	10	11	4	6	6	2	2	2	1	2		2
Investment firms	3	1			2			1	10		2				6	
Specialised PFS		3			1				7						5	
Support PFS								2							6	
Payment institutions	1															
Investment fund managers		1							4		2					

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 a 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 occur unexpectedly. 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 2017, six ad hoc on-site inspections were performed. They concerned, in particular, governance, anti-money laundering and counter-terrorist financing, MiFID and market risk.

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 covering the interest rate risk prepared by the ECB.

In 2017, the CSSF carried out four IRRBB on-site inspections, including one at a significant bank which started at the end of 2017 and still continues in the first quarter of 2018.

As regards the completed missions, deficiencies relating to governance, exhaustive risk identification, measurement and limitation of interest rate risk and reporting processes 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 covering the operational risk prepared by the ECB.

In 2017, the CSSF carried out this type of mission at two significant banks in the framework of the SSM. During the first mission, an agent of the OSI department participated with the mixed team in the on-site inspection of a European bank abroad. The purpose of this on-site inspection was to assess the operational risk management processes at the level of capital market and asset management/asset servicing-related activities. The other mission aimed to check the management of outsourcing processes during the preparation, implementation and monitoring phases at a significant bank in Luxembourg. The observed deficiencies concerned, in particular, the documentation of the controls, the involvement of the second line of defence during the outsourcing implementation phase, the inventory of the outsourced activities and the consideration of the concentration risk for less significant providers.

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.

After an in-depth analysis of the procedures in this respect, the processes relating to the granting of credits, the monitoring of credits, the management of defaulted credits as well as the acceptance and monitoring of guarantees are tested on the basis of samples. The different internal reports relating to these processes are also reviewed. Moreover, the governance in place for credit risk management is examined.

The "Credit risk" on-site inspections are performed based on the methodology covering the credit risk prepared by the ECB. In 2017, the ECB implemented new control mechanisms, notably for data collection and credit file reviews with respect to some types of credit portfolios. These mechanisms will harmonise and optimise data collection as well as credit file reviews for future on-site inspections. In this context, the CSSF participates in several working groups overseen by the ECB.

In 2017, the CSSF carried out "Credit risk" on-site inspections at 11 banks, including one at a significant bank which started at the end of 2017 and still continues in the first quarter of 2018.

These on-site inspections concerned various topics such as real estate (residential and commercial) credits, lombard loans, trade financing, syndicated loans and corporate banking loans.

The major flaws identified during the "Credit risk" on-site inspections are, on the one hand, flaws relating to collateral management and, on the other hand, flaws relating to procedures and processes of on-going credit monitoring.

As far as collateral management is concerned, the CSSF identified deficiencies at the level of the methodologies used (assessment at the beginning or during the life of the credit), of the LTV, of their back-testing and of the exception management (identification and communication to managing bodies).

As regards on-going credit monitoring, the CSSF noted that the classification of credits within the systems sometimes differed from the real risk incurred or that it was not in line with the regulatory requirements. Moreover, the aggregation of credits in terms of debtors or group of connected debtors is still an issue and impacts particularly the report on large exposures. These different elements may thus result in the communication of inaccurate information to the managing bodies or competent authorities.

The absence of a definition or adapted processes for the identification of credits in default and forborne credits remains a recurrent flaw. Finally, as far as governance is concerned, the process for the regular update of credit policies and procedures remains a problem and shortcomings were often noted with respect to the risk appetite framework (system of limits, monitoring and communication) and the risk management framework (weight and resource of the risk function).

In addition and although it is not a "Credit risk" on-site inspection, the OSI department also participated in the macroprudential exercise regarding five Luxembourg banks carried out as part of the implementation of the ESRB recommendations of 31 October 2016 aiming to address the shortcomings in the real estate data.

1.5. "Anti-money laundering and counter-terrorist financing" (AML/CFT) on-site inspections

"AML/CFT" on-site inspections are carried out at all the professionals of the financial centre in order to assess that the quality of the AML/CFT framework is in line with the legal and regulatory requirements. Inspections cover notably both private banking (portfolio management, domiciliation, etc.) and UCI activities. Since 2017, the issue of predicate tax offences has been included in the inspection programme of the CSSF.

In 2017, the CSSF carried out 27 "AML/CFT" on-site inspections and supervised the *cabinets de révision agréé* (approved audit firms) during their missions relating to the Panama Papers affair.

Within the context of the publication of a series of documents referred to as "Panama Papers" by the International Consortium of Investigative Journalists, the CSSF decided to mandate different *cabinets de révision agréés* in order to carry out on-site inspections in relation to account holders such as off-shore companies at about 30 banks of the financial centre. These inspections allowed the CSSF to assess the cases of non-compliance with the legal and regulatory AML/CFT framework in force in Luxembourg which were identified by the mandated *cabinets de révision agréés.* They covered, notably, the procedural aspect of the due diligence measures applied by banks to off-shore companies, the quality of the Know-Your-Customer documentation and information based on a sample of off-shore customer files, the quality of the Know-Your-Transactions documentation and information based on the same sample as well as the risk-based approach applied by the different banks. Following the analysis of the results pointed out by the different *cabinets de révision agréés* and a similar inspection carried out at other professionals of the financial centre, the CSSF imposed during the last quarter of 2017 injunctions and administrative sanctions in a number of cases. Thus, administrative sanctions were imposed on nine entities, including four banks, in the form of fines totalling EUR 2,012,000.

Throughout 2017, particular emphasis was given to compliance with the AML/CFT professional obligations in relation to possible offences of aggravated tax fraud or tax evasion. In this context, significant and recurring deficiencies were noted at several inspected entities. For example, the absence of sufficient documentation to conclude that a customer is tax transparent and to reasonably exclude the risk of a predicate tax offence being committed, was noted on several occasions.

Moreover, some flaws considered as important due to their frequency and severity were observed in 2017:

- absence of specific measures or insufficient measures to understand ownership and control structure of the customer, notably in case of bearer shares;
- absence of information or insufficient information on the purpose and intended nature of the business relationship;
- insufficient information or documentation on the origin of the funds;
- absence of update or incomplete update of documents, information and data gathered while fulfilling the customer due diligence obligations;

- absence of consideration or aggregation of risks relating to beneficial owners and proxies during the assessment of global risks attributed to a business relationship;
- insufficient second level monitoring to be carried out by the compliance function;
- failure to report to the Financial Intelligence Unit (FIU) when there is suspicion of money laundering or terrorist financing, including the case where the contact with a possible customer does not lead to an entry into relationship;
- delay in the submission of suspicious transaction reports by professionals;
- insufficient supporting documents or critical analysis with respect to the plausibility of certain specific transactions.

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 “group head” function exercised by a Luxembourg entity in 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 2017, the CSSF carried out 13 “Corporate governance” on-site inspections at credit institutions, investment firms and specialised PFS. Moreover, two agents of the OSI department participated in a “Corporate governance” on-site inspection carried out, in the framework of the SSM, by a mixed team at a European significant bank abroad.

In 2017, emphasis was laid on on-site inspections regarding the functioning of the Board of Directors and authorised management as well as the collaboration between these two bodies, the functioning of their committees, the internal control functions in general and the “group head” function in particular.

The following most significant flaws, in terms of recurrence or seriousness, were identified during the 2017 “Corporate governance” on-site inspections:

- weaknesses in the identification, registration and management of conflicts of interests at the level of the Board of Directors and authorised management;
- absence of transparency and inconsistency in the decision-making processes at the level of the Board of Directors, the authorised management and the specialised committees or management committees;
- insufficient on-going training programme, in particular for members of the Board of Directors or the authorised management with limited experience in the Luxembourg financial sector;
- deficiencies in the assessment of professional qualification of the members of the Board of Directors, the authorised management and the persons in charge of internal control functions;
- inconsistencies between the identification and supervision of risks in the monitoring plans of the internal control functions.

The following main flaws were identified in 2017 during on-site inspections regarding, more particularly, the remuneration aspect:

- quantitative criteria for determining the remuneration of the entity’s decision-makers not taken into account;
- lack of precision and control in the implementation of the remuneration policy.

1.7. "Business model & profitability assessment" on-site inspections

The purpose of the "Business model & profitability assessment" on-site inspections is to check the manner in which the business strategy of an institution and its risk strategy are linked while observing its medium- and long-term financial interests.

In 2017, the CSSF carried out this type of mission at four banks of the financial centre. Moreover, at the ECB's request, the OSI department led an on-site inspection, in the framework of the SSM, at a significant bank abroad. A team of inspectors from several countries and from the ECB was set up to perform this on-site inspection.

It should be pointed out that the supervision of business models and profitability drivers is one of the ECB's priorities for the 2017 and 2018 on-site inspections.

Besides compliance with the adjustment requirements, 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 assessment of the viability and sustainability of a bank.

The following significant weaknesses were identified in 2017:

- incomplete identification and knowledge of the factors which play a decisive role in the determination of the economic performance;
- absence of or simplistic justification for the assumptions regarding the medium-term budget plan and the future capital base.

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 2017, the CSSF carried out six "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.

The following most significant flaws, in terms of frequency or seriousness, were identified during the "MiFID" missions in 2017:

- absence of formalisation of the appropriateness or suitability assessment of the proposed products or services;
- shortcomings identified in the controls relating to compliance with the investment profiles (in particular, excessive delays in the resolution of alerts detected during these controls);
- absence of a register listing possible conflicts of interests and/or incomplete identification of possible conflicts of interests;
- shortcomings identified in the controls performed by the internal control functions (linked, in particular, to the absence of completeness on all MiFID topics and insufficient formalisation of the controls carried out by the Compliance function).

1.9. "Depositary bank" on-site inspections

In 2017, the CSSF conducted 10 on-site inspections regarding the "Depositary bank" function, including six at significant banks.

In the framework of these inspections, the CSSF ensured that the supervised entities carry out the depositary function in compliance with the existing laws and regulations. The purpose of these inspections was notably to identify the failures to comply with the delegated regulations (Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 and Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012), the national laws (the Law of 17 December 2010 relating to undertakings for collective

investment and the Law of 12 July 2013 on alternative investment fund managers) and Circular CSSF 16/644 on the provisions applicable to credit institutions acting as UCITS depositary.

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 some weaknesses, notably in the processes in place regarding the oversight duties, whether these weaknesses concern incomplete controls with respect to regulatory requirements or failures in relation to independence of the controls.

The management of the different types of delegates in charge of the custody of assets as well as the supervision of outsourced operational tasks related to the depositary function remained major issues identified during these on-site inspections.

1.10. “UCI central administration” on-site inspections

In 2017, the CSSF conducted eight “UCI central administration” on-site inspections at three banks (including one significant bank), three specialised PFS, one investment firm and one management company.

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. They were carried out at both large-sized players of the financial centre and small entities with the aim to control the general organisation of these providers.

The main flaws identified during these on-site inspections concerned notably the supervision of outsourced operational tasks and the documentation of the procedures.

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 2017, this team carried out nine on-site inspections at six banks, two support PFS and one investment firm.

The main flaws, in terms of frequency or seriousness, identified in 2017 during the “IT risk” on-site inspections concerned:

- internal control, in particular the independence and efficiency of the three lines of defence;
- IT security, including in particular the management of privileged accesses and the management of cyber threats;
- continuity of activities as a whole (governance, plans and tests);
- outsourcing, in particular the contractual aspects and operational follow-up.

1.12. “Liquidity risk” on-site inspections

The “Liquidity risk” on-site inspections were carried out together with the Banque centrale du Luxembourg. They aim at assessing the situation and management of the liquidity risk of the inspected institutions.

1.13. “Risk management” on-site inspections

The “Risk management” on-site inspections concerned credit risk. They were carried out on 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 2017 was conducted by the ECB at a significant bank.

1.14. “Other” on-site inspections

In addition to the on-site inspections presented above, two very specific inspections were carried out at a player of the financial sector, one of which focussed on the issue of securities and the other on the review of the IT system detecting suspicious transactions in relation to money laundering.

1.15. Introductory visits

Introductory visits are aimed at professionals that recently received their authorisation and, where appropriate, at existing players that received an authorisation to carry out a new activity in addition to the existing authorisations. Usually carried out within the first six months following the professional’s authorisation, the purpose of these visits is to verify that the contemplated business plan is being followed and that the systems and infrastructures are correctly implemented.

In 2017, the CSSF undertook 17 introductory visits at new players of the financial centre.

In some cases, the introductory visits revealed weaknesses in the entities’ organisation of the day-to-day management, in the consistency of their activities with the scope of their authorisation and in their internal procedures and documents.

2. DECISIONS AS REGARDS SANCTIONS AND ADMINISTRATIVE POLICE TAKEN IN 2017

The total amount of administrative fines imposed by the CSSF in 2017 reached EUR 17,571,271, against EUR 1,330,950 in 2016.

This amount which is substantially higher than in the previous years is mainly the result of the transposition and application in Luxembourg law of European directives providing new rules on the determination of the amount of administrative sanctions.

In the case of legal persons, these provisions introduce notably a rule according to which the maximum amount of the administrative fine represents a determined percentage of the total annual turnover. Alternatively, the CSSF can impose administrative fines of up to twice the amount of the profits gained or losses avoided because of the breach of the law where those can be determined. Examples are the Law of 23 July 2015 transposing Directive 2013/36/EU (CRD IV) and amending the Law of 5 April 1993 on the financial sector (cf. Article 63-2), the Law of 10 May 2016 transposing Directive 2014/91/EU (UCITS V) and amending the Law of 17 December 2010 relating to undertakings for collective investment (cf. Article 148) and the Law of 10 May 2016 transposing Directive 2013/50/EU and amending the Law of 11 January 2008 on transparency requirements for issuers (cf. Article 25).

In 2017, the CSSF took the following decisions with respect to sanctions and administrative police.

2.1. Credit institutions

In 2017, the CSSF imposed eight administrative fines and one warning on credit institutions pursuant to Articles 63 and 63-2 of the Law of 5 April 1993 on the financial sector.

Three of these fines amounting to EUR 8,985,000, EUR 3,768,842 and EUR 60,000, respectively, were imposed due to shortcomings regarding internal governance and non-compliance with the AML/CFT professional obligations. Two fines amounting to EUR 40,000 and EUR 80,000, respectively, were imposed for non-compliance with the AML/CFT professional obligations. One fine amounting to EUR 81,079 was imposed due to shortcomings in relation to the depositary bank function. A credit institution had to pay a fine of EUR 60,000 for non-compliance with the professional obligations as regards MiFID regulations. Moreover, the CSSF imposed a fine of EUR 828,000 on a credit institution for serious shortcomings regarding internal governance, inaccurate or incomplete disclosure in relation to large exposures and exposures in excess of the

limits set out in Article 395 of Regulation (EU) No 575/2013. In addition, the CSSF issued a warning to a credit institution for non-compliance with the deadline for the submission of the long form report.

In the context of the analysis performed by the CSSF in relation to the Panama Papers affair and the sanctions imposed on nine entities in the form of fines totalling EUR 2,012,000, four credit institutions were sanctioned for non-compliance with several AML/CFT professional obligations.

On 18 occasions, the CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector for the following reasons:

- three cases of shortcomings relating to the internal governance arrangements;
- four cases of shortcomings as regards the AML/CFT professional obligations;
- two cases of shortcomings as regards the MiFID professional obligations;
- four cases of shortcomings noted in the framework of credit risk management;
- two cases of shortcomings noted in the framework of interest risk management;
- three cases of shortcomings noted in the depositary bank function.

Moreover, in 2017, the CSSF filed three complaints with the State Prosecutor relating to illegal exercise of banking activities by unauthorised entities.

2.2. Investment firms

In 2017, the CSSF imposed seven administrative fines pursuant to Article 63 of the Law of 5 April 1993 on the financial sector. All these fines were imposed on investment firms as legal persons.

A fine of EUR 50,000 was imposed on an investment firm for non-compliance with certain professional obligations as regards MiFID regulations. Three fines were imposed on an investment firm for the appointment of a director without prior approval of the CSSF (EUR 40,000), for failing to pay the 2017 annual fee to the CSSF (EUR 25,000) and for failing to act in response to an injunction of the CSSF pursuant to Article 59 of the Law of 5 April 1993 on the financial sector (EUR 15,000). Two other investment firms had to pay fines amounting to EUR 5,000 and EUR 10,000, respectively, for not submitting the closing documents within the time limits set.

In the context of the analysis performed by the CSSF in relation to the Panama Papers affair and the sanctions imposed on nine entities in the form of fines totalling EUR 2,012,000, one investment firm was sanctioned for non-compliance with several AML/CFT professional obligations.

The CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector on 13 occasions for the following reasons:

- shortcomings identified at the level of compliance with the remuneration policy;
- doubts about compliance with the legal and regulatory provisions relating to the day-to-day management;
- shortcomings relating to the internal governance arrangements;
- non-receipt of the requested documents and information concerning the internal governance arrangements;
- non-receipt of the requested closing documents;
- shortcomings as regards the AML/CFT professional obligations;
- non-compliance with the own funds requirements in accordance with Article 92 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;
- non-compliance with Article 22 of the Law of 5 April 1993 on the financial sector regarding external auditing;
- non-compliance with the provisions of Article 54(2) of the Law of 5 April 1993 on the financial sector;
- shortcomings identified in the relationship of an investment firm with the external *réviseur* (auditor) and related to the certification of the 2015 annual accounts.

Following the withdrawal of its authorisation by the Minister of Finance, one investment firm was placed under the regime of suspension of payments. The *Tribunal d'arrondissement de et à Luxembourg* (Luxembourg District Court) ordered later the dissolution and liquidation of the investment firm in question.

In 2017, the CSSF issued a warning to five natural persons in accordance with the provisions of Article 63(2) of the Law of 5 April 1993 on the financial sector for non-compliance with the professional obligations of the financial sector relating to their mandates as authorised managers of an investment firm.

The CSSF filed three reports with the State Prosecutor pursuant to Article 23(2) of the Code of Criminal Procedure (*Code d'instruction criminelle*) in 2017.

In the same year, the CSSF filed nine complaints with the State Prosecutor regarding entities which provided investment services without authorisation.

2.3. Specialised PFS

As far as non-compliance with the AML/CFT professional obligations is concerned, the CSSF imposed, in 2017, an administrative fine of EUR 13,000 on a specialised PFS in accordance with the provisions of Article 63 of the Law of 5 April 1993 on the financial sector. A natural person also received a reprimand by the CSSF pursuant to the provisions of Article 63(2) of the above-mentioned law.

In the context of the analysis performed by the CSSF in relation to the Panama Papers affair and the sanctions imposed on nine entities in the form of fines totalling EUR 2,012,000, two specialised PFS were sanctioned for non-compliance with several AML/CFT professional obligations.

Another administrative fine of EUR 5,000 was imposed on a specialised PFS for failure to submit the accounting documents and other information requested by the CSSF.

In accordance with the provisions of Article 63(2) of the Law of 5 April 1993 on the financial sector, the CSSF also issued a warning to a natural person, shareholder and director of a specialised PFS due to non-compliance with the professional obligations relating to the notification laid down in Article 18 of the above-mentioned law.

On one occasion in 2017, the CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector to require a specialised PFS to comply with the applicable legal provisions relating to capital base.

The CSSF also filed one complaint with the State Prosecutor in accordance with the provisions of Article 23(2) and (3) of the Code of Criminal Procedure (*Code d'instruction criminelle*) under the exercise of its supervisory function of specialised PFS.

2.4. Support PFS

Pursuant to Article 63 of the Law of 5 April 1993 on the financial sector, the CSSF imposed, in 2017, an administrative fine amounting to EUR 5,000 on a support PFS for non-filing of its position as regards insufficient capital base within the time limits set.

2.5. Investment fund managers (IFMs)

In accordance with Article 148(1) of the Law of 17 December 2010 relating to UCIs, the CSSF imposed an administrative fine amounting to EUR 4,000 on the *dirigeant* (director) of one IFM for filing an incomplete declaration of honour.

In addition, the CSSF imposed an administrative fine of EUR 6,000 on an IFM for lack of transparency in the transmission of information, non-compliance with the procedures and arrangements imposed pursuant to the provisions of point (a) of Article 109(1) of the above-mentioned law and non-compliance with the requirements regarding the delegation of functions to third parties prescribed by the provisions of Article 110 of this law.

In the context of the analysis performed by the CSSF in relation to the Panama Papers affair and the sanctions imposed on nine entities in the form of fines totalling of EUR 2,012,000, two IFMs were sanctioned for non-compliance with several AML/CFT professional obligations.

2.6. Undertakings for collective investment[3]

In accordance with Article 148(1) of the Law of 17 December 2010 relating to UCIs, the CSSF imposed administrative fines amounting to EUR 2,000 each on the *dirigeants* (directors) of two UCIs for non-filing of the annual financial report, on the *dirigeants* of two UCIs for non-filing of the management letter and on the *dirigeants* of two UCIs for non-filing of the long form report.

Moreover, the CSSF imposed administrative fines amounting to EUR 10,000 each on the *dirigeants* of one UCI due to the transmission of documentation and other information that proved to be incomplete, incorrect or false and to non-compliance with the rules governing the publications of balance sheets and accounts.

In accordance with Article 51(1) of the Law of 13 February 2007 relating to specialised investment funds, the CSSF imposed administrative fines amounting to EUR 2,000 or EUR 4,000, as the case may be, on the *dirigeants* (directors) of 18 SIFs for non-filing of the annual financial report, on the *dirigeants* of 19 SIFs for non-filing or incomplete transmission of the management letter as well as on the *dirigeants* of three SIFs for filing an incomplete declaration of honour.

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 three SICARs for non-filing of the annual financial report, on the *dirigeants* of three SICARs for non-filing of the management letter and on the *dirigeants* of one SICAR for filing incomplete documents.

During 2017, the CSSF decided to withdraw 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 seven 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 81,500. Moreover, the CSSF imposed an administrative fine of EUR 1,150 as regards the control of major holdings under the Transparency Law.

During an investigation for breach of the provisions of the Transparency Law, the Law on Takeover Bids and the Law of 9 May 2006 on market abuse (Market Abuse Law), the CSSF imposed administrative fines on certain persons who were party to an undisclosed concert action in breach of the provisions of the Law on Takeover Bids and an administrative fine of EUR 1 million on a natural person for market manipulation pursuant to the provisions of the Market Abuse Law. The above decisions have been challenged before the administrative courts.

2.8. Audit profession

In accordance with Article 43 of the Law of 23 July 2016 concerning the audit profession, the CSSF imposed, in 2017, a temporary ban to sign statutory audit reports against a *réviseur d'entreprises agréé* (approved statutory auditor) for a period of 12 months.

In accordance with the above-mentioned article, the CSSF also imposed a permanent prohibition against a *réviseur d'entreprises agréé* and his/her *cabinet de révision agréé* from carrying out statutory audits and signing audit reports, the withdrawal from the public register as well as a permanent prohibition from carrying out the activities referred to in letter (b) of the first subparagraph and in the second subparagraph of Article 1(34).

[3] It should be pointed out that these administrative fines are still subject to reviews (*recours gracieux* or *recours administratif*) which are pending before the administrative courts.

Pursuant to the provisions of point (f) of Article 43(1) of the Law of 23 July 2016 concerning the audit profession and taking into account the provisions of Article 44 of this law, the CSSF imposed an administrative fine amounting to EUR 29,600 on a *réviseur d'entreprises agréé*. This administrative fine was imposed based on the provisions of Article 40(2) and points (a) and (b) of Article 43(2) 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.

For a description of the functions and composition of the Resolution Board, please refer to Chapter I "Governance and functioning of the CSSF". The Resolution Board met five times in 2017 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 14 persons as at 31 March 2018.

In line with the distribution of responsibilities, particularly between the Resolution Board and the Single Resolution Board (SRB), the RES department is especially in charge, at individual and group level, to submit the following for decision to the Resolution Board, as concerns credit institutions and investment firms falling under the scope of the BRRD Law or the SRM Regulation:

- adopting resolution plans and resolvability assessments;
- measures to address or remove impediments to resolvability;
- appointing a special manager;
- ensuring a fair, prudent and realistic valuation of the assets and liabilities;
- applying 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;
- adopting resolution decisions and applying resolution tools in accordance with the relevant procedures and safeguards;
- writing down or converting relevant capital instruments;
- executing 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 meetings on the BRRD at the level of the European Council as well as in the SRB's and the EBA's work.

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 Crisis Management (SGCM), joint subgroup of the Standing Committee on Regulation and Policy (SCRePOL) and the Resolution Committee.

For a detailed description of the SRB's tasks, functions and composition, please refer to 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 2017 during the adoption by the SRB, meeting 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. Moreover, the agents of the RES department participate in the work of the following permanent working sub-committees of the SRB: SRB Resolution Committee, 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 of 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 excluding SRB, the RES department heads four resolution colleges (three colleges relating to banks for which the CSSF is the group-level resolution authority and a "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 of the aforementioned less significant banks have been adopted by the Resolution Board.

Two CSSF-CODERES circulars were published in 2017 concerning, on the one hand, the raising of 2017 contributions for the Single Resolution Fund and, on the other hand, the collection of information for the calculation by the SRB of the 2018 contributions to the same fund.

CHAPTER XVIII

PROTECTION OF DEPOSITORS AND INVESTORS

With the entry into force of the Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), the duties relating to the protection of depositors and investors carried out in the past by the Association pour la Garantie des Dépôts, Luxembourg have been transferred to the Council for the Protection of Depositors and Investors (CPDI), a new executive body of the CSSF which manages and administers the Fonds de Garantie des Dépôts Luxembourg (FGDL) and the Système d'Indemnisation des Investisseurs Luxembourg (SIIL).

Please refer to Chapter I "Governance and functioning of the CSSF" for a description of the CPDI's functions and composition.

The FGDL is an *établissement public* (public body), separate from the CSSF, established under Article 154 of the BRRD Law. The FGDL is the recognised Luxembourg deposit guarantee scheme referred to in Article 4(1) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes. It collects the contributions due by participating credit institutions, manages the financial means and, in the event of insolvency of a member institution, makes the repayments as instructed by the CPDI. Unlike the FGDL, the SIIL is financed *ex post*, i.e. contributions are collected from its members only in the event of a failure.

The CPDI is assisted in the performance of its duties by the CSSF department "Depositor and Investor Protection" (PDI department), which was created in 2016 and counted four employees at the end of 2017. In general, the PDI department performs the operational tasks of the FGDL and of the SIIL.

• Activities of the CPDI

In 2017, the CPDI held three meetings focussing, in particular, on the following topics:

- the drawing-up of a programme for a full cycle of stress tests compliant with the EBA Guidelines on stress tests for deposit guarantee schemes (EBA/GL/2016/108);
- the performance of a test on the FGDL's financial capacity; and
- a quality check on the "Single Customer View" file provided by each FGDL member. This file, whose format and content are defined in Circular CSSF 13/555, is a database containing necessary information for the CPDI to calculate the amounts repayable to depositors in the case of a failure of a member institution. The quality check, which concerned format compliance, internal consistency of data and the timeliness of delivery, showed that 70% of the files were of satisfactory quality. However, the analysis also revealed that the file's definition, which was originally drawn up by the Association pour la Garantie des Dépôts, Luxembourg (i.e. the former *ex post* financed private deposit guarantee scheme in place before the transposition of Directive 2014/49/EU in 2015), needs to be modernised. The CPDI intends to initiate this upgrade in 2018.

Other major issues were the further development of infrastructures allowing a swift and efficient repayment in case the deposit guarantee scheme is triggered, notably the development of a software and the implementation of a printing service. The software should allow automating, as far as possible, the compensation process. The main functions of the software include reading the "Single Customer View" files and providing a quality report, calculating the amount to be paid out for each depositor and the total payment volume, extracting the mailing addresses, entering a new bank account number for each depositor to ensure the payment of the compensation, generating payment instructions and managing the exchange of technical information with the guarantee schemes of other Member States in the context of a cross-border failure.

Moreover, the CPDI published six circulars relating to the survey on the amount of covered deposits and the determination of *ex ante* contributions to the FGDL.

Finally, the CPDI updated the website www.fgdl.lu to a more user-friendly layout and further developed its content by adding, inter alia, a depositor's corner and an FAQ section.

• *Ex ante* contribution collection for the FGDL

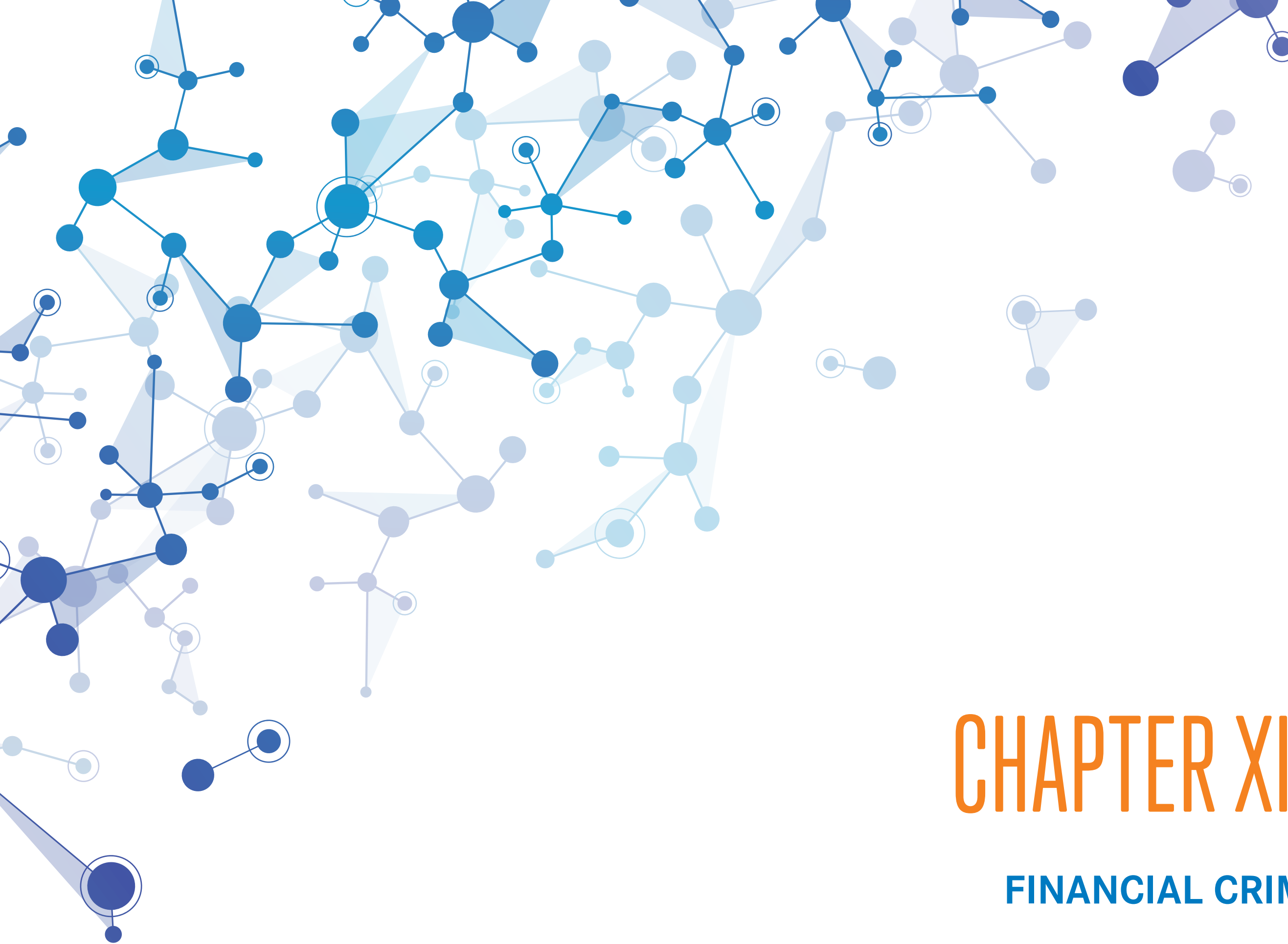
Pursuant to Articles 179(2) and 180 of the BRRD Law, the FGDL collects the contributions from credit institutions, including Luxembourg branches of credit institutions having their registered office in a third country, and from POST Luxembourg for its provision of postal financial services. The calculation method, approved by the CSSF in accordance with the requirements of Article 182(3) of the BRRD Law and published as an annex to Circular CSSF-CPDI 16/01, has been confirmed and adjusted to the 2017 situation through Circular CSSF-CPDI 17/06. The calculation of the contributions thus continues to be based on the amount of covered deposits and the degree of risk incurred by the participating member. The entities concerned paid *ex ante* contributions totalling EUR 78.8 million to the FGDL for the financial year 2017.

The FGDL will reach the target level of 0.8% of covered deposits that is required by Directive 2014/49/EU at the end of 2018. This amount is currently estimated at EUR 240 million.

In accordance with Article 180(1) of the BRRD Law, the FGDL will continue to collect contributions in order to build up a buffer of additional financial means to reach a target level of 1.6% of the covered deposits at the end of 2026.

• Interventions

In 2017, the FGDL did not perform any reimbursement of deposits, nor finance any resolution or measure to safeguard the depositors' access to covered deposits in the context of winding-up or reorganisation procedures. Likewise, the SIIL did not compensate any investor in 2017.



CHAPTER XIX

FINANCIAL CRIME

The following developments present the CSSF's involvement in determining anti-money laundering and combating the financing of terrorism (AML/CFT) policies at national and international level throughout 2017. The operational part of the CSSF's activities with respect to AML/CFT supervision is further detailed in the chapters regarding supervision and in Chapter XVI "Instruments of supervision" of this annual report.

1. AMENDMENTS TO THE REGULATORY FRAMEWORK REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

1.1. Amendments to the European framework on AML/CFT

1.1.1. Commission delegated regulations amending Commission Delegated Regulation (EU) 2016/1675 of 14 July 2016 supplementing Directive (EU) 2015/849 by identifying high-risk countries with strategic deficiencies

By way of Delegated Regulations (EU) 2018/105 of 27 October 2017 and (EU) 2018/212 of 13 December 2017, the European Commission added first Ethiopia, then Sri Lanka, Trinidad and Tobago and Tunisia to the list of third-country jurisdictions which have strategic deficiencies in their AML/CFT regimes and pose significant threats to the financial system of the EU in accordance with the criteria set out in Article 9 of Directive (EU) 2015/849 of 15 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (IVth AML/CFT Directive).

1.1.2. Non-cooperative jurisdictions for tax purposes

On 5 December 2017, the Council of the EU approved and published conclusions including an EU list of non-cooperative jurisdictions for tax purposes[1]. The EU list was drawn up following an assessment and a dialogue with many third countries and territories. In parallel to the work of the Council of the EU, discussions took place within the OECD and within the context of the G20. The purpose of the initiative was to promote governance globally in order to make every effort in fraud and tax evasion prevention. The list will be reviewed regularly and has already been amended for the first time in January 2018 when most of the listed jurisdictions decided to participate in the EU assessment process by way of a constructive dialogue and to take measures in order to address the identified problems[2]. The nine jurisdictions, which are still on the list, are required to comply with the EU criteria on sound tax governance in order to put an end to the practices leading or likely to lead to a loss of tax revenue for EU Member States. Pending these changes, the EU and the Member States could take defensive measures.

1.1.3. Proposal for a 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 and Directive 2009/101/EC

A political agreement was reached on 20 December 2017 between the EU Presidency and the European Parliament on the new EU rules aiming at strengthening the current anti-money laundering and especially counter-terrorist financing arrangements[3], notably by tightening up the transparency rules to prevent any large-scale concealment of funds.

Among the main changes, it is worth mentioning:

- wider access to beneficial ownership registers to ensure increased transparency of ownership of corporate and other legal entities as well as trusts. Registers will be interconnected to facilitate cooperation between Member States. Access to information on beneficial ownership is planned as follows: public access to beneficial ownership information on companies; access based on the legitimate interest to beneficial ownership information on trusts and similar legal arrangements; public access upon written request to beneficial ownership information on trusts which own a company that is not incorporated in the EU;
- risk management linked to prepaid cards and virtual currencies, notably by subjecting the virtual currency exchange platforms and custodian wallet providers to AML/CFT obligations and by reducing certain electronic money-related thresholds.

1.2. Amendments to the Luxembourg regulatory framework

1.2.1. Law of 13 February 2018 transposing certain provisions of the IVth AML/CFT Directive

The Law of 13 February 2018 mainly aims to (1) transpose into Luxembourg law the provisions relating to the professional AML/CFT obligations and powers of the supervisory authorities arising from 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 (IVth AML/CFT Directive), and (2) implement Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds.

Certain provisions of the Law of 13 February 2018 have a direct impact on the duties and obligations of the professionals of the financial sector in this regard:

- new definitions are introduced and existing definitions are amended, including that of "politically exposed persons" which is supplemented with the addition of brothers and sisters and that of "beneficial owner" which is, on the one hand, specified by measures aiming to determine the direct or indirect ownership of a given participation and, on the other hand, extended in case of failure to identify this person or of uncertainty on the identification of the natural person who holds the position of managing official;

[1] http://www.consilium.europa.eu/media/31945/st15429en17.pdf.

[2] http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018XG0126(01)&from=EN.

[3] http://data.consilium.europa.eu/doc/document/ST-15849-2017-INIT/en/pdf.

- a new specific article concerning the obligation to assess risks according to certain criteria defined by the law and to duly document and maintain this assessment up-to-date; the annexes of the law thus specify certain risk factors that must be taken into account, in particular to determine the scope of the due diligence measures because, henceforth, the law only provides for specific arrangements for certain electronic money products under which professionals are authorised to apply simplified due diligence measures;
- requirements relating to record-keeping have been reviewed, in particular to meet the requirements with regard to personal data processing, which are specified in an additional paragraph strengthening the rights of new customers to information;
- as regards the cooperation with the authorities, the protection of the professional/employee or managing official of the professional in case of disclosure in good faith has been reinforced;
- whistleblowing measures have been introduced;
- an entire chapter is dedicated to supervision and enhanced powers, notably as regards sanctions, from competent authorities in respect of AML/CFT;
- criminal sanctions have been increased.

It is reminded that the Law of 23 December 2016 implementing the 2017 tax reform has already transposed the provisions of the IVth AML/CFT Directive dealing with “tax crimes” into national law by including aggravated tax fraud and tax evasion related to direct or indirect taxes in the list of predicate offences. Following this law, Circular CSSF 17/650, drafted jointly with the Financial Intelligence Unit (FIU), (1) provided clarification from both authorities as regards the practical application of the new legal provisions by the professionals of the financial sector supervised by the CSSF and (2) provided a list of indicators to assist the professionals in relation to suspicious transaction reports in this respect.

In addition to these new laws, two other draft laws will supplement the transposition of the IVth AML/CFT Directive shortly:

- draft bill No 7217 which establishes a beneficial ownership register and transposes Article 30 of the IVth AML/CFT Directive;
- draft bill No 7216 which establishes a trust register and transposes Article 31 of the IVth AML/CFT Directive.

1.2.2. Law of 13 June 2017 on payment accounts

This law notably aims at transposing into Luxembourg law Directive 2014/92/EU of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features.

If the law, in particular, requires relevant credit institutions to not discriminate against consumers legally resident in the EU by reason of their nationality or place of residence or by reason of any other ground as referred to in Article 21 of the Charter of Fundamental Rights of the EU, where these consumers apply for access to a payment account, it also enables these institutions to reject an application for opening a standard payment account where the opening or operation of such an account would result in an infringement of the Law of 12 November 2004 on the fight against money laundering and terrorist financing (Article 24).

1.2.3. Ministerial regulations

In 2017, the Ministry of Finance issued seven new 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 255 persons and 80 entities.

1.2.4. CSSF circulars and other information

On 17 February 2017, the CSSF together with the FIU published the common Circular CSSF 17/650 aimed at guiding professionals subject to the CSSF's supervision in the practical implementation of the new legal provisions related to predicate tax offences, recently integrated in the Penal Code. It should be noted that the new tax crimes are qualified as predicate money-laundering offences as from 1 January 2017. The obligations of the entities supervised by the CSSF with respect to money-laundering prevention in relation to the aforementioned tax crimes also take effect as from 1 January 2017.

On 5 July 2017, the CSSF published Circular CSSF 17/660 on the implementation, on 26 June 2017, of Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006.

On 24 July 2017, the CSSF published Circular CSSF 17/661 adopting joint guidelines issued by the three European Supervisory Authorities (EBA/ESMA/EIOPA) on money laundering and terrorist financing risk factors. These guidelines include general requirements on professional obligations and set out specific risk factors in connection with specific activities, for example the issue of electronic money, correspondent/retail banking, fund management and remittance.

In 2017, the CSSF again updated, by way of three circulars (CSSF 17/652, 17/659 and 17/672), the list of jurisdictions that have AML/CFT deficiencies following the FATF statements in this regard.

By way of Circular CSSF 18/680 of 23 January 2018, the CSSF adopted the joint guidelines of the three European Supervisory Authorities relating to the measures payment service providers should take to detect missing or incomplete information on the payer or the payee.

Finally, by way of Circular CSSF 18/684 of 13 March 2018, the CSSF drew the professionals of the financial sector's attention to the most important changes introduced by the Law of 13 February 2018 in the Luxembourg AML/CFT framework.

It should also be noted that the CSSF FAQ on AML/CFT and IT requirements for specific customer on-boarding/KYC methods has been amended and is available on the CSSF website (Financial crime > Anti-money laundering and counter-terrorist financing > Additional documentation).

2. CSSF PARTICIPATION IN MEETINGS REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING AND REGARDING INTERNATIONAL FINANCIAL SANCTIONS

2.1. 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 and consecutive action remained a major cause for concern in 2017.

Moreover, de-risking situations, especially in the context of correspondent banking relationships as well as in the FinTech/RegTech field were the subject of discussions within the FATF in which representatives of the civil society and private sector were involved.

Furthermore, the FATF work led to the publication of the following key documents in 2017:

- Guidance on Private sector information sharing;
- Updated FATF Guidance on AML/CFT measures and financial inclusion, with a supplement on customer due diligence.

All the publications of the FATF are available under http://www.fatf-gafi.org/.

2.2. National dimension

At national level, the CSSF held, in 2017, formal meetings with representatives of the FIU and/or the State Prosecutor. Discussions concerned, in particular, certain suspicious reports of major importance for the Luxembourg financial centre and the follow-up to suspicious reports following the inclusion of new tax crimes to the list of predicate money-laundering offences.

Several coordination and consultation meetings of all the national authorities competent in AML/CFT were also held, in 2017, under the chairmanship of the Ministry of Justice and the Ministry of Finance, respectively, depending on the topics of the corresponding working groups. The meetings focussed on the work as regards the transposition of the IVth AML/CFT Directive, the discussions on the text of a new AML/CFT directive, the decisions taken on international financial sanctions (both at the level of the European or UN organisations and at the European judicial level due to the major decisions of the Court of Justice of the EU) as well as the preparation of the FATF's plenary meetings.

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 notably discuss the Risk Assessment relating to AML/CFT.

Agents hired in 2017 and 2018: Department "Information systems of the CSSF"

From left to right: Vincent FRIDERICH, Vito DE MICHELE, Cédric BARTHELEMY, Andy CATANI, Sarah ZIMMERMANN, Patrick LOUIS, Stéphane ZIVEC, Qi SHEN, Dirk VAEL, Lucie EVORA LOPES, Franz FONTEYNE

Absent: Stéphane RAPAILLE, Nicolas REGHEM

FINANCIAL CONSUMER PROTECTION

1. FINANCIAL CONSUMER PROTECTION AND FINANCIAL EDUCATION

Financial consumer protection is expanding continuously in the financial centre and the CSSF's powers in this respect are increasing accordingly.

Thus, the legislator entrusted the CSSF with the competence of applying and implementing Chapter 6 entitled "Mortgage credit agreements" introduced in the Consumer Code by the Law of 23 December 2016 (1) transposing Directive 2014/17/EU of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010; and (2) amending the Consumer Code. This law which entered into force on 1 January 2017 has already produced its first protective effects on consumers during the financial year 2017.

The concern for financial consumer protection was also felt by the legislator when he provided that the CSSF is the competent authority to ensure the application and enforcement of the Law of 13 June 2017 on payment accounts and (1) transposing Directive 2014/92/EU of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features, and (2) amending the Law of 15 December 2000 on postal financial services, as amended.

Moreover, as supervisory authority of the financial centre and as part of the mission conferred upon it by its organic law, the CSSF is continuously ensuring the protection of consumers' rights in the area of financial services, particularly with regard to the latest technological developments. This willingness to protect financial consumers' rights is also reflected in the work of the European supervisory authorities and international organisations such as the OECD or FinCoNet.

• 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 2017. High-Level Principle 9 which is dedicated to complaint handling and redress has been, in particular, a core element in the reflections of the Task Force.

In the field of FinTech, the work focussed on how the regulatory framework is likely to enable the development of innovative approaches as regards financial services, while ensuring an appropriate level of consumer protection. The analysis of the report "Ensuring financial education and financial consumer protection for all in the digital age" took place within this framework.

Furthermore, it should be noted that the Task Force's work also aimed at protecting consumers in consumer credit issues.

• International Financial Consumer Protection Network (FinCoNet)

FinCoNet is an international organisation which gathers supervisory authorities from 24 countries that are responsible for financial consumer protection. It aims at fostering information exchange and cooperation between supervisory authorities in order to encourage a proper conduct of the market and a strong consumer protection in banking and credit.

In 2017, FinCoNet published a summary report "Digitalisation of Short-Term, High-Cost Consumer Credit". All the publications of FinCoNet are available on the website www.finconet.org under the section "Resources".

Moreover, FinCoNet organised, in 2017, in cooperation with the Japanese Financial Services Authority, an international seminar addressing the topic of virtual currencies and the challenges faced by the supervisory authorities in respect of financial consumer protection.

• Financial Consumer Protection Committee (PCF Committee)

In July 2017, the Minister of Finance adopted the national strategy developed by the PCF Committee and, at the same time, mandated the CSSF to develop and to coordinate the initiatives taken in Luxembourg in the field of financial education. This decision was taken following discussions of the High Committee of the Financial Centre (*Haut Comité de la place financière*) during which all the members upheld the CSSF's arguments on the significance of financial education in Luxembourg.

The PCF Committee subsequently decided to create working groups specifically dedicated to the following topics:

- Credit and over-indebtedness;
- Financial education in teaching;
- Pensions/insurance.

In addition to financial education, the PCF Committee's work focussed on the new regulations having an impact on consumer protection, i.e.:

- the Law of 13 June 2017 on payment accounts which deals with transparency as regards fees linked to payment accounts, payment account switching and access to a payment account with basic features;
- the Law of 23 December 2016 on credit agreements for consumers relating to residential immovable property;
- MiFID II.

• 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. Over 120 countries are represented in the INFE. A total of 84 authorities, including the CSSF, has the status of fully fledged members.

The INFE also seeks to promote and facilitate international cooperation between the different participants (politicians, regulators, associations, etc.) concerned with the financial education issue at global level.

Considering the topicality of the subject, the INFE created in 2017 a working group relating to the financial education challenges with respect to digitalisation. This Working Group on Digital Financial Literacy thus decided, during its first meeting in May 2017, that the preparation of guidelines in this regard would be one of its priorities. A Policy Guidance Note should be prepared and submitted for final approval to the OECD/INFE's members during their meeting in May 2018.

- **Committee 8 on Retail Investors of IOSCO**

The Committee's mandate is to perform IOSCO's tasks in relation to financial education, to advise the IOSCO's Board on issues relating to investor protection and to work on the policy to be adopted in this field.

In 2017, IOSCO finalised its final report on the vulnerability of elderly people and published an interim report on the use of the methods of behavioural economics in financial education.

Moreover, the Committee was mandated to carry out a survey among its members in order to develop a toolbox of educational material to help regulators educate investors on the risks relating to leveraged OTC derivatives. Another of its mandates is to develop a core competence framework for investors as regards financial education.

Given the success of the first World Investor Week in 2017, the IOSCO's Board mandated the Committee to organise a new edition in October 2018. This is a global campaign to raise awareness of financial education and investor protection.

2. OUT-OF-COURT RESOLUTION OF COMPLAINTS

Since its creation, the CSSF has assumed a role of intermediary in the out-of-court dispute settlement aiming at professionals subject to its supervision.

The CSSF handles complaints which are submitted to it 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. The second section of the regulation aims to specify certain obligations incumbent upon professionals in relation to the internal handling of complaints or in their relationship with the CSSF.

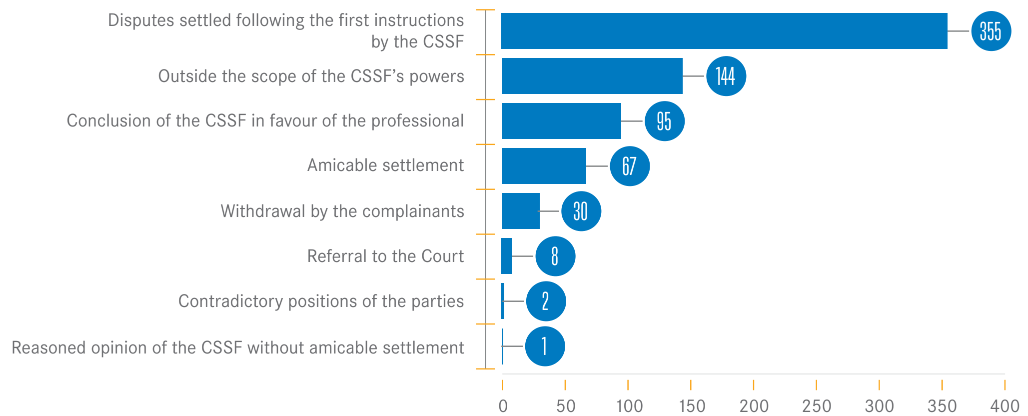
CSSF Regulation N° 16-07 takes into account the requirements of Regulation (EU) No 524/2013 of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC.

As Regulation CSSF N° 16-07 entered into force on 11 November 2016, the financial year 2017 was, to some extent, its testing phase.

2.1. Statistics regarding CSSF complaint handling in 2017

In 2017, the CSSF received 705 files from customers of entities subject to its supervision and closed 702 files (including files received before 1 January 2017 and which had not yet been closed).

Outcome of the CSSF's intervention/reasons for closing the files



When the CSSF receives a complaint, it responds by sending an acknowledgement of receipt which includes all the useful instructions for the complainant to resolve the dispute with the professional without additional intervention by the CSSF. This letter 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.

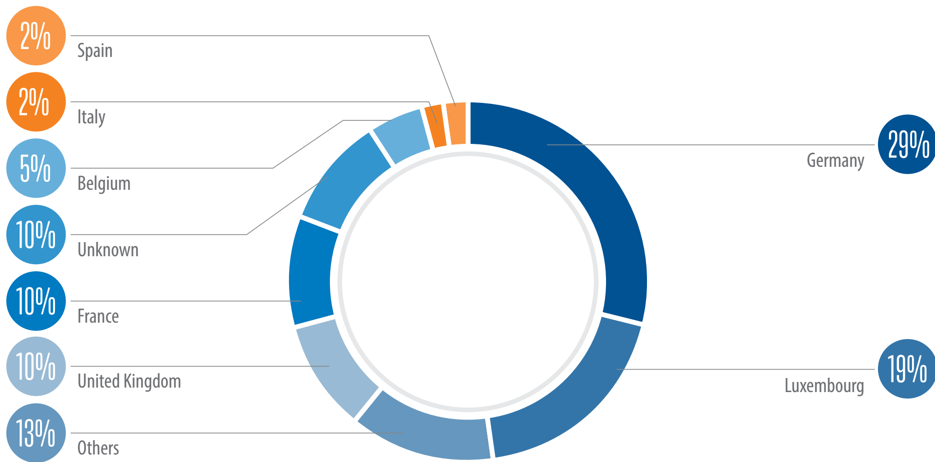
Judging by the high number of disputes which were settled following these first instructions by the CSSF, the CSSF's approach consisting in favouring the dialogue between the parties to the disputes and not contacting immediately the supervised entity concerned by a complaint, is successful.

144 requests for the out-of-court resolution of complaints were inadmissible for the following reasons:

- complaints involving entities[1] that are not subject to the CSSF's supervision (54%);
- complaints concerning a non-financial product (17%);
- complaints falling within the scope of the insurance sector (16%);
- expiry of the one-year time limit for filing a complaint with the CSSF (4%);
- complaints already dealt with by another alternative dispute resolution body (4%);
- complaints already heard by a court (2%);
- failure of the complainant's capacity to act (2%);
- complaints concerning the commercial policy of the professional (1%).

[1] Excluding the insurance sector.

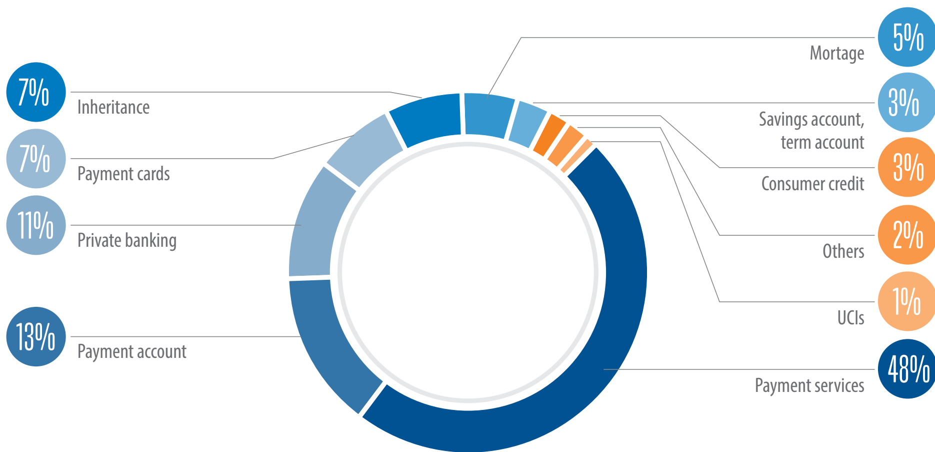
Breakdown of the disputes according to the complainants' country of residence



The share of complaints from complainants residing in Germany prevails with 29% and increased as compared to the preceding financial year (23% in 2016).

The country of residence of the complainants is not identified in 10% 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 38 different countries.

Breakdown of complaints according to their object



The breakdown of complaints according to their object remained stable in 2017 compared to 2016.

With 48%, the major share of complaints submitted to the CSSF concerned problems linked to the use of electronic payment services. The share of complaints relating to private banking (11%) is stable as compared to the previous financial year (10% in 2016). The same holds true for complaints relating to mortgages (5% against 6% in 2016).

The share of complaints against UCIs remains low in comparison with the importance of the investment fund sector in Luxembourg.

2.2. Complaints handled in 2017

2.2.1. Falsification of the details relating to the account receiving a transfer of funds

The CSSF regularly receives complaints where the falsification of the customer account details is at the heart of the dispute.

In one case, the funds received by the complainant following the redemption of his units in an investment fund were transferred, without his knowledge, to an account opened by fraudsters with a third-party bank. Indeed, fraudsters succeeded in misleading the bank with which the complainant had opened an account to receive the proceeds from the sale of his securities by making them think that the complainant had changed the bank details of this account.

It turned out that few days before the performance of the contentious transfer, the complainant's business agent asked the complainant's bank to confirm the details of the account to which the complainant usually made his transfers. The bank then provided him with the required bank details but which were in fact falsified details transmitted a few days earlier by the fraudsters. However, neither the complainant's business agent nor the complainant himself noticed this falsification.

When analysing the file, the CSSF noticed that the contacts between the fraudsters and the bank first took place by telephone, then by emails. The CSSF noticed that the telephone number used by the fraudsters and their email address did not correspond to the details included in the complainant's file to contact him. After the execution of the instruction from the fraudsters to transfer the proceeds of the sale of the complainant's securities to a falsified account, the complainant blamed the bank for having transferred the proceeds of the redemptions of his units to an account that did not correspond to the one he indicated for receiving funds.

The CSSF was of the opinion that both, the complainant and his business agent, had been negligent because they had not verified whether the account number which had been communicated to them by the bank following their confirmation request had been changed without their knowledge. Nevertheless, the CSSF also concluded that the bank lacked diligence because it should have noticed that the fraudsters contacted it via a telephone number and an email address which did not correspond to the contact data included in the account opening documents of the customer.

Finally, the CSSF found a shared responsibility and requested the bank to take it into account in the compensation proposal it has been invited to make to the complainant.

In another case, the complainant blamed his bank for having executed a falsified transfer order. The bank received by mail a written application which apparently came from the complainant. By this letter, the fraudsters, posing as the complainant, after having intercepted one of his letters to the bank, requested the bank to close the account and to transfer the account balance to an account opened with a third-party bank located in the country of residence of the complainant.

The bank argued by claiming, inter alia, that it did nothing wrong by acting on the instructions to close the account and to transfer the balance account to an account abroad. In defence, the bank notably referred to the following disclaimer provided for in its terms and conditions: "Except in case of gross misconduct on its part, the Bank shall not be liable for the consequences which may arise from the execution of forged instructions which it receives.".

The bank also mentioned a decision of the Court of Appeal of 12 June 2013 (Pasicrisie, 2013, No 4, pp. 358-361) that holds that "a contractual term may model the obligation to make a refund in case of a counterfeited payment order and cause the account holder to bear the risk of payment made to a third party".

The CSSF noticed that the bank did not mention the extract of the Court's decision of 12 June 2013 in its entirety. It drew the bank's attention to the details provided in the decision as regards the contractual term which could model the refund obligation in the event of a counterfeited payment order. The Court of Appeal in particular specified that "if […] this term only aims at exempting the bank from its contractual liability, it does not preclude a refund request by the customer who requires his account be re-credited following the execution of a counterfeited payment based on the payment right and the application of the principle that "who pays wrongly, pays twice" […]".

The CSSF concluded that the aforementioned disclaimer provided for in the terms and conditions of the bank is without effect where the opposing party requires that his account be re-credited based on the payment right and in accordance with the principle that "who pays wrongly, pays twice".

The decision of the Court of Appeal also provided that the depositary bank could escape its refund obligation by proving that the payment it executed and for which the customer requested a refund was the result of a fault attributable to the customer. In the case in question, the bank did not provide the evidence that the complainant had a wrongful behaviour so that the bank did not manage to be exonerated from its liability.

The CSSF closed this case by concluding that the bank had to refund the contentious amount to the customer.

2.2.2. Cash withdrawals made by a dishonest employee from his employer's account

The CSSF received a complaint where a dishonest employee managed to make the bank believe that he had been duly authorised by his employer to withdraw, at the offices of six different agencies of the bank, an amount totalling EUR 250,000 by way of 48 withdrawals of amounts varying between EUR 4,500 and EUR 10,000 over a period of ten weeks.

The aggrieved employer argued that even if his dishonest employee had apparently a genuine proxy when he carried out the contentious withdrawals, the bank should have noticed that the withdrawals deserved close scrutiny, in particular since the complainant had never carried out such cash withdrawals and the frequency, number and scope of the contentious withdrawals did not correspond to his profile as known by the bank.

The bank explained to the CSSF that the contentious withdrawals ended when it contacted the management of the company for which the dishonest employee worked to discuss the withdrawals which eventually attracted its attention. During this conversation, the bank learned that its customer was unaware of the withdrawals made by his employee.

The bank tried to exonerate itself from liability by stressing that, at each withdrawal at the office of the bank, the employee presented his identity card and an original proxy bearing a signature conforming to the specimen of the complainant's authorised signatory who had a single signing authority over the bank account of the company for which the employee worked.

Finally, the CSSF held that the frequency, number and scope of the contentious withdrawals should have raised the bank's attention and encouraged it to check the authenticity of the proxy provided by the employee. The CSSF also held that the presentation by the employee of a genuine-looking proxy at each withdrawal should not have led the bank to neglect the required verification in the light of the frequency and importance of the withdrawals.

2.2.3. Termination of business relations by the bank

The CSSF received a complaint where the complainant who can be considered as a long-standing customer of her bank challenged its decision to terminate the business relationship without communicating the reasons therefor. The complainant contacted the CSSF notably in order to learn the reasons for the termination of the business relationship and to obtain compensation for the non-material damage she suffered due to this termination.

When analysing the file, the CSSF noticed that the bank carried out the contentious termination by applying its terms and conditions which included, inter alia, the following extract: "[...] Except otherwise provided for in a specific agreement between the Bank and the Customer, either party can terminate the mutual relations at any time, without stating reasons. Where the Bank provides payment services to a consumer Customer, the notice period is 2 (two) months [...]". The bank thus acted in accordance with its terms and conditions which authorised it to terminate the business relationship without stating reasons subject to a two months' notice period.

This is, in no way, contrary to the doctrine and case law which provide that where the parties did not themselves set a term to their commitment (which was the case here), each party has in principle a unilateral termination right and may use this right without stating reasons subject to a reasonable notice period.

In this respect, Mr Olivier Poelmans[2] wrote: “Where a contract includes successive service provisions and an indefinite term, it can be terminated *ad nutum* by the unilateral will of either party to the agreement. Indeed, it is contrary to public order to maintain someone in agreement relations indefinitely. Continuous commitment is prohibited. The termination, which needs not be justified by a fault of the other party and reasoned, must be accompanied by a reasonable notice period.”.

The bank terminated the business relationship with a two months’ notice period and the CSSF concluded that it was not at fault.

In another case, the complainant blamed his bank for having terminated the mortgage contract unilaterally, and for having initiated the first steps for the compulsory sale of the mortgaged property serving as collateral for his mortgage contract. The complainant argued before the CSSF that his financial situation had improved and that he was henceforth able to make significant efforts to repay his mortgage, thereby avoiding the sale of the mortgaged property.

The bank drew the CSSF’s attention to the reasons which led the bank to terminate the mortgage and to initiate the compulsory sale procedure of the complainant’s property. The bank thus alleged and provided evidence that the complainant had already been offered a debt repayment plan. However, the complainant did not fulfil its commitments. Moreover, the complainant stated to the bank that he would sell himself the property given as collateral (broken promise). In addition, the bank learned that the complainant contracted other debts with other financial institutions without informing it.

When analysing the file, the CSSF noticed that the complainant did not comply with his repayment obligations, right from the first instalments. Furthermore, the bank tried to be accommodating vis-à-vis the complainant, but the latter had not made efforts in order to fulfil his commitments.

The CSSF noted a certain negligence by the complainant in so far as he did not actually provide the bank with all the information it needed to be aware of his financial situation.

The CSSF finally held that it was understandable that the bank lost faith in its customer and terminated the mortgage contract before initiating a compulsory sale procedure of the mortgaged property.

2.2.4. Inattentive customers

In a case dealt with by the CSSF, the complainant blamed his bank with which he deposited securities from a certain issuer, for not having informed him of the capital increase of the issuer in question. These securities granted subscription rights which could be exercised during the capital increase of the issuer.

The complainant claimed that he could not exercise his subscription rights in due time because the bank did not inform him of the capital increase. The complainant then requested the bank to compensate him for the loss suffered because he could not exercise his subscription rights.

The bank explained to the CSSF that the information on the capital increase had been shared with the complainant in due time prior to the capital increase. The bank specified that it sent the complainant two emails (one to his secured email address provided by the bank and another one to his personal email address) to inform him of the event in question.

When analysing the elements of the file, the CSSF noticed that the bank’s terms and conditions, as accepted by the complainant, provided that the customers receive information from the bank mainly electronically. Yet, during the examination of the complaint file by the CSSF, the complainant acknowledged that he had not read the bank’s terms and conditions and that he had not consulted his emails during the relevant period either. Moreover, the CSSF noticed that the complainant contacted the bank concerning the exercise of his subscription rights long after the expiry of the deadline for the exercise of these rights.

[2] Mr Olivier Poelmans, “Droit des obligations au Luxembourg, Principes généraux et examen de jurisprudence”, pp. 288-289, Éditions Larcier 2013.

The CSSF ended its intervention by holding that the damage the complainant attributed to the bank resulted in fact from his act.

In another complaint file, the complainant blamed his bank, in particular, because it did not contact him before his sell order relating to put options was "automatically" executed. The complainant also charged the bank with producing an investor profile which did not correspond to him even when he acknowledged having completed it. He notably drew the CSSF's attention to the fact that his investor profile rightly mentioned that the investor could lose all his investment when investing in options. The complainant relied on this provision to argue that he had not been informed by the bank that he could lose more than the capital invested when investing in options. Yet, in this case, the complainant lost more than the capital he invested in options.

As regards this latter grievance, the CSSF noticed that the complainant actually completed the form relating to his investor profile by ticking the affirmative answer to the question as to whether he had already invested in options. Furthermore, the complainant also indicated that he was aware of the fact the investment in options could result in significant losses.

To convince the CSSF that the complainant was aware of the fact that he could lose more than the capital invested in put options, the bank produced the following excerpt of the document additional to its terms and conditions concerning the trade with option transactions which the complainant had accepted via connection log: "If you buy a long position put, the risks incurred, even if they can be very significant, are limited because the maximum possible loss corresponds to the amount of the premium paid to acquire your option, except in case of automatic exercise at maturity where the losses can exceed the premium's amount".

From the foregoing, the CSSF held that the complainant was properly informed by the bank of the risks incurred by him when speculating on put options. The CSSF also noticed that, at the time when the complainant gave the contentious sell order, he had access to the document entitled "Risks (overview of key features and risks of financial instruments)" which includes clear and precise provisions on the significant loss risks associated with the leverage effect of the put option.

The CSSF finally closed the complaint file without holding any liability on the part of the bank.

2.3. FIN-NET

FIN-NET which was launched in 2001 by the European Commission aims at enhancing the cooperation between national ombudsmen in financial services and at offering consumers easy access to extra-judicial mechanisms for cross-border dispute resolution in the area of financial services.

Prompted to familiarise the consumer with the use of out-of-court settlement and keen to promote its public image in 2017, FIN-NET requested its members to release a short animation film under its logo on their websites[3].

Moreover, in 2017, FIN-NET focussed on data protection in the area of financial services which represents a multi-faceted issue.

[3] CSSF website: http://www.cssf.lu/en/consumer/complaints/.

Agents hired in 2017 and 2018: Departments "Coordination of the UCI departments' specific IT tools" and "UCI Operations"

From left to right: Thomas LOCKWOOD, Sylvère RICHARD, Kathleen LUDWIG, Daniel GODINHO FRAGOSO, Matthieu PFEIFFER, Fouad EL BERKANI, Cédric DUHAUT, Christophe GILLES, Emmanuelle GOND, Geoffrey VISTICOT, Pierrick BENA, Christophe CARPENTIER

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 a regulation in order to establish a European Deposit Insurance Scheme (EDIS)

The text, which was still subject to discussions in 2017, was dealt with in detail in the CSSF Annual Report 2015.

However, it should be noted that in its "Communication on completing the Banking Union" of 11 October 2017, the European Commission aims at addressing the concerns of certain Member States, which arose during negotiations. The ideas proposed by the European Commission include an introduction of the European scheme in two phases. In a first re-insurance phase, the intervention of EDIS would be limited to providing refundable liquidity support to national Deposit Guarantee Schemes. The transition to the second phase, which allows for a mutualisation of losses would be conditional on the successful implementation of risk reduction measures and an asset quality review.

1.2. 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

The texts, which were still subject to discussions in 2017, were dealt with in detail in the CSSF Annual Report 2016.

1.3. Proposal for a 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 and Directive 2009/101/EC

The proposal for a directive is further detailed in point 1.1.3. of Chapter XIX "Financial crime".

1.4. 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

On 20 September 2017, the European Commission published new proposals for reforms aiming to adjust and improve the framework in which the three European Supervisory Authorities (EBA/ESMA/EIOPA, together the ESAs) evolve.

The objective of these amendments is to grant new governance and funding powers to the ESAs, enabling them to better assume their responsibility as regards supervision of financial markets. The European Commission reviewed the extent of the ESAs' mandate in light of the policy objectives of the Capital Market Union and following the decision of the United Kingdom to leave the EU.

The main proposed changes consist in extending the supervisory powers of ESMA notably so as to allow it to:

- authorise and supervise the EU's main benchmarks and endorse non-EU benchmarks for use in the EU;
- approve certain prospectuses published by EU-based entities and all prospectuses published by entities based outside the EU but drawn up in conformity with EU rules;
- authorise and supervise European venture capital funds (EuVECA), European social entrepreneurship funds (EuSEF) and European long-term investment funds (ELTIF);
- coordinate market abuse investigations;

- entrust the ESAs with the responsibility to check the consistency of the work programmes of individual supervisory authorities and monitor authorities' practices in allowing banks, fund managers, investment firms and other market players to delegate some business operational functions to non-EU countries;
- create executive boards allowing the ESAs to take decisions independently from national interests;
- define the contributions of the financial sector players to the funding of the ESAs in order for them to be independent from national supervisory authorities;
- prioritise financial technologies (FinTech) and coordinate national initiatives to promote innovation and strengthen cybersecurity.

2. DIRECTIVES AND REGULATIONS TO BE TRANSPOSED INTO NATIONAL LAW

2.1. Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II)

Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MiFIR)

Both European texts entered into force on 3 January 2018.

Draft bill No 7157, which aims to transpose MiFID II into Luxembourg law and to implement certain provisions of MiFIR, was submitted to the Chambre des Députés on 3 July 2017.

For further details on the main amendments introduced by MiFID II and MiFIR into MiFID (2004/39/EC), please refer to point 1.9. of Chapter XV "Banking and financial legislation and regulations" of the CSSF Annual Report 2011.

2.2. 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)

Draft bill No 7165 on central securities depositories and implementing Regulation (EU) No 909/2014 was submitted to the Chambre des Députés on 9 August 2017.

The draft bill determines certain elements that the CSDR leaves at the discretion of the Member States, such as (i) the designation of the competent authority in charge of carrying out the missions referred to in the regulation as regards initial authorisation and supervision of central securities depositories, (ii) the need to give indispensable supervisory and investigatory powers to the competent authority to exercise its functions and (iii) the obligation to establish rules relating to sanctions as well as other administrative measures applicable to breaches of the CSDR requirements. The draft bill designates the CSSF as the competent authority for the purpose of the CSDR.

2.3. Regulation (EU) No 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)

Draft bill No 7199 which implements Regulation (EU) No 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) was submitted to the Chambre des Députés on 25 October 2017. This draft bill designates the CSSF and the Commissariat aux Assurances as the competent authorities to ensure compliance with the regulation. It should be noted that the PRIIPs Regulation has been applicable since 31 December 2016.

2.4. 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 repealing Directive 2007/64/EC (PSD2)

The directive was discussed in detail in the CSSF Annual Report 2016.

The draft bill which aims to transpose the PSD2 into Luxembourg law was submitted to the Chambre des Députés in October 2017.

2.5. Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012

The regulation was discussed in detail in the CSSF Annual Report 2015.

Draft bill No 7194 implementing Regulation (EU) No 2015/2365 on transparency of securities financing transactions and of reuse (SFTR) was submitted to the Chambre des Députés on 10 October 2017. This draft bill implements the SFTR into Luxembourg law and notably amends the Law of 17 December 2010 relating to UCIs, the Law of 12 July 2013 on AIFMs and the Law of 7 December 2015 on the insurance sector. Among other things, the draft bill designates the CSSF and the Commissariat aux Assurances as the competent authorities to impose sanctions in case of regulatory breaches.

2.6. 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)

The Benchmark Regulation has been applicable since 1 January 2018. It was discussed in detail in the CSSF Annual Report 2016.

Draft bill No 7164 implementing Regulation (EU) 2016/1011 and amending (i) the Consumer Code, (ii) the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de surveillance du secteur financier) and (iii) the Law of 7 December 2015 on the insurance sector, was submitted to the Chambre des Députés on 4 August 2017. In order to operationalise Regulation (EU) No 2016/1011, the draft bill designates the CSSF as the competent authority for benchmark administrators and as the default competent authority for the supervised entities governed by the regulation. Exception to this default competence is made for supervised entities under the supervision of the Commissariat aux Assurances, the latter being designated as the competent authority for the purpose of the regulation for benchmarks for supervised entities under its supervision. The competent authorities will have the necessary supervisory and investigatory powers to exercise their missions and a sanctions regime is provided for in accordance with the provisions of Regulation (EU) 2016/1011.

2.7. Directive (EU) 2016/2341 of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision

The directive was discussed in detail in the CSSF Annual Report 2016. It must be transposed into national law by 13 January 2019.

2.8. Directive (EU) 2017/2399 of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy

Directive (EU) 2017/2399, which amends Article 108 of Directive 2014/59/EU (BRRD), was published in the Official Journal of the EU on 27 December 2017. The directive requires Member States to ensure that ordinary unsecured debt instruments and other ordinary unsecured liabilities that are not debt instruments

have a higher priority ranking in their national insolvency laws than the new non-preferred senior class of debt instruments. Thus, the new non-preferred senior class of debt instruments should have a higher priority ranking in their 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 internal bail-in by limiting, and even avoiding, its application to non-covered deposits.

The directive must be transposed into national law before 29 December 2018.

3. LAWS AND REGULATIONS ADOPTED IN 2017

3.1. Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents

The regulation was discussed in detail in the CSSF Annual Report 2016. It was published in the Official Journal of the EU on 13 April 2017 and has been applicable since 1 January 2018.

3.2. Law of 17 May 2017 on the application of Regulation (EU) No 655/2014 of 15 May 2014 establishing a European Account Preservation Order procedure to facilitate cross-border debt recovery in civil and commercial matters, amending the New Code of Civil Procedure and the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de surveillance du secteur financier), as amended

The Law of 17 May 2017 designates the CSSF as the authority responsible for obtaining information within the meaning of Article 14 of Regulation (EU) No 655/2014.

Article 14(1) of the aforementioned regulation provides for the following intervention conditions for the CSSF: "Where the creditor has obtained in a Member State an enforceable judgment, court settlement or authentic instrument which requires the debtor to pay the creditor's claim and the creditor has reasons to believe that the debtor holds one or more accounts with a bank in a specific Member State, but knows neither the name and/or address of the bank nor the IBAN, BIC or another bank number allowing the bank to be identified, he may request the court with which the application for the Preservation Order is lodged to request that the information authority of the Member State of enforcement obtain the information necessary to allow the bank or banks and the debtor's account or accounts to be identified.".

In order to allow the CSSF to fulfil its function as authority responsible for obtaining information, the Law of 17 May 2017 provides that the CSSF uses the method for obtaining information referred to in Article 14(5)(a) of Regulation (EU) No 655/2014, namely the obligation for all banks in the Luxembourg territory to inform the CSSF whether a certain debtor holds an account with it.

3.3. Law of 13 June 2017 on payment accounts

The law is further detailed in point 1.2.2. of Chapter XIX "Financial crime".

3.4. Regulation (EU) 2017/1129 of 14 June 2017 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

The regulation is further explained in point 1.1. of Chapter XII "Supervision of securities markets".

3.5. Regulation (EU) 2017/1131 of 14 June 2017 on money market funds

The Regulation, which was published in the Official Journal of the EU on 30 June 2017, entered into force on 20 July 2017 and will apply as from 21 July 2018.

3.6. Regulation (EU) 2017/1991 of 25 October 2017 amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds

The regulation was discussed in detail in the CSSF Annual Report 2016. It was published in the Official Journal of the EU on 10 November 2017 and has been applicable since 1 March 2018.

3.7. Regulation (EU) 2017/2395 of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State

The regulation inserts a new Article 473a into Regulation (EU) No 575/2013 (CRR) which allows institutions to opt for the application of transitional arrangements (from 1 January 2018 to 31 December 2022), enabling them to mitigate the impact of the introduction of IFRS 9 (applicable since 1 January 2018) on prudential own funds.

The institutions that use the transitional arrangements may choose to apply only the static approach or the dynamic approach:

- static approach: consideration of the initial impact related to the application of IFRS 9 for the credit losses (on 1 January 2018);
- dynamic approach: consideration, in addition to the initial impact, of any growth of expected credit loss provisions after the date of transition to the new standard.

3.8. Regulation (EU) 2017/2401 of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

Regulation (EU) 2017/2401 defines the prudential requirements that apply to institutions performing securitisation transactions, including a differentiated capital treatment for securitisations that qualify as simple, transparent and standardised (STS). The regulation must be read jointly with 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.

3.9. 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

The regulation is further detailed in point 2. of Chapter X "Supervision of securitisation undertakings".

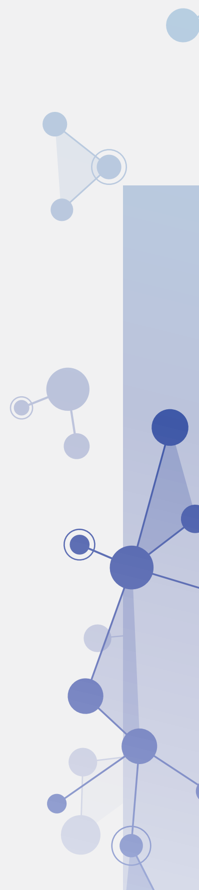
3.10. Grand-ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF

The purpose of this Grand-ducal regulation, which repeals and replaces Grand-ducal Regulation of 28 October 2013 on the fees to be levied by the CSSF, is to adapt the schedule of the fees to be collected by the CSSF to cover its personnel, financial and operating costs, in accordance with Article 24 of its organic law, to the rise in supervisory costs, without changing its fundamental structure nor derogating from the general principle according to which the costs generated by the supervision of a category of entities are to be covered by the fees to be levied on this category.

LIST OF ABBREVIATIONS

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
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
CdRS	Comité du Risque Systémique - Systemic Risk Board (SRB)
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
ELTIF	European Long-Term Investment Fund
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
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
IRE	Institut des réviseurs d'entreprises - Luxembourg institute of registered auditors
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
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
SME	Small and Medium-sized Enterprises
SRB	Single Resolution Board
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
VaR	Value-at-Risk



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