



Commission de Surveillance
du Secteur Financier

Annual Report 2020





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Although the pandemic caused by the coronavirus is not a black swan as it was entirely predictable, it remains nevertheless true that this very rare event, which had extremely brutal consequences, dominated the year 2020.

An epidemic in Asia became a pandemic affecting the entire planet, undermining at first the health of citizens and the healthcare systems. The health crisis then became an economic crisis, the effects of which could however be limited – for now – with the intervention of the political powers and the central banks. The financial crisis which could have ensued has been avoided so far, notably as the result of the reform of the financial system implemented after the financial crisis of 2007–2008. However, this good news should not make us forget the human tragedy caused by the coronavirus nor the economic distress of the entrepreneurs and their families.

What did the CSSF do? As the prudential supervisory authority, the CSSF must be operational at all times. Even if it was not prepared for the pandemic – no one was – its business continuity plan, the digitisation and modernisation of the work organisation pursued by the CSSF for several years allowed seamless continuity of services, even during the lockdown, when, at the end of the first week, 99% of its agents worked offsite and partially outside Luxembourg borders. The lockdown and strict sanitary rules forced the CSSF to innovate. For example, on-site

inspections, an indispensable tool for its controls, continued to take place but via videoconferencing tools. I would like to thank all the CSSF agents most warmly for the efforts they provided throughout the pandemic and continue to provide despite illness or difficult family situations.

The CSSF also showed flexibility in relation to the supervised entities, be it at the level of reporting, extensive use of IT tools, capital requirements, operational constraints, massive use of teleworking, moratoria and other arrangements. It issued a series of guidance for supervised entities, including regularly updated FAQs. A particular concern was the supervision of liquidity of investment funds, notably of some money market funds, where a crisis could be avoided through the funds' use of certain instruments but also and foremost through the purchase of private and public sector debt by the ECB via its Pandemic Emergency Purchase Programme (PEPP) and other purchase programmes. Another special focus of the CSSF was the monitoring of the development of mortgage loans, corporate loans and loans to individuals, in times of crisis. In both cases, close supervision was carried out via a specific reporting and dialogue with the industry, and the follow-up was performed by the CSSF as well as the Comité du Risque Systémique, where the CSSF is represented along with the Ministry of Finance, the Banque centrale du Luxembourg and the Commissariat aux Assurances. Throughout the

year, the CSSF was in close contact with the European and international institutions, notably the ECB, the EBA, ESMA, the FSB and the Basel Committee, with the objective of flexibility, in line with the law and European standards, as well as the safekeeping of the financial stability, in mind.

The supervised entities deployed their business continuity plans successfully and no major operational incident has been reported. Thanks to new loans granted (with or without partial State guarantee) and to moratoria, the banks acted responsibly and helped cushion the economic shock caused by the pandemic. In June 2020, moratoria reached almost EUR 3.7 billion but decreased to EUR 446 million at the end of 2020.

Even though COVID-19 drastically changed our lives and our work in 2020, other subjects marked the year.

It had to be ensured that the entities concerned with Brexit were prepared for the end of the transitional period on 31 December 2020. Thus, the CSSF provided a framework for the access of providers established in the United Kingdom to the Luxembourg market, determined the equivalence of the British regime in the context of the MiFID II/MiFIR third-country regime and reviewed a certain number of authorisation files received in the context of Brexit.

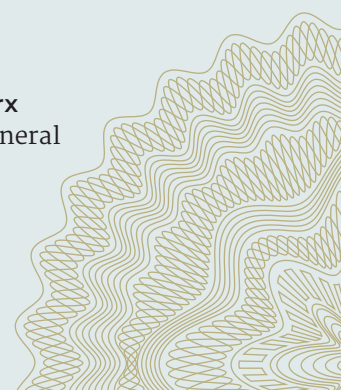
The greening of finance is more than ever topical, while companies emerge from the health and economic crisis. The CSSF closely monitored the developments at European level, and notably the preparation of the entry into force, on 10 March 2021, of the EU regulation on sustainability-related disclosures in the financial services sector, while

Level-2 texts and the taxonomy had not yet been published. The CSSF adopted a tolerant and firm approach: tolerance with respect to certain open questions, pending notably a clarification by the European Commission, firmness with respect to those which do not prepare themselves and fail to comply with the standards. The CSSF will not use gold plating; there will not be additional national requirements, but the ambitious goals of the EU will have to be implemented in the Luxembourg financial sector which, given its importance, will significantly contribute to the transition towards and the financing of a more sustainable economy.

The digitisation, under way prior to the health crisis, was accelerated as a result of the latter, especially due to the fact that a significant number of employees had to work remotely during a longer period. The CSSF will remain vigilant as to cybercrime risks and the risks posed by business models of entities not sufficiently preparing for the digital era. One of the key topics for the digitisation and the greening of the financial industry will be to ensure training and sufficient knowledge at all levels, starting with the boards of directors and the executive committees.

I wish you all a pleasant reading!

Claude Marx
Director General



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COVID-19

2020's biggest challenge

Interview with
Jean-Pierre Faber,
Claude Wampach and
Marco Zwick, Directors of the CSSF



What challenge did the COVID-19 pandemic pose the CSSF?

Jean-Pierre Faber The COVID-19 pandemic is first and foremost a human and health crisis. As every responsible employer, the CSSF's priority was to safeguard the health of its collaborators and of their families. To do so, we decided to allow 98% of our agents to work in home office as of 16 March 2020.

But on the other hand, we also had to guarantee our business continuity. Because we knew that the supervised entities were potentially facing serious difficulties, which in turn might impact the financial centre's stability and the Luxembourg economy.

And what was the impact of the pandemic on the Luxembourg banking industry?

Claude Wampach The Luxembourg banking sector was financially strong at the end of 2019. In the wake of the 2008 financial crisis, requirements for banks had been tightened, which was coordinated at a global level by the Basel Committee for banking supervision in which the CSSF represents Luxembourg.

Looking back on 2020, COVID-19 did not cause irreversible damage to the Luxembourg banking sector. This statement must be put into context though.

The crisis caught banks, like any other employer, off guard. The sanitary measures required them to adapt to new production processes, which was a huge challenge. In general, this was quite successful with around 90% of banking employees shifting to teleworking. Ultimately, operational capacities were nearly not impacted.

Concerning the impact for the banking business in itself, one must bear in mind the economic impact of COVID-19. The sales of many firms fell drastically, revenues nosedived but costs could often not be cut to the same extent. The Luxembourg State stepped in with huge resources in order to support the firms, and thereby the economy. But the banking sector played an active role as well, by granting bridge loans which helped stabilising the

economy. In March and April 2020, the volume of such loans grew by more than EUR 10 billion, 2 billion of which went to Luxembourg counterparties.

The fact that banks could bear this financially is a consequence of their financially sound situation in terms of solvency and liquidity.

Even if cautious optimism is allowed, the economic development against the backdrop of the pandemic remains uncertain. Although banks didn't suffer any significant rise in loan defaults in 2020, they made additional reserves amounting to EUR 600 million in order to offset possible future loan defaults. This represents no less than 13% of the 2020 gross result.

And for the Luxembourg fund industry?

Marco Zwick For the Luxembourg fund industry, there were two big impacts.

On one hand, there was a lot of volatility in the market, which caused a significant impact on the assets under management. So, there were a lot of questions surrounding liquidity management at that moment in time.

The second big impact was more a logistical one, which consisted in having the deployment of the business continuity plans by the companies. It resulted in remote working for most people working in the Luxembourg fund industry.

The Luxembourg fund industry was quite resilient, despite the initial impact we saw back in March with the funds under management going down from EUR 4.67 to 4.15 trillion, which was a drop exceeding 11%. This drop was well recovered during the year to reach almost EUR 5 trillion at the end of 2020.

As we speak today at the end of April 2021, the funds under management have now exceeded EUR 5.25 trillion.

So, there was an initial shock on the market, which was mainly caused by the prices, but we saw a quite big and a quite robust recovery both on the net inflow side for the investment funds and also due to market effect.

What is the role of a supervisory authority in such a crisis?

Marco Zwick The role of a supervisory authority is to assist and to provide guidance to the market and, if there is a fire, to avoid that it can spread to other sectors. So, our role is similar to a “fire prevention” unit.

Claude Wampach Every crisis needs to be handled with a steady but firm hand. Sheer activism must be avoided. If necessary, a framework helping to manage the emergency must be created. And there is a need for accompanying measures and precise guidance to help the supervised entities through the crisis in an orderly manner.

How did the CSSF set up to face this crisis?

Jean-Pierre Faber I am very proud to say that all meetings we intended to organise were maintained. And that even our on-site inspection programme has been kept to our schedule. Both of course in a remote mode using modern communication technologies.

The pandemic did not stop our way forward, also thanks to all of our agents' great commitment. We finalised a number of major technological projects. We continued to deploy our e-portal strategy to make exchanges with supervised entities faster, smoother and more transparent. And we tackled the major challenge of setting up a centralised register of bank accounts.

I think the way we dealt with the crisis is also an illustration of the transformative journey the CSSF is on. Three years ago, we conceived a strategy to make our institution even more efficient, with the same number of staff. We heavily invested in the technological equipment of our collaborators. We started reviewing our processes through lean management. And we elaborated a “digital curriculum vitae” helping our staff to understand the digital revolution we are in, as well as to appropriate the new working tools that we make available to them.

All this was stress tested during the pandemic and makes us more agile.

What did the CSSF do to help the industry through this crisis?

Claude Wampach The CSSF took a set of measures including guidance to banks or resulting in the creation of a regulatory framework to manage the crisis. In terms of the regulatory framework, one example is the EBA moratoria. The CSSF created a regulatory framework in Luxembourg, in cooperation with the European Banking Authority, EBA, to accommodate large-scale moratoria on loan repayments. A moratorium is a situation in which a bank allows customers to defer loan and interest repayment for a period of time. This is exactly the type of instrument that enables banks, in COVID-19 times, to give solvent customers the necessary wiggle room in order to survive the crisis. In July 2020, the volume of such moratoria granted by Luxembourg retail banks grew to the considerable amount of EUR 3 billion. Today, this amount is below EUR 150 million again. However, the CSSF made it clear that such moratoria, if not granted to solvent customers, could jeopardise the financial stability, and required banks to consider the issue of credit risk carefully.

With regard to the guidelines given by the CSSF, we can notably look at those relating to the organisation of banking business. With COVID-19, production shifted to teleworking. It is not the CSSF's role to regulate this organisation in every detail. Each bank must decide for itself as every case is specific. The CSSF only issued the additional instruction that teleworking-related risks, specifically cybercrime, need to be addressed.

Marco Zwick First of all, the CSSF looked at the issues at hand and concluded that some reporting should be postponed and to give some leeway to the market, which was under stressful condition.

At the same time, we were needing some additional information, some statistics on a weekly and on a daily basis. We addressed a targeted reporting to the 122 major fund management companies in Luxembourg.

So, I think there was a lot of interaction, a lot of questions raised to us, also concerning liquidity

management tools: how to use them, under which circumstances to use them and how to inform the investors.

What lessons can be learned and what is your outlook for the future?

Marco Zwick We learned that the liquidity management tools have been handled in a professional manner. The good news being that the toolbox we have is very large and that these tools were used in the best way.

One of the future topics for further analysis will be the efficient use of liquidity management tools, with a focus on the liquidity mismatch for open ended funds and the liquidity management of money market funds.

The other lesson is to show how important international cooperation has been between national supervisory authorities, between national authorities and ESMA and also between national supervisory authorities and the private sector.

Claude Wampach The supporting measures of governments and central banks will expire eventually. Until then, it is important to stabilise the economy as a whole. However, there will be firms that will not survive this crisis, and this will leave its mark in the banks' balance sheets. On the negative side, state and corporate debt as well as social imbalances, whose consequences can't be determined with absolute certainty yet, will remain in the long run. On the positive side, there is the structural shift towards more sustainability.

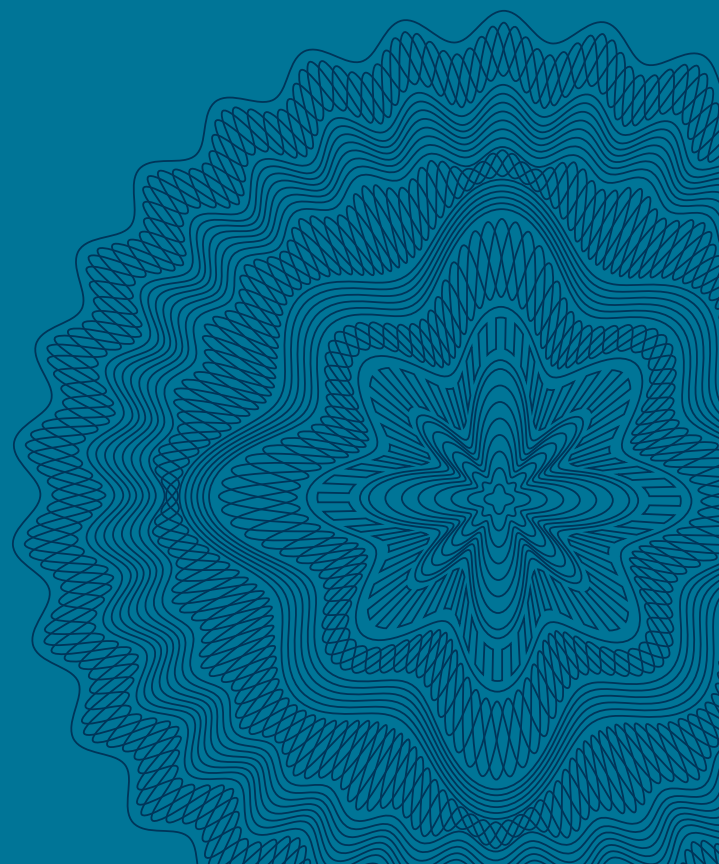
Jean-Pierre Faber One lesson that can be drawn one year after the pandemic started, is that we were shown how fragile our whole societies are.

But there are also some positives. It is an accelerator for the digitalisation of the way we are working. In a few months' time we have made great strides implementing and securing new ways of exchanging with the industry.

It also confirmed the interest of teleworking. The pandemic stressed the necessity to create a context allowing this practice, but

also framing it in regard to the specific requirements of the financial industry and to Luxembourg financial centre's unique context. We finally did this by issuing Circular CSSF 21/769 on teleworking in April 2021, after intense consultation with the industry in order to make sure that our text provided for enough flexibility to consider very different situations. So, on this topic, the Luxembourg financial centre is also ready for the future.

Marco Zwick On a positive note, we can also conclude that the industry has been very resilient and that it has demonstrated that it is not the source of the problem, but a key contributor to the solution of the problem.





FINANCIAL INNOVATION

How the CSSF facilitates financial innovation.

Interview with
Françoise Kauthen,
Director of the CSSF

Financial technologies affect all financial sector activities of the CSSF's supervisory areas. What have been the recent key trends of financial innovation observed by you, as a regulator of the financial sector?

Trends in financial innovation are not significantly different from technical innovation trends in other sectors. Artificial intelligence, machine learning, cloud computing, DLT techniques, together with a massive drive towards digitalisation, including data digitalisation, are transforming our daily activities.

The pandemic situation starting as from the first quarter of 2020 has globally accelerated existing trends in the financial sector activities and regulation. Major developments have been noted in two areas of financial services and products: accelerated inclusion of new technologies and consideration of sustainability criteria.

Why start with quoting the accelerated inclusion of digitalisation and sustainability, two trends of the financial sector which might appear to be completely dissociated issues?

In fact, financial innovation should not be considered as a goal in itself, it should serve as a tool to support activities in a responsible way, to gain in efficiency in areas as for example the one of sustainable finance. Work on technological solutions based on DLT techniques for issues like filling existing data gaps in the field of ESG (economic, social, governance) related information is one concrete illustration of responsible financial innovation.

On the other hand, innovation touching on digital onboarding based on artificial intelligence or machine learning for example should be duly challenged on social and governance questions like discrimination, exclusion of certain people or gender inequality. In the recent proposal for an EU Regulation for Trustworthy AI, harmonized rules that respect fundamental rights are foreseen in order to mitigate the high risk of such systems in this context.

Why is it important for the financial industry to keep up with the new technologies?

It is important for supervised entities to be in phase with the new technologies.

New technologies are transforming financial activities, financial products as well as financial regulation. It is key for traditional players to keep up with new technologies in order to be able to offer customers competitive and tailored services and products.

The fact that innovation through traditional process updating of existing systems, the

It is key for traditional players to keep up with new technologies in order to be able to offer customers competitive and tailored services and products.



so-called "legacy systems" is complex, slow and costly should be another good reason to follow evolutions of the FinTech area where alternative solutions are often developed from scratch using a more agile project management.

Finally, supervised entities should also keep an eye on technical innovation in order to be able to mitigate upcoming new risks technologies and to find vulnerabilities and tools to manage their ICT and security risks.

Does the CSSF as a financial regulator encourage financial innovation in the financial sector?

As a regulator, our mission is to enable and encourage positive innovation. We are convinced that financial innovation is capable to actively support financial sector activities in a responsible way. The CSSF aims at having a proactive flexible regulatory approach in order not to hinder new opportunities and benefits coming from financial innovation.

To this end, in 2020, we created a division dedicated to financial innovation: the CSSF's "Innovation Hub". It is the single point of contact for any person seeking to present an innovative solution, initiate an open dialogue or raise any question related to financial innovation. Through the permanent contact with market players, the Innovation Hub enables the CSSF to gain the best possible

safeguard the role of prudential supervision and supervision of the financial markets in ensuring the safety and soundness of the financial sector with a special focus on consumer protection, market confidence and AML issues.

What have been the main areas of the CSSF work during 2020?

2020 was marked by three major projects.

In the area of virtual assets, the VASPs (Virtual Asset Service Providers) registration regime for AML/FT supervisory purposes started at the end of the first quarter of 2020.

The creation of the Innovation Hub and the practical development of its centralisation, coordination and supporting tasks allow us to give better guidance to the industry.

During the last quarter of 2020, with the upcoming European Digital Finance Package, work rapidly started on the proposals for the Digital Operational Resilience Act (DORA), the Regulation of Markets in Crypto-Assets (MICA) and the DLT pilot regime. The CSSF welcomed those proposals and fully supports their objectives, i.e. to mitigate risks of digital transformation by strict and common rules on digital/ICT operational resilience and to regulate currently out-of-scope crypto-assets and their service providers. First major points of attention have been proportionality, interaction with existing legal framework and clarification of the scope and the new supervisory regimes.

What are the biggest challenges and opportunities for 2021?

When I think about future challenges and opportunities, I think that there are areas where specific financial regulation is beneficial in order to foster technical financial innovation or is needed in order to preserve the safety and soundness of the financial market. Recent examples of regulatory initiatives are the different elements of the European Digital Finance Package.



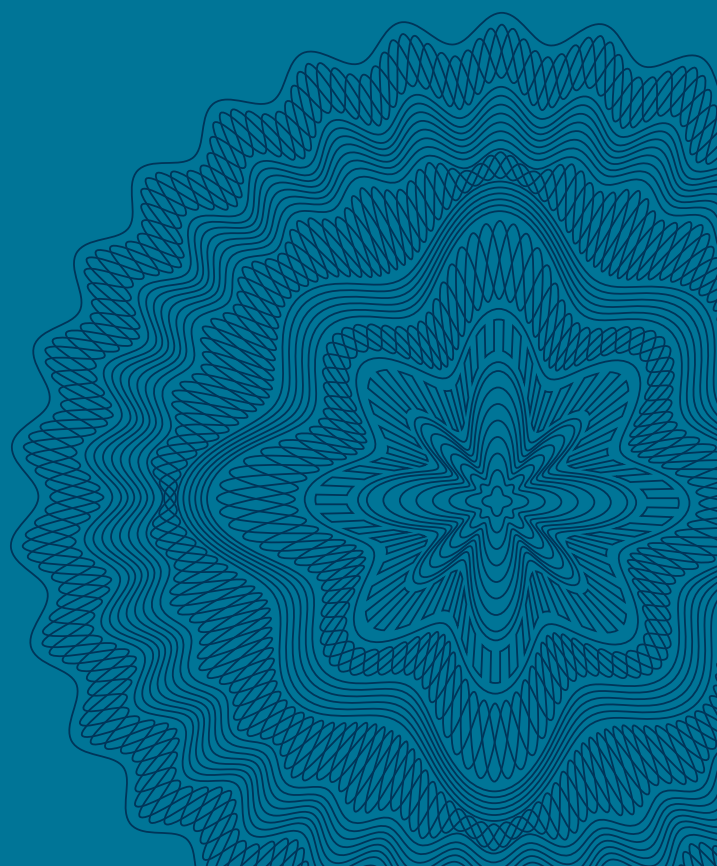
Digitalisation processes and fast-changing technology in some areas as digital payments, artificial intelligence processes and crypto-assets will remain a major challenge for the CSSF.

understanding of FinTech developments and expectations and to address the forthcoming challenges. By promoting a constructive and open dialogue, the Innovation Hub contributes to the concrete realisation of financial innovation projects.

At the same time, the CSSF, according to its mission statement, has to adopt a prudent risk-based regulatory approach in order to

The CSSF, as a regulator, will first have to actively contribute with its practical experiences to those massive fascinating regulatory packages. Once adopted, the work will continue on regulatory standards, and integration of the new rules and the new actors in the CSSF supervisory activities. We already see financial market participants preparing for the new requirements or working on elaborating new opportunities. Their practical questions and the transition preparations to the new requirements are a big challenge for 2021/2022.

At the same time, digitalisation processes already initiated which continue to develop at high speed and fast-changing technology in some areas as digital payments, artificial intelligence processes and crypto-assets like stablecoins will remain a major challenge for the CSSF.





Brexit

Challenge met.

Interview with
Anne-George Kuzuhara,
Deputy head of department,
Bank Regulatory Policy,
and Isabelle Jaspart,
Head of division, Legal Department

What challenges did Brexit pose for the market participants?

Anne-George Kuzuhara 2020 was a critical year for financial service providers and products impacted by Brexit. It was a year of transition at the end of which all financial institutions on both sides of the Channel would lose their European passport granting a free access to one another's market.

2020 was also a year full of uncertainties. Until the very last days of 2020, it was unclear if the UK and the European Union would reach an agreement to frame the future of their relationship, whether that deal would include financial services and provide a solution to substitute the loss of passporting rights.

All concerned entities, whether established in the EU and providing services in the UK or established in the UK and providing services in the EU, were therefore facing a potential risk of cliff effect threatening the continuation of their activities and services to their clients.

What were the challenges for Luxembourg as a financial center?

Anne-George Kuzuhara The challenge for the Luxembourg financial center was to avoid the damage that could have resulted from a no-deal scenario, given the large dependencies between Luxembourg and the UK and the complementary character of our respective financial centers.

Brexit therefore posed a clear risk. Actions had to be taken to assess the situation and to find solutions to mitigate this risk.

What were the potential risks to customers?

Isabelle Jaspart There was a real and immediate risk for financial stability. Consumers and investors were facing a risk of disruption of the financial services they were receiving.

Despite the uncertainties surrounding the outcome of the negotiations between the UK and the EU, financial institutions were requested by supervisors to assess the impact of the end of the transition period on them and their customers. Financial institutions had to inform their customers of any potential disruption in the continuity of the services to allow them to timely exercise their rights.

In case of any risk for the availability or continuity of the services, institutions were therefore expected to explain to their customers the impact of the discontinuation of services and the way to exercise customer's rights.

What part supervisors played in addressing these challenges? How did the CSSF accompany the Brexit?

Anne-George Kuzuhara Facing all these challenges, the CSSF has continued to commit a substantial amount of resources to mitigate the risks posed by Brexit. We have undertaken, for each type of financial service and entity under our supervision, a thorough assessment of the potential cliff effect that could come from the termination of the transition period with no agreement in general or no agreement on financial services. The CSSF has extensively communicated on its expectations and provided guidance to market participants.

Supervisory dialogues took place to ensure that firms would finalise the full execution of their contingency plans before the end of the transition period and, for those firms active in the UK, that they had duly applied for the UK temporary regime (TPR) to continue their operations there.

Most importantly, the CSSF has assessed the needs for UK equivalence decisions, and the necessity to enter into cooperation agreements with UK authorities.

What was the situation on the 1st of January 2021?

Isabelle Jaspart Thanks to a number of actions taken in 2020, a smooth transition to 2021 was made possible.

The cooperation agreements that had been drafted and agreed have allowed to avoid disruptions at the end of the transition period, as for example in the area of asset management, where cooperation between authorities was a requirement.

A milestone in the CSSF's Brexit works was the release at the end of 2020 of the CSSF's equivalence decision for UK firms providing investment services to certain clients in Luxembourg and the application of the third-country regime to the UK. This was in particular relevant in the area of asset management and notably for the delegation of collective portfolio management.

What can we expect for the future?

Isabelle Jaspart On 26 March 2021, the UK and the EU signed a Memorandum of Understanding that creates the framework for voluntary regulatory cooperation in financial services. The MoU establishes the Joint UK-EU Financial Regulatory Forum, which will serve as a platform to facilitate dialogue on financial services issues.

In 2021, the CSSF will continue to monitor the situation in the UK, in particular in the context of the assessment of the equivalence granted by the CSSF.

A new page is being written in the relationship with the United Kingdom based on a new and stable framework. The future of the relationship will depend on how both sides will envisage the future cooperation. From the CSSF point of view, our excellent relationship with the UK financial authorities allows us to envisage the future with confidence.

I. Governance and functioning of the CSSF

1. Governing bodies and Committees

1.1. CSSF Board

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. The Board 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 Board is not competent to intervene in the CSSF's prudential supervisory matters.

CSSF Board composition

Chairwoman	Maureen Wiwinius
Members	Catherine Bourin
	Daniel Croisé
	Yasmin Gabriel
	Camille Thommes
	Pascale Toussing
Secretary	Claude Wirion
	Danielle Mander

1.2. Resolution Board

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.

Resolution Board composition

Chairman	Romain Strock
Members	Bob Kieffer
	Gaston Reinesch
	Claude Wampach
	Karin Guillaume
Secretary	Nicole Lahire

1.3. Council for the Protection of Depositors and Investors

The Council for the Protection of Depositors and Investors (CPDI) is the internal executive body of the CSSF in charge of managing and administering the Fonds de garantie des dépôts Luxembourg (FGDL) and the Système d'indemnisation des investisseurs Luxembourg (SIIL). 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.

Council for the Protection of Depositors and Investors composition

Chairman	Claude Wampach
Members	Bob Kieffer
	Gaston Reinesch
	Yves Maas
	Karin Guillaume
Secretary	Laurent Goergen



Left to right: Françoise Kauthen, Claude Wampach, Claude Marx, Marco Zwick, Jean-Pierre Faber

1.4. Executive Board

The senior executive authority of the CSSF is the Executive Board, composed of a Director General and of four Directors. It develops the measures and takes the decisions it deems useful and necessary for the fulfilment of the CSSF’s mission and its organisation. Moreover, it sets up a five-year “target contract” with the Minister of Finance. The Executive Board is responsible for the reports and proposals it must submit to the Board and the Government as part of its responsibilities.

Composition of the Executive Board

Director General	Claude Marx
Directors	Françoise Kauthen
	Jean-Pierre Faber
	Marco Zwick
	Claude Wampach

1.5. Consultative Committee for Prudential Regulation

The Government may seek the advice of the committee, established by the Law of 23 December 1998 creating the CSSF, concerning any draft law or Grand-ducal regulation as regards regulations in the area of the supervision 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 questions.

Consultative Committee for Prudential Regulation composition

Executive Board of the CSSF	Claude Marx (Chairman)
	Françoise Kauthen
	Jean-Pierre Faber
	Marco Zwick
	Claude Wampach
Members	Emmanuel Gutton
	Guy Hoffmann
	Robert Scharfe
	Camille Seillès
	Camille Thommes
	Vincent Thurmes
Secretary	Danielle Mander

1.6. Consultative Committee for the Audit Profession

The Government may seek advice from the committee, established by the Law of 18 December 2009 concerning the audit profession, on any draft law or Grand-ducal regulation related to statutory audits and the audit profession subject to the oversight of the CSSF. The CSSF's Executive Board seeks the opinion of the committee on any draft CSSF regulation related to statutory audits and the audit profession. Members of the committee may also seek its advice concerning the implementation or application of the legislation regarding the public oversight of the audit profession overall or for specific questions.

Consultative Committee for the Audit Profession composition

Executive Board of the CSSF	Claude Marx (Chairman)
	Françoise Kauthen
	Jean-Pierre Faber
	Marco Zwick
	Claude Wampach
Members	Anouk Agnes
	Christiane Chadoeuf
	Thierry Flamand
	Philippe Meyer
	Andy Pepin
	Gilles Pierre
	Daniel Ruppert
Secretary	Philippe Sergiel
	Anne-Sophie Theissen
	Danielle Mander

1.7. Consultative Committee for Resolution

The Government may seek advice from the committee, established by the BRRD Law, on any draft law or grand-ducal regulation as regards regulations in the resolution field falling within the competence of the CSSF. The Resolution Board seeks an opinion of this committee on any draft CSSF regulation relating to resolution. Members of the committee may also seek its advice concerning the implementation or application of the regulations on resolution overall or for specific questions.

Consultative Committee for Resolution composition

Resolution Board	Romain Strock (Chairman)
	Karin Guillaume
	Bob Kieffer
	Gaston Reinesch
Members	Claude Wampach
	Jean-Louis Barbier
	Doris Engel
	Claude Eyschen
	Nico Picard
	Philippe Sergiel
Secretary	Vincent Thurmes
	Nicole Lahire

1.8. Permanent and ad hoc expert committees

The expert committees assist the CSSF in analysing the development of the different financial sector segments, give their advice on any issue relating to their activities and contribute to the drawing-up and interpretation of the regulations relating to the specific areas covered by the respective committees. In addition to the permanent committees, ad hoc committees are formed to examine specific subjects.

The permanent expert committees are currently the following.

- AML/CFT Advisory Committee

Permanent external members:
Luxembourg Bankers' Association (ABBL),
Association of Luxembourg Compliance Officers (ALCO), Association of the Luxembourg Fund Industry (ALFI), Luxembourg Association of Professional Wealth Managers (ALPP),

Luxembourg Association of Professionals in Risk Management (ALRiM), Luxembourg Institute of Internal Auditors (IIA), Luxembourg Institute of Statutory Auditors (IRE), Administration de l'enregistrement, des domaines et de la TVA (AED), Commissariat aux Assurances (CAA), Financial Intelligence Unit (CRF), Ministry of Finance, Ministry of Justice, Luxembourg State Prosecutor's Office (Parquet)

- Investment Fund Managers Committee

CSSF members:

Marco Zwick (Chairman), Pascal Berchem, Irmeline Greischer, Jean-Paul Heger, François Hentgen, Alain Hoscheid, Laurent Van Burik, Rudi Dickhoff (Secretary)

External members:

Ravi Beegun, Michèle Berger, Hermann Beythan, Stéphane Brunet, Ruth Bültmann, Olivier Carré, David Claus, Jacques Elvinger, Jean-Marc Goy, Emmanuel Gutton, Emmanuel-Frédéric Henrion, Alain Kinsch, Corinne Lamesch, Charles Muller, Virginie Ng Wing Lit-Boulot, Pierre Schleimer, Denise Voss, Pierre Weimerskirch, Serge Weyland, Thomas Seale, Julien Zimmer

- Capital Markets Committee

CSSF members:

Françoise Kauthen (Chairwoman), Marc Limpach, Paul Wiltzius (Secretary)

External members:

Julie Becker, Philippe Hoss, Nicki Kayser, Christian Kremer, Henri Wagner

- Audit Technical Committee

CSSF members:

Frédéric Tabak (Chairman), Agathe Pignon, Anne Wirard, Pedro Da Costa, Mathieu Antoine (Secretary)

External members:

Yohan Blaise, Bettina Blinn, Christelle Bousser, Olivier Lefèvre, Sylvie Testa

2. Human resources

2.1. CSSF staff

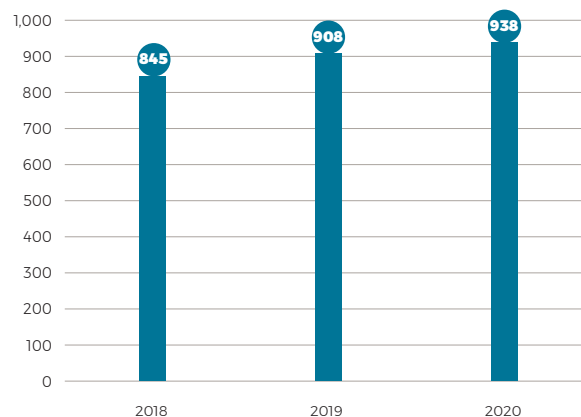
As a response to the constant increase in the missions conferred on it, the number of CSSF staff has been growing continuously since 2010. The year 2020 confirmed this trend with the recruitment of 55 new agents. In parallel, 25 agents left the CSSF during the year, which resulted in a net increase of 30 agents and bringing the CSSF staff to a total of 938 agents as of 31 December 2020 (+3.30%). This is the equivalent of 845 full-time jobs (+3.94%).

The number of agents with alternate work arrangements (part-time, partial leave, parental leave or unpaid leave) amounted to 252 as at 31 December 2020, representing 26.87% of total staff.

As regards parental leave, it is worth noting that the split leave of eight hours per week, i.e. a 20% reduction in weekly working time, is very popular among CSSF agents and represented 71.67% of all granted parental leaves.

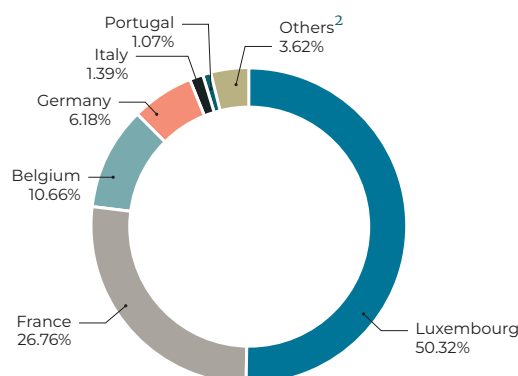
During 2020, the CSSF received 4,119 applications for vacancies. Recruitment efforts continued to be essentially focussed on IT profiles and strengthening of support functions, as well as on AML/FT profiles in order to support the departments in their prudential supervisory tasks. The CSSF continued to be present at recruitment events which were held virtually in 2020 due to the health situation. During the lockdown periods, recruitment interviews took place via videoconference. Moreover, the recruitment section of the CSSF website¹ was adapted and allows to digitally process the applications end-to-end.

Movements in staff numbers



CSSF agents represent 17 nationalities, the Luxembourg nationality being the most represented with 50.32% of total staff. However, this percentage decreases from year to year.

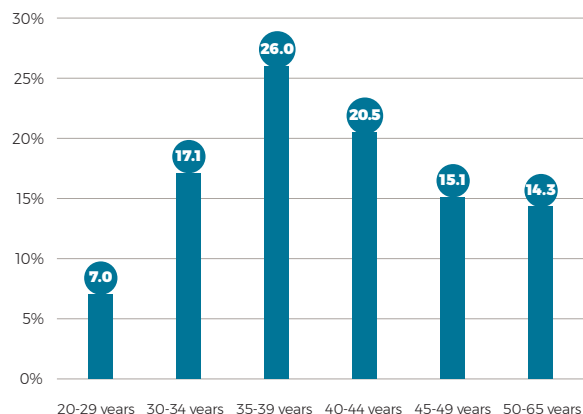
Breakdown of staff by nationality



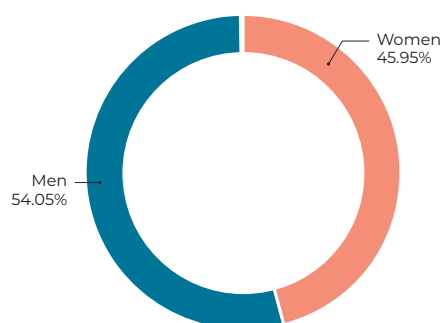
The average age of the CSSF staff members slightly increased from 40.10 years as of 31 December 2019 to 40.52 years at the end of 2020.

¹ <https://careers.cssf.lu/en/home/>.

² Spain (0.75%), the Netherlands (0.53%), Austria (0.43%), Romania (0.43%), Bulgaria (0.43%), Poland (0.32%), Greece (0.32%), Finland (0.11%), Sweden (0.11%), Ireland (0.11%), Hungary (0.11%).

Breakdown of staff by age

Women make up 45.95% of total staff and men 54.05% as of 31 December 2020.

Breakdown of staff by gender

As regards the position of men and women in the hierarchical structure, out of a total of 135 people with hierarchical responsibility, 45 were women (33.33%) and 90 men (66.67%) as of 31 December 2020.

CSSF hierarchy structure

	Women	Men	Total
Director General	0	1	1
Directors	1	3	4
Resolution Director	0	1	1
Heads of department	11	15	26
Deputy heads of department	17	28	45
Heads of division	16	42	58
Total	45	90	135
In %	33.33%	66.67%	100.00%

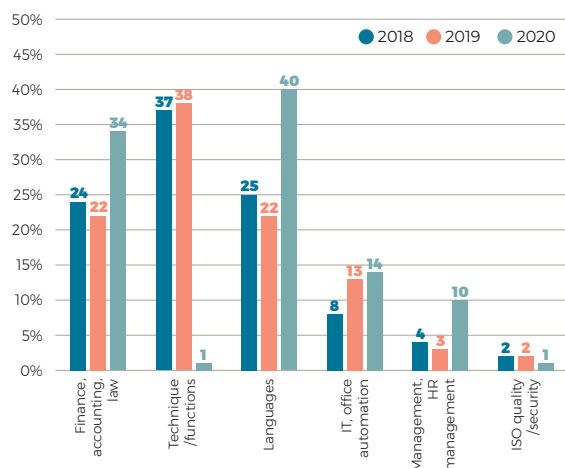
2.2. Training

The CSSF has always given special attention to the training of its agents to enable them to deal with the challenges they face in the context of continuous regulatory developments and methodology changes that come with a constantly changing environment.

Today, the CSSF has an extremely broad training catalogue as regards functions and IT as well as management and leadership.

In 2020, the CSSF agents completed a total of 23,521 training hours, which represents 3.13 training days per agent, down from 7.9 days on average per agent in 2019 mainly due to restrictions in relation to the pandemic. Given the health situation, most of the ongoing training took place remotely, in the form of webinars or e-learning thanks to the efforts of the “Training” team which was able to swiftly adapt to the new working methods. A digital curriculum vitae was set up in order to strengthen the technological competences of the agents with respect to automation and artificial intelligence. Moreover, Lean Management training was offered, the CSSF’s ambition being to certify 10% of its staff in Lean Management. There has been a decrease in soft skills training which can be explained by the fact that this training is less adapted to being held remotely. Finally, the whole CSSF staff participated in a mandatory e-learning in order to master the base requirements of the GDPR regulation.

Breakdown of training according to topic



2.3. Organisation chart

The organisation chart of the CSSF is available on the CSSF's website (About the CSSF > General organisation > Documentation > Publications).

3. CSSF 4.0 strategy

The CSSF 4.0 strategy is the transformation strategy aiming to allow the supervisory authority to respond even more efficiently, and with unchanged staff numbers, to the expectations expressed by its stakeholders, i.e. those of the civil society, politicians, media, notably in relation to ethical, consumer protection and the fight against financial crime topics, but also those expressed by the supervised entities, for example in terms of transparency and responsiveness in processing requests and authorisations.

The long-term vision that the CSSF expresses through this strategy is to allow real-time supervision. At short and medium term, it aims at establishing real-time exchanges with its stakeholders.

The CSSF 4.0 strategy is articulated around three dimensions: training, process reviews and digitalisation.

3.1. Training

As regards training, the CSSF is aware of its responsibility to accompany its agents facing the challenges of the ongoing digital revolution. Indeed, on the one hand, if the authority expects its agents to be able to supervise a market that increasingly uses innovative products and services, they must be able themselves to understand these innovations. On the other hand, if the CSSF provides them with more and more modern tools to perform their missions, they must be able to appropriate these tools. Very comprehensive training programmes around the digital curriculum vitae of the agents have therefore been set up. Most of these training sessions are available in the form of e-learning. The pace of these training sessions could therefore be pursued during this period of remote working.

3.2. Process reviews

As regards process reviews, the CSSF invested in Lean Management. But the sole endeavours of Lean Management experts will not be enough, however efficient they are. Thus, the goal of the CSSF's Executive Board is to train and to certify 10% of its agents in Lean Management over the next five years. In the meantime, 27 projects have been completed already or are being completed. Here again, the COVID-19 pandemic has not put a damper on the institution's ambitions. New methods to hold lean workshops remotely have even been invented. The purpose of the efforts of Lean Management and automation is to free up useful time of the agents, in order to assign tasks to them with greater added value. This is a continuous improvement process: as soon as work procedures have been reviewed, improved and implemented, these must be re-assessed over time.

3.3. Digitalisation

The CSSF places data and the review of its organisational processes at the core of its CSSF 4.0 strategy initiatives. This transformation is a decisive and necessary step to equip the authority in a world that is globally changing, accelerating and further transforming. The supervised entities are not exempt from this transformation; quite the contrary, they are active protagonists thereof. The CSSF wishes to accompany these changes in order to sustain its own competitiveness as a regulator in the competitive world of financial markets at international level.

The growing volume and complexity of “Data”, the allotted time to use the data and the Quality Control requirements lead the CSSF to speed up the implementation of the Data Hub concept.

In order to achieve this ambitious objective by 2022, the CSSF worked on three major areas in 2020, which, without any doubt, have been influenced by the health crisis.

- **First axis: a strong willingness to accentuate the delivery of digital solutions**

The year 2020 was not only marked by regulatory projects initiated at national, European and international level, but also by the CSSF’s efforts as regards the deployment of digital solutions and the optimisation of its external commitments. In light of this, the collaborative offer of digital solutions has been expanded towards external actors (Register of bank accounts, eProspectus Part 1, eDesk Survey, website www.cssf.lu, etc.) as well as internally (KPI³/KRI⁴, eBadging, eLearning, etc.). These projects allowed at the same time testing the agility of the CSSF’s technological know-how.

- **Second axis: new tools to support day-to-day activity**

A part of the technological roadmap linked to the CSSF 4.0 strategy involves the strengthening or provision of tools fostering communication between CSSF agents as well as with the supervised entities and the European and international institutions. The health crisis disrupted and accelerated the deployment agenda for these tools, thereby allowing to ensure the CSSF’s business continuity throughout such a particular Business Continuity Plan (BCP). Such an ambitious BCP was a challenge both for CSSF agents and for the industry and the economy as a whole. In this context, the agents adapted rapidly to the new tools which, today, are part of their daily work (for example Skype for business, Webex call & events organisation, Link-up digital magazine, eLearning platform and, finally, the secure remote access via VPN⁵ without which the CSSF would not be able to ensure its remote working functions).

- **Third axis: a new project management methodology**

An important step for the implementation of an efficient project management methodology was initiated within the CSSF in 2020 and pursued in 2021. The new agile Scrum approach and the implementation of the Product Owner roles allowed the CSSF to put 1,500 IT upgrades and new software installation in place in this year marked by the pandemic.

However, the health crisis led to the review of all IT projects over the years 2020 and 2021 in order to guarantee the implementation of projects regarded as a priority at a regulatory level or strategic for the future of the authority.

This added value created by the health crisis allowing the digital transformation of the CSSF is significant and sustainable, thus illustrating Albert Einstein’s adage: “In the middle of difficulty lies opportunity.”.

The reappraisal of the organisation and automation of the CSSF’s organisational processes will continue in 2021. This will be achieved through a guided and controlled transformation, without confusing speed and precipitation and with as priority axis the implementation of a Data Hub dedicated to business functions and the financial industry.

4. Health crisis management within the CSSF

With the emergence of the coronavirus in Luxembourg, the CSSF’s Executive Board decided to set up an extraordinary COVID-19 crisis management committee which started to meet as early as 27 February 2020 and which is still active given the development of the health situation in Luxembourg.

The committee is composed of the Director in charge of human resources and IT systems, the representatives of IT, human resources, Facility Management, Health and Safety, legal department, risk management, communication and a representative in charge of monitoring health protocols. The rate of meetings on a daily basis at the beginning of 2020 passed down to a rate of three meetings a week towards the end of 2020.

3 KPI: Key Performance Indicator.

4 KRI: Key Risk Indicator.

5 VPN: Virtual Private Network.

The COVID-19 committee has the following missions:

- implement the measures necessary to preserve the safety and health of the CSSF agents and visitors, in the light of the instructions of the government bodies;
- ensure business continuity within the CSSF and swiftly respond to the situation. Adaptations have thus been made at the level of human resources (remote working, certificates, etc.), IT infrastructure (VPN, telephony, etc.) and physical (work places, company restaurants, etc.) and external infrastructures (health protocols for visitors, service providers and suppliers);
- manage a steady level of two-way communication fostering a structured and levelled sense of urgency and attention via regular internal communications (over 300) and a constant implication of the CSSF's Executive Board.

As from 16 March 2020, the CSSF agents started working remotely, thereby ensuring the continuity of the CSSF's missions. The premises could be reintegrated as from 25 May 2020 based on team rotation. No agent, external provider or visitor contracted the coronavirus within the CSSF, as of 1 May 2021.

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 5,000 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. CSSF budget and annual accounts - 2020

6.1. CSSF budget

Budget planning is part of a multi-year planning of the CSSF's income/expenses; it thereby allows guaranteeing the financial balance of the CSSF in the long term.

The 2020 budget was approved by the Board of the CSSF on 26 November 2019 and the 2020 annual accounts related to the financial results on 30 March 2021.

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.

The key factors that have affected the 2020 budget are the following:

- continuing investments in the framework of the CSSF 4.0 strategy (cf point 3. above);
- the amount of operating and investment costs remained below the budgeted amounts set for 2020 which can be partially explained by the effect of the lockdown measures imposed by the Government to face the COVID-19 pandemic on certain cost categories (thus lower expenditure than planned), as well as by the implementation of a cost-saving program within the CSSF.

6.2. CSSF annual accounts - 2020

BALANCE SHEET AS AT 31 DECEMBER 2020

Assets	EUR
Fixed assets	63,239,094.00
Intangible fixed assets	4,184,094.24
<i>Development costs</i>	2,244,531.73
<i>Payments on account and intangible assets in progress</i>	1,939,562.51
Tangible fixed assets	59,054,999.76
<i>Land and constructions</i>	48,712,821.52
<i>Other fixtures, fittings, tools and equipment</i>	10,161,134.86
<i>Payments on account and tangible assets in progress</i>	181,043.38
Current assets	70,042,182.31
Debtors	4,019,634.46
<i>Trade debtors with a residual term of up to one year</i>	3,992,907.91
<i>Other debtors with a residual term of up to one year</i>	26,726.55
Cash at bank	66,022,547.85
Prepayment and accrued income	5,727,544.82
BALANCE SHEET TOTAL (ASSETS)	139,008,821.13

Capitalisation and indebtedness	
Own capital	59,057,548.24
<i>Profit brought forward</i>	71,561,375.17
<i>Result for the financial year</i>	-12,503,826.93
Provisions	17,296,465.86
<i>Other provisions</i>	17,296,465.86
Liabilities	62,654,807.03
Amounts owed to credit institutions	57,251,005.07
<i>with a residual term of up to one year</i>	5,388,660.69
<i>with a residual term of over one year</i>	51,862,344.38
Debts on purchases and provision of services	3,062,538.42
<i>with a residual term of up to one year</i>	3,062,538.42
Other debts	2,341,263.54
<i>Tax debts</i>	383,186.50
<i>Social security debts</i>	1,388,505.70
<i>Other debts with a residual term of up to one year</i>	569,571.34
BALANCE SHEET TOTAL (LIABILITIES)	139,008,821.13

PROFIT AND LOSS ACCOUNT AS AT 31 DECEMBER 2020

	EUR
Net turnover	123,732,267.90
Other operating income	334,663.17
Raw materials and consumables and other external charges	15,034,725.51
Raw materials and consumables	331,679.68
Other external charges	14,703,045.83
Staff costs	113,197,627.70
Wages and salaries	106,620,614.59
Social security costs	3,834,661.82
<i>relating to pensions</i>	555,713.88
<i>other social security costs</i>	3,278,947.94
Other staff costs	2,742,351.29
Value adjustments	5,061,592.30
on formation expenses and tangible and intangible fixed assets	5,061,592.30
Other operating charges	2,583,069.81
Interests and other financial charges	693,742.68
Other interests and financial charges	693,742.68
Result for the financial year	-12,503,826.93

Financial controller: EY



II. The European dimension of the supervision of the financial sector

1. Supervision of banks

1.1. Single Supervisory Mechanism (SSM)

1.1.1. SSM governance and the participation of the CSSF in the SSM governing bodies

During 2020, the CSSF participated in 24 meetings of the SSM Supervisory Board and in seven meetings of the Steering Committee, and contributed to around 2,650 decisions concerning specific supervised entities. The CSSF also contributed at technical level to the work of a large number of working groups set up by the ECB.

In 2020, the ECB continued to make changes to the organisational structure of its banking supervision arm¹, with a view to increase effectiveness, simplify supervisory processes, streamline procedures and enhance transparency.

1.1.2. Key developments in banking supervision in the SSM in 2020

In 2020, the main developments were related to topical issues, with a strong focus on the COVID-19 pandemic. At the same time, the SSM strived to adequately prepare for the medium-term, post-COVID-19, as regards in particular its ESG (Environmental, Social, and Corporate Governance) and digitalisation agenda.

• Measures taken in response to the COVID-19 pandemic

In the context of the outbreak of the COVID-19 pandemic, the SSM adapted its supervisory strategy in order to help preserving financial stability while ensuring that banks continue to fulfil their role in funding the real economy.

The SSM adopted measures aimed at providing banks temporary capital relief, inter alia by clarifying that banks may operate temporarily below the level of capital defined by the Pillar 2 Guidance and the combined buffer requirement, as well as the level of liquidity defined by the liquidity coverage requirement. In addition, the SSM adopted measures providing further flexibility in the prudential treatment of loans backed by public support measures and offering guidance to banks on how to avoid excessive procyclical effects when applying the IFRS 9 accounting standard.

During 2020, the SSM also took measures to ensure that banks conserved capital in the light of the extraordinary uncertainty and possible upcoming losses caused by the COVID-19 pandemic. Banks were temporarily recommended not to distribute dividends or buy back shares until 1 January 2021 and to exercise extreme prudence regarding dividends, share buy-backs and variable remuneration until 30 September 2021. In parallel, the SSM launched an extensive range of credit risk initiatives and external communications to ensure that effective credit risk management practices and sufficient operational capacity are in place to ensure that credit risk is

¹ www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200729~e5c783c499.en.html.

adequately assessed, classified and measured. By complying with the EBA Guidelines on legislative and non-legislative moratoria on loan repayments, the SSM provided banks with additional flexibility on forbearance classification under moratoria meeting the criteria of the EBA guidelines.

Finally, the SSM took steps to provide temporary operational relief to banks through individual measures such as adjusting timetables, processes and deadlines for on-site inspections and internal model investigations, among others. In the same vein, the SSM took a pragmatic approach to implementing its annual Supervisory Review and Evaluation Process (SREP).

With the pandemic, IT risk and cyber risk gained increasing prominence as credit institutions started moving to remote working arrangements to accommodate COVID-19 constraints. To strengthen the banks' resilience in this field, one of the SSM's priorities in 2020 was to assess IT and cyber risk by way of supervisory actions such as dedicated inspections, the annual SREP, the SSM cyber incident reporting process and other bank-specific and horizontal activities. In June 2020, the ECB released its annual report on the outcome of the SREP IT Risk Questionnaire (ITRQ), containing the key findings relating to the banks' IT risk practices.

A comprehensive overview of the measures taken in the context of the pandemic can be found on the ECB's website².

• FinTech and digitalisation

The SSM continued in 2020 the development of a supervisory approach concerning the use of FinTech by credit institutions. Published in August 2020, the ESCB/European banking supervision response to the European Commission's consultation on digital finance included detailed answers to questions on the various elements to be addressed in the European Commission's strategy. As regards supervisory technology, the SSM defined a long-term vision and a concrete action plan on the use of technology and digitalisation in the SSM and created several SSM-wide bodies driving the digital agenda.

• Climate-related and environmental risks

Climate-related and environmental risks was an important focus area for the ECB in 2020. Among the publications or guidelines on this topic, the SSM published its guide on climate-related and environmental risks which outlines its understanding of sound management of these risks, and the report on the institutions' climate-related and environmental risk disclosures, providing the SSM's expectations regarding the appropriate level of disclosure of these risks.

• Indirect supervision of Less Significant Institutions (LSIs)

While national competent authorities remain responsible for the direct supervision of LSIs, the ECB also has an oversight function for LSIs where it aims to ensure that high supervisory standards are applied across the euro area. In 2020, the ECB intensified its cooperation with the national competent authorities to proactively address the risks to LSIs stemming from the COVID-19 crisis. In particular, the ECB assessed the credit and liquidity risk vulnerabilities including, inter alia, the concentration of exposures to economic sectors more exposed to the consequences of the pandemic as well as possible vulnerabilities to sudden liquidity needs or shocks to funding sources.

The CSSF's stance is to fully align with the ECB's policies while applying them in a proportionate way to Luxembourg LSIs. In 2020, the main focus for the CSSF was on managing the COVID-19 impact.

² www.bankingsupervision.europa.eu/home/search/coronavirus/html/index.en.html.



1.2. European Banking Authority (EBA)

1.2.1. Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis and Circular CSSF 20/749

In order to minimise the medium- and long-term economic impacts of the efforts taken to contain the COVID-19 pandemic, Member States, including Luxembourg, implemented a broad range of support measures with the aim of supporting the short-term operational and liquidity challenges faced by borrowers.

In that context, the EBA took a number of initiatives to ensure a convergent treatment of the national measures against the background of the capital requirements regulation and its implementing guidelines. In addition, the EBA clarified the criteria to be met by legislative and non-legislative moratoria on loan repayments in order to exempt banks from their obligation to classify exposures as forborne or as defaulted when they benefit from such moratoria. In this context, the EBA published the Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02), which have been extended twice

(by EBA/GL/2020/08 and EBA/GL/2020/15). These Guidelines were implemented into the CSSF's supervisory practice via Circular CSSF 20/749 of 28 July 2020 adopting EBA/GL/2020/02, as amended by EBA/GL/2020/08 (the Guidelines) and amending Circular CSSF 20/741 adopted on 30 April 2020. With the national lockdown, Luxembourg retail banks, together with the ABBL, set up an EBA-compliant moratorium. The moratorium, which contributed to ensure appropriate corporate liquidity during the lockdown, was phased out in autumn 2020.

The EBA also published additional clarifications on the application of the prudential framework in response to issues raised as a consequence of the COVID-19 pandemic and frequently asked questions in the context of the Guidelines³ to contribute to a harmonised implementation by supervisors and credit institutions. These can be consulted in section 4 of the EBA Report on the implementation of selected COVID-19 policies⁴ that was published on 7 July 2020.

In addition, the EBA published several statements on different issues in the light of COVID-19, as for example on consumer and payments issues⁵ or on actions to mitigate financial crime risks⁶.

1.2.2. EBA Basel III impact study

The EBA published, on 15 December 2020, its updated ad hoc impact study on the implementation of Basel III in the EU in response to the EU Commission's call for advice. The study is based on a sample of 99 banks and has a reference date of December 2019. Under the full implementation of Basel III and conservative assumptions, the updated impact is meaningfully lower than previously estimated, using June 2018 data and a consistent sample. In addition, the report presents some qualitative reflections on the potential interactions between different elements of the Basel III framework and the estimated adverse impact of the COVID-19 crisis.

The EBA reaffirms its policy recommendations put forward in its previous advice and supports the full implementation of the final Basel III standards in the EU.

Given their strong capital levels, Luxembourg banks are generally in a comfortable position to meet the fully phased-in Basel III standards.

1.2.3. Regulatory requirements with respect to outsourcing

The EBA guidelines on outsourcing arrangements will be implemented by way of a circular, containing, in addition to the regulatory provisions on internal governance, documentation and risk management, prudential provisions applicable to IT-related outsourcing arrangements based or not on a cloud computing infrastructure (ICT outsourcing). The circular will apply to credit institutions, other professionals of the financial sector, payment institutions and electronic money institutions, including their branches, as well as to branches established in Luxembourg by the above-mentioned entities established outside the EU (third-country branches). Some provisions will also apply to the EU branches of the above-mentioned entities established in Luxembourg, in the areas where the CSSF retains supervisory competence pursuant to sectoral or thematic laws (such as AML/CFT or Luxembourg UCI depositaries). It will also apply to investment fund managers using ICT outsourcing. Under the risk-based approach, the extent of due diligence to be put in place by the supervised entities will depend on the relative importance of the outsourcing project. Thus, the outsourcing projects involving critical or important functions will be subject to stricter requirements, among which particularly the requirement to inform the CSSF in advance. The circular will specify the format of the integrated register of outsourcing that the entities must put in place by 31 December 2021.

³ www.eba.europa.eu/eba-issues-guidelines-address-gaps-reporting-data-and-public-information-context-covid-19

⁴ www.eba.europa.eu/eba-provides-clarity-implementation-prudential-framework-context-covid-19

⁵ Internet link: Statement on consumer and payment issues in light of COVID19.

⁶ Internet link: Statement on actions to mitigate financial crime risks in the COVID19 pandemic.

1.2.4. Transposition of CRD V into national law

Directive (EU) 2019/878 of 20 May 2019 (CRD V) amending Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) and the implementation of Regulation (EU) 2019/876 (CRR2) amending Regulation (EU) No 575/2013 (CRR) introduce significant amendments to the Law of 5 April 1993 on the financial sector due to the new approval regime for financial holding companies and mixed financial holding companies in accordance with Article 21a of the above-mentioned directive and to provisions regarding intermediate EU parent undertaking (IPU) in accordance with Article 21b of this directive. In addition, CRD V clarifies the scope of the provisions regarding variable remuneration by providing exemptions for small institutions and staff with low levels of variable remuneration and defining clear, consistent and harmonised criteria to this end. The transposition of the new provisions regarding the determination of additional own funds will be accompanied by the integration of the provisions on supervisory review and evaluation process into the Law of 5 April 1993 on the financial sector. These provisions are currently included in CSSF Regulation No 15-02.

As a reminder, CRD V and CRR2 are part of a banking reform package proposed by the European Commission, in November 2016, in order to complete the European post-crisis regulatory reforms. These measures aim at reducing the risks in the financial sector and implementing the global standards issued by the Basel Committee to render the financial system more resilient and stable in the context of the completion of the Banking Union and Capital Market Union.

1.2.5. Brexit

In 2020, the CSSF continued to engage a substantial amount of resources to assess and mitigate the challenges posed by Brexit. In this context, the CSSF carried on, for each type of financial service and entities under its supervision, a thorough assessment of the potential cliff effect that could result from the termination of the transition period with no agreement in general or no agreement on financial services. The CSSF also assessed the need for UK equivalence decisions and the necessity to enter into cooperation agreements with the UK authorities.

In the area of equivalence, a milestone was reached as regards asset management and in particular the delegation of collective portfolio management, when the CSSF released, in December 2020, its equivalence decision through CSSF Regulation No 20-09 for UK firms providing investment services to clients in Luxembourg.

In the area of cooperation with the UK authorities, the CSSF signed a Memorandum of Understanding with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in April 2019. The CSSF also signed the multilateral MoU under the auspices of ESMA. These cooperation agreements allowed avoiding disruptions at the end of the transition period, in particular with respect to asset management when cooperation of authorities is required.

2. Supervision of financial markets

2.1. European Securities and Markets Authority - ESMA

The CSSF participates actively in the work of the Investment Management Standing Committee (IMSC) and its sub-group, the Operational Working Group on Supervisory Convergence (OWG), which are composed of experts of the national competent authorities from Member States, assisted and coordinated by ESMA agents.

Since the outbreak of the COVID-19 pandemic, ESMA replaced the face-to-face meetings of the committees, working groups and the Board of Supervisors by conference calls in order to discuss, among others, the developments in the financial markets and investment funds impacted by the crisis and the use of liquidity management tools by investment funds.

As regards collective investment management, the following publications from 2020⁷ are worth mentioning.

On 10 January 2020, ESMA published the second annual statistical report on alternative investment funds (AIFs), containing data as at 31 December 2018 (ref. ESMA50-165-1032).

On 30 January 2020, ESMA launched a common supervisory action with the national competent authorities on the liquidity risk management by UCITS managers across the EU in order to assess whether market participants adhere to the UCITS liquidity risk management rules. The action was composed of two stages: (i) the collection by the national competent authorities of quantitative data from a large majority of the UCITS managers based in their respective Member States, to get an overview of the supervisory risks they face, and (ii) in-depth analyses on a sample of UCITS and UCITS managers. ESMA's final summary report is expected to be published in the first half of 2021.

On 31 March 2020, ESMA launched a public consultation (ref. ESMA34-39-966) on draft implementing technical standards under Regulation (EU) 2019/1156 of 20 June 2019 on facilitating cross-border distribution of UCIs.

The final report (ref. ESMA34-39-961) was published on 29 January 2021.

Following the public consultation launched in July 2019, ESMA published, on 3 April 2020, its final report concerning its guidelines on performance fees in UCITS and certain types of AIFs (ref. ESMA34-39-992)⁸.

On 6 April 2020, ESMA published the second annual report on performance and costs of retail investment products (ref. ESMA 50-165-1098) which provides a comprehensive overview of the EU retail investment products (UCITS, AIFs and structured retail products) from 2009 to 2018.

On 14 May 2020, ESMA published a public statement (ref. ESMA50-158-2232) to support the Recommendation of the European Systemic Risk Board (ESRB) of 6 May 2020 on liquidity risks in investment funds associated with COVID-19 (ref. ESRB/2020/4). Consequently, ESMA and the national competent authorities carried out a supervisory exercise, in the summer of 2020, on a sample of UCITS and AIFs having exposures to corporate debt and real estate assets. The objective was to assess the preparedness of these investment funds to renewed heightened market volatility and liquidity/valuation risks as was the case in spring of 2020. ESMA's final summary report to the ESRB (ref. ESMA34-39-1119) was published in November 2020.

On 4 June 2020, ESMA published a supervisory briefing on the supervision of costs in UCITS and AIFs (ref. ESMA34-39-1042). The purpose of the document is to ensure convergence on the supervision of costs and, in particular, on the obligation to prevent undue costs being charged to investors. It is intended for national competent authorities and also for market participants by giving indications of the expectations and compliant practices regarding cost-related provisions.

On 9 July 2020, ESMA published a public statement (ref. ESMA34-39-1096) in relation to Article 35 of Regulation (EU) 2017/1131 on money market funds and, more specifically, the question of the extent to which intermediation of credit institutions in the purchase of short-term assets, held by

7 www.esma.europa.eu/regulation/fund-management.

8 See also Circular CSSF 20/764 of 18 December 2020 regarding Guidelines on performance fees in UCITS and certain types of AIFs.

money market funds facing liquidity challenges, is compatible with the provisions of this Article 35.

On 16 July 2020, ESMA published the official translations of its guidelines on liquidity stress testing in UCITS and AIFs (ref. ESMA34-39-897)⁹. These guidelines respond to a recommendation issued by the ESRB on 14 February 2018 and addressed to ESMA in the context of the work on liquidity and leverage risks in investment funds.

On 20 July 2020, the three European Supervisory Authorities (EBA, ESMA and EIOPA) announced (ref. ESAs 2020 19) that the draft regulatory technical standards amending 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 did not receive the necessary support for its adoption (notably at the level of the EIOPA Board).

On 18 August 2020, ESMA addressed a letter to the European Commission (ref. ESMA34-32-550) in which it proposes amendments to the AIFMD in some areas, among which the harmonisation between the UCITS and the AIFMD regimes, the delegation and substance requirements, the availability of additional liquidity management tools (LMT) in the EU Member States, the AIFMD reporting regime and data use, the harmonisation of supervision of cross-border activities, the review of certain definitions of the directive (including the definition of AIF) or the definition and rules for reverse solicitation.

On 2 October 2020, ESMA published its 2021 work programme (ref. ESMA20-95-1273), the key priorities being supervisory convergence (including liquidity risk in funds, liquidity management tools and ESG reporting), risk assessment (with a focus on ESG and the impact of the COVID-19 pandemic and Brexit), the single rulebook (particularly, the review of MiFID, AIFMD and the technical standards under EMIR) and direct supervision (including the recognition of third-country central counterparties).

On 5 November 2020, ESMA launched a consultation (ref. ESMA30-379-325) on draft advice relating to the application of Article 8 of Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation). According to Article 8, any undertaking which is subject to an obligation to publish non-financial information (pursuant to Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups) must disclose information on how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation.

On 9 November 2020, ESMA launched a consultation (ref. ESMA34-39-926) on marketing communications under Regulation (EU) 2019/1156 of 20 June 2019 on facilitating cross-border distribution of UCIs. The draft guidelines which are the subject of the consultation aim at ensuring that marketing communications addressed to investors are identifiable as such, that they describe the risks and rewards of purchasing units or shares of UCITS and AIFs (including EuVECAs, EuSEFs, ELTIFs and MMFs) in an equally prominent manner and that all information included in marketing communications is fair, clear and not misleading.

On 12 November 2020, ESMA published its report on the penalties and measures imposed by national competent authorities in accordance with Article 99 of the UCITS Directive in 2019 (ref. ESMA34-45-934). Further, on that same day, ESMA also published its first report on the penalties and measures imposed under the AIFMD in 2018-2019 (ref. ESMA34-32-548).

Additionally, on 12 November 2020, ESMA published a report (ref. ESMA34-39-1119) on the preparedness of investment funds that have significant exposures to corporate debt and real estate assets to potential future adverse liquidity and valuation shocks, following a supervisory exercise on these funds that ESMA coordinated and carried out with the national competent authorities in response to the ESRB recommendation on liquidity risks in investment funds of May 2020.

⁹ See also Circular CSSF 20/752 of 29 September 2020 regarding ESMA Guidelines on liquidity stress testing in UCITS and AIFs.



On 16 December 2020, ESMA published the update (ref. ESMA34-49-289) of its guidelines on stress test scenarios under the Money Market Fund Regulation pursuant to Article 28 of this regulation, which requires that these guidelines be updated at least every year taking into account the latest market developments.

On 17 December 2020, following the public consultation which ran from 23 March until 1 September 2020, ESMA published its final report (ref. ESMA34-32-552) regarding Guidelines on Article 25 of the AIFMD. These guidelines aim at allowing convergence on the manner the national competent authorities assess how the use of leverage in the AIF sector contributes to the

build-up of systemic risk in the financial system. They respond to a recommendation issued by the ESRB on 14 February 2018 and addressed to ESMA in the context of the work on liquidity and leverage risks in investment funds.

On 6 January 2021, ESMA announced the launch of a second common supervisory action with national competent authorities which will focus on costs and fees of UCITS. Thus, ESMA aims at ensuring that fund managers and the other entities concerned comply with the obligation not to charge investors undue costs and adhere to the defined requirements on fees set out in the regulatory framework regarding UCITS.



III. Macprudential supervision of the financial sector

- **The pandemic led to increased monitoring of macroprudential risks.**

In March 2020, the spread of the pandemic induced lockdowns and changed public life in Luxembourg. This had consequences for many small and medium enterprises (SMEs), like for example restaurants or shops as they had to close down or reduce customer traffic. Other sectors of the economy closed down entirely for a certain amount of time, as for example the construction sector. While large parts of the workforce could switch to teleworking, a considerable number of people were temporarily subject to partial unemployment schemes or let go entirely.

These developments led to strains on liquidity for non-financial corporations (NFCs) as well as households. Government support measures, coupled with massive provision of liquidity by central banks, significantly helped to mitigate rising risks of credit defaults and calm turmoil in financial markets.

In April 2020, the CSSF launched a COVID-19 survey to follow up with Luxembourgish banks on the uptake of moratoria pursuant to the EBA guidelines 2020/02 and credit guarantees for NFCs, SMEs and self-employed entrepreneurs. The data received in this survey was provided to the Luxembourg Systemic Risk Committee (Comité du Risque Systémique – CdRS), of which the CSSF is a member, to monitor credit developments in a timely manner.

The COVID-19 survey showed that loan moratoria were the most popular measure for NFCs to weather the troubles caused by the COVID-19 pandemic and avoid a liquidity squeeze. The requests for moratoria peaked at EUR 3.7 billion by June 2020. At the end of 2020, the total volume of active moratoria on loans stood at about EUR 450 million. The volume of State guaranteed loan requests gradually increased between April and October 2020, and the volume stabilised at EUR 180 million at the end of the year – less than a tenth of the quota provided by the Government. A large majority of State guaranteed loan requests – more than four fifths – were approved by the participating banks.

The outbreak of the COVID-19 also led in some instances to significant margin calls in derivatives trading, across centrally cleared and non-centrally cleared markets. As a national competent authority in charge of the supervision of clearing members and of financial and non-financial counterparties of central counterparties (CCPs), and based on an ESRB recommendation in this respect (ESRB/2020/6), the CSSF issued Circular CSSF 20/761 to encourage entities under its supervision to set margins that limit liquidity risks arising from margin calls and internal risk management procedures.

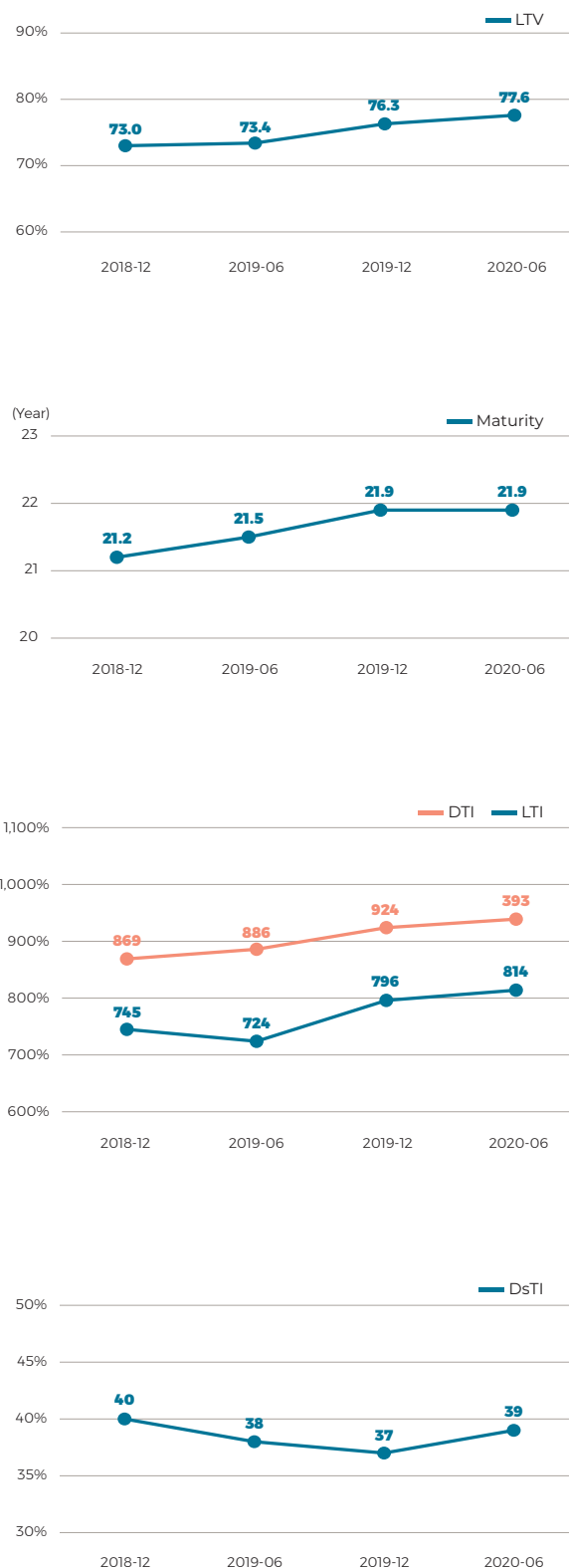
• Risks in real estate markets were on the rise.

Developments in residential real estate continued strongly despite the pandemic and house prices accelerated in 2020. Similarly, credit growth and household indebtedness continued to rise. House prices reached new heights with an annual growth rate of 13.8% over the first quarters of 2020. This particularly strong growth rate stands out compared to previous years and contrasts with the contraction in economic growth caused by the pandemic. In sum, the share of lending for house purchase (outstanding amount) in GDP has remained on an upward trend and stood at 56% of nominal GDP in 2020. Household indebtedness in Luxembourg remains high. The ratio of households' aggregated debt over annual gross disposable income stood at 178% in 2018. Also, borrower-based debt and loan ratios collected by the CSSF on a bi-annual basis such as Debt-To-Income (DTI) and Loan-To-Income (LTI) ratios are both on an upward trend, with the DTI increasing to 939%¹.

In the first semester of 2020, a total amount of EUR 3.3 billion residential real estate credit was granted. This represents an increase of 3% year-on-year.

According to the CSSF survey on borrower-based lending standards, the average loan-to-value ratio (LTV ratio), which describes the relation between the mortgage loan amount and the value of the property, increased by 4.2 percentage points in one year. It reached 77.6% in the first semester of 2020. Loans with an LTV ratio above 90% represented 33% of total new loans in the first semester of 2020. Maturity at origination peaked at a value of almost 22 years. From the debt service ratio, it appears that on average around 39% of the annual disposable income is dedicated to debt repayment.

Development in LTV, maturity, LTI/DTI and DsTI



¹ A DTI of 939% suggests that the average borrower has a total debt of more than nine times his/her annual disposable income.

- **To contain household vulnerabilities, the CdRS introduced loan-to-value limits on mortgage credit.**

The CdRS continued to monitor vulnerabilities in the residential real estate sector (RRE sector) throughout 2020. At the end of 2020, the CdRS recommended the CSSF to enact legally binding borrower-based measures for the RRE sector (CRS/2020/005). On 7 December 2020, the CSSF followed up on this recommendation and issued the CSSF Regulation No 20-08, tying the loan amount that a household can borrow for the acquisition of RRE property to its own funds' contribution, thus limiting indebtedness and leverage. The measures cover new mortgage loans contracted after 1 January 2021 for RRE properties located in Luxembourg and collateralised by RRE property located in Luxembourg. It applies to the financing of owner-occupied dwellings and to non-commercial buy-to-let property.

The LTV limits introduced by CSSF Regulation No 20-08 represent legally binding maximum limits that banks cannot exceed at any time. Within the legal limits, banks determine the amount they lend to customers as a function of the client's capacity to repay the loan, taking into consideration adverse developments that could diminish the client's ability to honour his/her payment obligations on the loan as they become due. In conclusion, the LTV limits do not represent an indication of the loan amount a bank should propose to a client but merely a maximum it should not exceed.

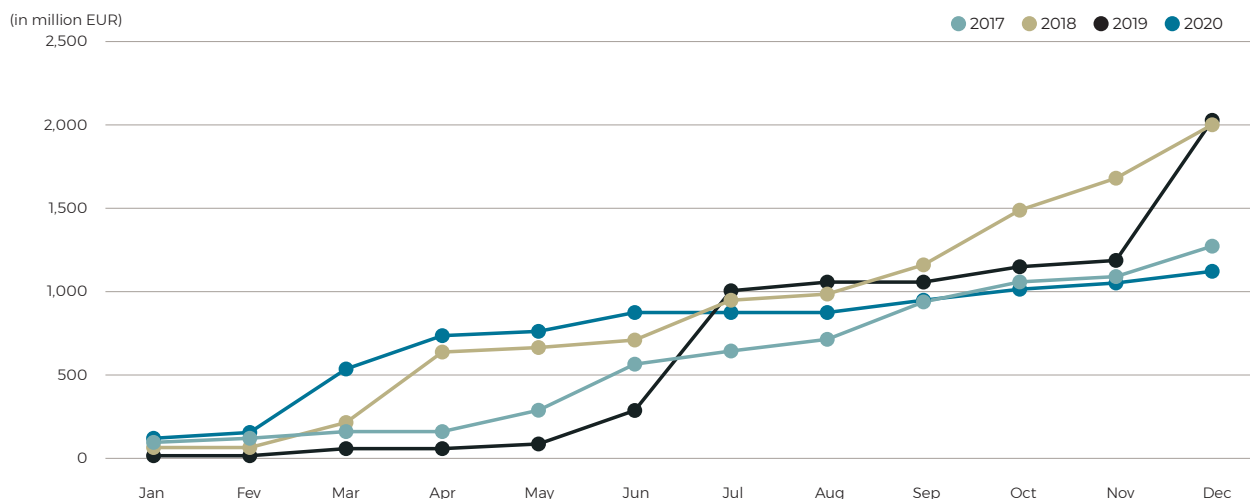
- **Activities in commercial real estate were affected by the pandemic.**

The CSSF also monitors developments in the commercial real estate sector (CRE sector).

At the European level, CRE markets had already entered a more mature phase before the outbreak of the COVID-19, with positive but diminishing CRE price growth rates. The COVID-19 crisis has led to an extended drop in the CRE market activity, with market indicators continuing to suggest a substantial price correction. There were 50% fewer transactions in EU CRE markets in the last three quarters of 2020 than in the same period in 2019. This type of drop in transactions tends to precede price corrections. Also, despite the fact that REIT prices increased sharply in November 2020 following positive vaccine news, they continue to underperform wider financial markets and are trading 20% below their pre-crisis levels. Finally, the beginning of a correction can also be seen in standard CRE price indices.

In Luxembourg, the CRE market was buoyant during the first half of 2020, with cumulative transactions reaching record levels, before stabilising in the second half of the year. In June 2020, the cumulative transaction volume reached EUR 875 million compared to EUR 287 million one year before, while at the end of 2020, the market reached an investment volume of EUR 1 billion, compared to EUR 2 billion the year before.

Cumulative transaction volume of investment in CRE in Luxembourg²



Office transactions remained the main driver of growth for 2020 despite a relative decline in terms of market shares. Investors originated mainly from neighbouring countries which altogether represent almost 65% of the transaction volume.

While the market has been characterised by lower growth, vacancy rates and yields have remained relatively stable. Industry data show that in the office sector, vacancy rates remained stable at 3.6% in the third quarter of 2020 as compared to 3.7% in the third quarter of 2019, while yields also did not move much with 3.9% in the third quarter of 2020 compared to 4% one year before³. Bank exposures to the CRE sector have not been affected by the pandemic so far. Despite a declining trend in 2019, the latest data for the third quarter of 2020 have shown an increase in exposures toward real estate developers and the non-residential sector compared to the same period one year earlier.

- **At national and international level, the CSSF participated in discussions regarding the financial stability of other financial intermediaries.**

The ESRB (European Systemic Risk Board) analyses the dependencies, interconnectedness and mechanisms of contagion between sub-sectors of the economy. Its work complements that of the Financial Stability Board (FSB) at an international

level. As designated macroprudential authority, the CSSF takes part in the work of the ESRB by participating in its committees and working groups. The ESRB issues recommendations and opinions likely to affect the financial sector in Luxembourg.

The Expert Group on Investment Fund Liquidity and Leverage of the ESRB, in which the CSSF participated, issued, on 14 February 2018, recommendations to the European Commission and ESMA on liquidity and leverage risks in investment funds. Meanwhile, ESMA finalised the work on the guidelines on liquidity stress testing in UCITS and AIFs, as well as in relation to the recommendation on Article 25 of Directive 2011/61/EU.

Moreover, the ESRB published recommendations in the context of the crisis related to the COVID-19 pandemic in spring 2020. These recommendations concern, in particular, the liquidity risks in investment funds (ESRB/2020/4) and the liquidity risks arising from margin calls (ESRB/2020/6). The CSSF actively contributed to this work, especially to recommendation ESRB/2020/4.

Just as at the European level, the CdRS in Luxembourg also followed closely the impact of the COVID-19 pandemic. It held 14 virtual meetings in 2020, to which the CSSF contributed in several manners, including via reports on the situation of investment funds in Luxembourg and the related developments, in order to closely monitor the financial stability risks in the whole financial sector.

² Source: Real Capital Analytics (RCA).

³ JLL, Office Market Dashboard Luxembourg T3 2020.



IV. The international dimension of the CSSF's mission

1. Basel Committee on Banking Supervision

The CSSF participates in the work of the Basel Committee, the main sub-committees (Policy Development Group and Supervision and Implementation Group) and some working groups which are particularly relevant for banking supervision in Luxembourg. This is the case for the areas of fight against money laundering and terrorist financing, large exposures, liquidity, or subjects covering operational aspects such as digitalisation, or accompanying measures aiming at combating the effects of global warming.

As early as March 2020, the Basel Committee adjusted its mode of operation as well as its work plan to accommodate the fallout of the COVID-19 pandemic on the banking sector. As a consequence, the implementation of Basel III was postponed by one year. The Committee also advocated that banks, while remaining prudent, use the flexibility of the Basel III framework, including the liquidity and capital buffers, in particular to avoid credit rationing.

The Committee took the opportunity of the temporary freezing of its regulatory work and relating public consultations, against the backdrop of COVID-19, to revise its strategic positioning. These reflections confirmed that a sharper focus should be laid on supervisory topics, including the identification and monitoring of banking risks at global level. In addition, the structure and mandates of the working groups have been reviewed at the end of the year, effective 2021.

The Basel Committee's publications and information on its mission and organisation are available on the website www.bis.org.

2. International Organization of Securities Commissions

2.1. 45th Annual Conference of the International Organization of Securities Commissions (IOSCO)

Owing to the COVID-19 pandemic, the Annual Conference of IOSCO, which was planned to take place in Dubai, was replaced by a series of virtual meetings from 9 to 18 November 2020 between the securities and futures markets regulators, including the CSSF, and other members of the international financial community¹.

Among the priority themes discussed during these meetings were the impact of the pandemic on financial markets, the resilience of non-bank financial intermediation (NBFIs) in light of the recent publications of the Financial Stability Board (FSB) and the strengthening of the collaboration between the FSB and IOSCO, in particular with respect to the ongoing work on NBFIs (cf. point 2.2.1. below).

The European regulatory agenda, the relaunch of the Capital Market Union, supervisory convergence, sustainable finance and the challenges associated with the implementation of a European taxonomy were also among the issues that have been addressed.

1 www.iosco.org/news/pdf/IOSCONews583.pdf.

2.2. Work of the IOSCO Committees

2.2.1. Financial Stability Engagement Group (FSEG)

Established by IOSCO at Board level, the FSEG held nine meetings that mainly focused on the contribution to NBFI-related work in 2020.

Since the beginning of the COVID-19 pandemic in spring 2020, the FSEG has been collaborating intensively with the FSB Steering Committee on NFBI (FSB SCN) as regards financial stability issues. The work notably focused on liquidity risk in open-ended type investment funds and on the difficulties of certain money market funds in March/April 2020 ("Money Market Funds during the March-April Episode - Thematic Note", OR03/2020)². As regards money market funds, work continued within the FSB Technical Expert Group on MMF, gathering IOSCO members (including the CSSF) and FSB members in order to work jointly on possible follow-up action for money market funds in order to increase their resilience, by taking into account conclusions on the issues encountered by this type of funds during the spring episode.

Furthermore, IOSCO members also provided FSB members with information on the use of liquidity management tools (LMT).

2.2.2. Committee 5 on Investment Management

Notwithstanding the fact that the committee's work had been slowed down by the COVID-19 pandemic, IOSCO published the following documents prepared by Committee 5 in 2020.

The "Report on the Fifth IOSCO Hedge Fund Survey" was published on 15 April 2020³. This survey of the participating member states' industry is based on the data as of 30 September 2018 collected by the supervisory authorities, including the CSSF, at the beginning of 2019.

The consultation report on the "The use of artificial intelligence and machine learning by market intermediaries and asset managers" was published on 25 June 2020⁴. It was drawn up by Committee 3 on Regulation of Market Intermediaries and Committee 5 (for asset management) with the input of a working group within Committee 5 under the chair of the CSSF and the Monetary Authority of Singapore. The consultation ended on 26 October 2020.

The publication on 22 December 2020 of a questionnaire for industry participants on Exchange-Traded Funds (ETFs)⁵ is also noteworthy. The submission deadline was 1 March 2021.

Moreover, Committee 5 finalised the work on the FSB recommendations, published on 12 January 2017, concerning the implementation of a framework assessing leverage in investment funds (Recommendations for a Framework Assessing Leverage in Investment funds, Ref.: FR18/2019). The work accomplished in 2020 notably aimed at establishing a report template that the different national competent authorities are expected to provide to IOSCO periodically.

² www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf.

³ www.iosco.org/news/pdf/IOSCONEWS565.pdf and www.iosco.org/library/pubdocs/pdf/IOSCOPD653.pdf.

⁴ www.iosco.org/news/pdf/IOSCONEWS571.pdf and www.iosco.org/library/pubdocs/pdf/IOSCOPD658.pdf.

⁵ www.iosco.org/news/pdf/IOSCONEWS586.pdf and www.iosco.org/about/?subsection=c5-questionnaire-etfs-for-industry-participants.

Finally, the Central Expert Group (CEG) of Committee 5 worked jointly with the FSB Standing Committee on Assessment of Vulnerabilities on liquidity risk in open-ended investment funds. The purpose of this study is to analyse open-ended investment funds that suffered redemption pressure during the turmoil in March 2020 and to cover themes such as underlying asset liquidity or the availability and use of liquidity management tools (LMT).

2.2.3. Assessment Committee

The CSSF participates actively in the work of the IOSCO Assessment Committee and its Implementation Task Force Sub-Committee. The Assessment Committee is responsible, among other things, for maintaining the IOSCO Principles and Methodology, which involves supporting the users of the methodology, updating the methodology and assessing the need to update the IOSCO Principles. The thematic review on the money market funds reforms (“Consistency of Implementation of Money Market Fund Reforms”), under the chair of the CSSF, was published on 20 November 2020⁶.

2.2.4. European Regional Committee

The CSSF is a member of the European Regional Committee, which is one of the four regional committees set up by IOSCO in order to allow the national competent authorities to exchange views on issues relating to securities regulation in the European region.

3. The MiFIR third-country national regime

In 2020, the CSSF has provided clarifications with respect to the territoriality aspects of the provision of cross-border investment services by non-EU/EEA firms to certain clients in Luxembourg under the national third-country regime permitted under Regulation (EU) No 600/2014 (MiFIR). This regime, as well as the conditions for firms to be met to make use of it, is described at length in Circular CSSF 19/716. Circular CSSF 20/743, which complements Circular CSSF 19/716, clarifies the criteria that firms need to take into account to make their own assessment of whether their services are deemed to be provided in Luxembourg (the principle of territoriality).

In conjunction with Circular CSSF 19/716 as amended by Circular CSSF 20/743 and in particular the national third-country regime under MiFIR, the CSSF has recognised the equivalence of the regimes of Canada, the Swiss Confederation, the United States of America, Japan, Hong Kong Special Administrative Region of the People's Republic of China and Republic of Singapore through CSSF Regulation No 20-02, as well as the equivalence of the United Kingdom of Great Britain and Northern Ireland through CSSF Regulation No 20-09.

6 www.iosco.org/news/pdf/IOSCONEWS582.pdf and www.iosco.org/library/pubdocs/pdf/IOSCOPD665.pdf.





V. Financial innovation and sustainable finance

1. Financial innovation

2020 was marked by the adoption of the Digital Finance Package by the European Commission on 24 September 2020. The Digital Finance Package is an ambitious set of different measures to boost the European financial services market in the digital era, providing at the same time an overview of the financial services' future and a concrete illustration of the innovative and overwhelming potential of new technologies.

The measures included in the different initiatives of the Digital Finance Package perfectly illustrate the growing impact of financial innovation and new technologies on the financial sector, be it at the level of innovative processes, products and services or at the level of new types of professionals to supervise. They give rise to a number of significant challenges for regulators.

The publication of the Digital Finance Package occurred only shortly after the announcement by the CSSF, on 1 September 2020, of the creation of an Innovation Hub within the CSSF. From an organisational point of view, the Innovation Hub has been integrated as a specific division within the "Innovation, Payments, Market Infrastructures and Governance" department. The purpose of this re-organisation is to enable the CSSF to embrace the new challenges resulting from the financial sector's digital transformation and to centralise the processing of cross-sectoral questions on this topic at the level of a division with own resources.

The missions of the new Innovation Hub are far-reaching and cover all departments of the CSSF transversally. At the same time, they are well-targeted as they focus on innovation. The implementation and follow-up of a financial innovation strategy are also part of the missions.

Thus, the main purpose of the Innovation Hub is the follow-up and support of the financial sector's digital transition at the level of the CSSF, which is reflected in a certain number of "external" and "internal" missions. The main missions are specified hereafter.

1.1. "External" missions

1.1.1. Centralisation, coordination and assistance

The CSSF provides the market and FinTech players with a single point of contact to discuss any subjects related to innovation and new technologies, in particular the processing of innovative products, services and business models from a regulatory point of view, to answer questions and to assist the persons seeking information in identifying the competent departments and organising meetings or coordinating cross-sectoral files. The Innovation Hub is actively assisted by the different CSSF departments and business lines and acts as coordinator within the CSSF.

As in previous years, a majority of requests addressed to the CSSF in 2020 concerned the provision of payment services, followed by a certain number of questions on different topics such as RegTech, crowdfunding, tokenisation, etc.

1.1.2. Knowledge building

Following up on innovation, FinTech and digital transformation developments is a top priority for the Innovation Hub. Indeed, the Innovation Hub must keep up with the latest regulatory and technology developments to be in a position to answer to questions in the context of its missions, but also to assess, at an early stage, the impact of new technology or regulatory developments on the Luxembourg financial centre and to define the approach and the concrete measures to adopt.

In 2020, in a proactive dialogue-promoting approach, the Innovation Hub enhanced communication with already existing market players and also with FinTech companies that are not yet established. Indeed, the CSSF encourages proactive exchanges and the working-out of solutions, while acquiring specific knowledge, notably from a technical point of view, and in relation to the sector's expectations.

These communication efforts have also been supported by concrete market monitoring measures initiated by the Innovation Hub, in particular through the launch, in 2020, of a first initiative consisting in contacting a certain number of supervised entities in order to discuss the level of integration of the new technologies in their business models. This exercise, which allows the CSSF getting a better insight of the level of new technologies adopted by the financial sector, will continue in 2021.

Moreover, the data collected in the context of the market monitoring will allow completing the work of the CSSF, notably in the context of national, European or international working groups.

Lastly, a good knowledge of the market also implies a good knowledge of the initiatives and discussions led by other stakeholders, be it organisations close to the financial centre's players or experts with different backgrounds. With this aim in mind, the Innovation Hub tried to improve networking and its exchanges with the professional associations and other organisations such as Luxembourg for Finance (LFF), the LHoFT and the University of Luxembourg.

Despite the fact that the COVID-19 pandemic heavily restricted mobility in 2020, the CSSF pursued its cooperation as a member of numerous working groups at EU and international level via digital means.

1.2. "Internal" missions

The work that is carried out by the Innovation Hub in close cooperation with the financial sector also continues within the CSSF. The Innovation Hub's objective is, in particular, to assist the different departments on any question related to innovation and new technologies, and to raise general awareness on these topics, inter alia by making available an internal exchange, consultation and cooperation platform.

A close cooperation between the various departments involved in financial technologies and their different applications allows:

- a more efficient handling of cross-sectoral themes, the aim being streamlining the exchange of information between departments and the processing of issues and specific files;
- evaluating the opportunities linked to the different technologies applied and assessing their risks and any mitigation measures;
- identifying possible regulatory obstacles or gaps resulting from specific sectoral laws and suggesting coordinated solutions;
- writing analyses, guidance and best practices to be published on the CSSF website;
- identifying domains in which targeted actions could be necessary for the protection of financial consumers, market integrity or financial stability.

The Innovation Hub acts as a dialogue facilitator and as an advisor, initiating knowledge-sharing and coordinating with the different departments on the answers to provide to the cross-sectoral aspects of financial innovation.

1.3. Priorities and challenges

The work of the Innovation Hub aims to allow the CSSF to take into consideration the developments and expectations of the financial sector, in order to play an active supporting role in the changes brought about by innovation and financial technologies, to be a competent and reliable partner to exchange on specific issues and to foster regulatory input on the challenges relating to financial innovation and new technologies, in a proactive and coordinated way.

Enhancing internal and external communication on financial innovation, building a global vision for the development of the financial centre as regards financial innovation and coordinating cross-sectoral studies on specific issues and obstacles identified, which may notably result from national or EU regulatory gaps, in order to find suitable solutions are among the current priorities of the Innovation Hub.

Priority themes for 2021 have been determined based on the level of penetration of new technologies and on specific use cases identified within the financial sector, as well as on the basis of the regulatory developments drawn up at national, EU and international level.

Moreover, in the coming months, the CSSF will allocate dedicated resources to support the workload resulting from the European Commission's Digital Finance Package and its consequences on the financial sector and on the different departments of the CSSF. The CSSF supports the European Commission declaration that digital transition must be a key priority for the financial sector, not only in the context of the recovery plan resulting from the COVID-19 pandemic. Thus, according to the European Commission, the strategic objective of the European financial sector should be to fully embrace the digital revolution in finance, its trends and opportunities, to benefit consumers and businesses, headed by strong EU market players, without however making concessions on strong European values and a sound risk regulation.

Lastly, it is worth mentioning that the regulator must, whilst actively accompanying this digital transformation process, remain neutral and maintain a flexible regulatory approach in order not to hinder new opportunities by creating excessive barriers to innovation. Supervised entities should be granted sufficient freedom to develop and adopt a personalised, future-proof digital strategy, in compliance with their business models and fundamental values.

2. Sustainable finance

2.1. The European level

Since the adoption of the UN Sustainable Development Goals (SDGs) and the Paris Agreement, the need to actively fight the consequences of climate change is on the agenda of all major policy-making and standard-setting institutions.

At European level, the European Commission has elaborated an ambitious and comprehensive regulatory framework broken down into numerous concrete actions, and has thus taken the role of a globally recognised pioneer in the context of sustainable finance. Indeed, starting with the publication of an extensive package in March 2018, resulting in an Action Plan on financing sustainable growth, comprising the Disclosure, the Benchmark and the Taxonomy regulations, it has set a strong basis on which other initiatives can be built. Furthermore, a green deal has been put in place with the objective for Europe to become the first continent to be carbon neutral by 2050, and halve greenhouse gas emissions by 2030.

The European agenda regarding sustainable finance and the resulting "renewed sustainable finance strategy" will impel the financial sector as a whole, as well as its individual actors, to question the values on which they are building their financial business by actively considering environmental, social and governance (ESG) criteria.

2.2. The national level

Through the Roadmap for Sustainable Finance in 2018, the Luxembourg Government has published an extensive declaration of intent aiming at integrating sustainable finance into all areas of the financial centre.

In line with the political commitment of the Government, the CSSF is inscribing its supervisory actions in the strong will of the aforementioned national and European initiatives. Thus, in an open-minded and evolving manner, the CSSF is including ESG issues in its supervisory strategy and daily supervision. As a financial market supervisory authority as well as within its mission of prudential supervision of financial market players, the CSSF considers ESG related risks, especially climate risks, as one of the major threats to financial resilience, financial market stability and market growth. At the same time, the CSSF appreciates the large opportunities sustainable finance offers to supervised entities, financial markets and investors.

The CSSF recognises that it might not always be easy to provide clear indications of all of its expectations within the existing principle-based European regulatory framework. International fast-moving development of market practice and multiple guidance related frameworks, as well as in the future more detailed European and international regulations, common practices and recommendations are adding complexity to present issues. The CSSF's supervisory methods currently encompass awareness raising, disclosure requirements, products and services supervision, financial market education, guidance, enforcement strategies, stress testing and participation in national and international regulatory work.

The CSSF is persuaded that the Luxembourg financial sector with its significant volumes in certain areas, as for example investment funds and bonds listings, as well as with its supporting expertise, is capable to significantly contributing to the long-term sustainability goals while at the same time seizing the opportunities offered and maintaining high professional standards. The CSSF is determined to assume its responsibilities to accompany this transition of the financial sector and its players in a proactive way, concentrating its efforts on support, regulation, risk-based supervision, awareness-raising and education. The CSSF is indeed convinced that the regulator has an important role to play not only in encouraging, but also in accelerating transformation, while preserving the conditions for financial stability and ensuring that the financial services industry remains competitive.

2.3. The CSSF internal organisation – the Internal Group on Sustainable Finance

While sustainable finance issues have been integrated into the CSSF work at the level of the different departments for a while already, the CSSF has decided in 2020 to set up a specific internal group dedicated to sustainable finance with the mission to accompany the transition towards a more sustainable financial sector.

This multidisciplinary team with specific competencies and missions is notably in charge of elaborating concrete actions, as for example the CSSF workplan concerning ESG issues, actions and timelines to be integrated into the prudential supervision at different departments, training programs, supervisory initiatives, legislative proposals, communications, critical assessment of integration of ESG actions within the external consultation processes, networking with stakeholders and contributions to national and international work streams.

2.4. Specific CSSF initiatives and communications in 2020

2.4.1. Financial education

The CSSF takes an active role in educating investors in the context of responsible savings and investments. In collaboration with the ABBL, educational videos on responsible investments and savings were published in 2020 and a section on sustainable development was added to the website www.letzf.in.lu, whose purpose is to promote general knowledge in financial matters.

2.4.2. Preparation of the financial sector

The CSSF aims to prepare the financial sector for the impact of the new European regulations, by inciting the financial players to make sustainable development part of their internal organisation, activities, corporate strategy and risk management. In anticipation of the coming into force of national and European regulatory texts, the CSSF used soft law in order to work towards the objective of the greening of the financial sector. Thus, the CSSF integrated ESG Governance issues in its revised Circular CSSF 12/552 on central administration, internal governance and risk management by adding new requirements on diversity of members of the management body and on the development and maintenance of a sustainable business model requiring to take account of all material risks, including ESG risks.

2.4.3. Communications

The CSSF has launched on its website a dedicated page on sustainable finance where it regularly publishes regulations, communications, press releases or other information in relation to sustainable finance, in order to keep the market informed about the latest developments in this regard.

In a press release dated 22 December 2020, the CSSF presented the result of a thematic review on climate-related information published by issuers. While a review of issuers' non-financial information has already been performed twice before (on the basis of the high-level text of the non-financial reporting directive and the European Commission's general non-binding guidelines), the 2020 campaign focused more specifically, and in a more granular way, on climate-related disclosures. Considering the growing expectations of investors and other stakeholders on the quality and comparability of climate-related disclosures, the CSSF has examined the current state of climate-related reporting for a selection of issuers under its supervision. The results of the thematic review have shown without doubt that there are still significant gaps to fill and that further improvements in the quality and comparability of climate-related disclosures are urgently required to meet the needs of investors and other stakeholders.

2.4.4. Guidance and ESG disclosure

The CSSF is guiding market participants in the implementation of new European rules, such as those on transparency on sustainable investments and sustainability risks resulting from Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR). The SFDR lays down harmonised rules, for financial market participants and financial advisors, on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products.

When preparing for the entry into force of the SFDR and its related regulatory technical standards (RTS), the CSSF first issued a press release confirming the application dates of the SFDR. A further CSSF communication on regulatory requirements and fast track procedure in relation to SFDR was addressed to investment fund managers of UCITS and AIFs who need to comply with harmonised rules on transparency with regard to sustainability risks and the consideration of adverse sustainability impacts and the provision of sustainability-related information.

2.4.5. Legislative proposals

The CSSF submitted its drafting proposals in the context of the preparation of the implementation of European regulation into Luxembourg law.

2.4.6. Participation in national, European and international groups

The CSSF contributed actively to the working streams of the European Commission and the European supervisory authorities as well as to international working groups such as the NGFS, whose purpose is to help strengthen the global response required to meet the goals of the Paris Agreement and to enhance the role of the financial system in risk management and mobilisation of capital for green and low-carbon investments in the broader context of environmentally sustainable development.

still too many different reporting standards and frameworks, some of which are high-level, others voluntary, resulting in potentially misleading, inconsistent and non-comparable information. The CSSF acknowledges that this is a supervisory challenge which has to be raised at European and, even more, international level.

Beside its contribution to the further development of the legislative framework, and being aware that supervisory action might be demanding within this evolving framework, the CSSF will already speed up consideration of ESG disclosure requirements on product level, on entity level and on services level in a proportionate manner in its supervisory processes.

2.5. Forward looking

In 2021, the CSSF aims to further develop its actions, keeping national, European and international agendas closely in mind. The CSSF will continue integrating ESG risk assessments, ESG governance considerations, ESG advisory procedures and other relevant internal processes of supervised entities into its prudential supervision for all market participants within the scope of its supervision. It will continue with its proactive approach, consisting notably in clarifying, at a sufficiently early stage, its expectations concerning climate-related and environmental risks, and strengthen the dialogue with national stakeholders.

The CSSF will continue its supporting and supervisory enforcement work on what it considers a fundamental area, the ESG disclosure requirements. ESG disclosure requirements at entity level are a key element for the success of the development of sustainable finance. High quality, standardised, comparable, comprehensive and reliable information, both on an entity's financial performance and on an entity's impact, are of outmost importance and a crucial starting point. The information should be adapted to the targeted investors and consumers, in order to enable them to take well-informed investment decisions, to enable consumers to opt for a service provider presenting a defined ESG profile or to enable advisors and other professionals to provide suitable advice or portfolio management satisfying appropriate ESG criteria. Whereas progress has been made over the last years in the area of ESG disclosure, there are

VI. Supervision of banks

1. Banking supervision practice

1.1. Organisation of the supervision

For banks, the responsibility for direct prudential supervision in the strict sense is organised as follows.

Banks established in Luxembourg by category

Type of credit institution	Competent authority	Number	
		2019	2020
Significant institutions incorporated under Luxembourg law	ECB	31	31
Less significant institutions incorporated under Luxembourg law	CSSF	56	56
Branches of a significant institution	ECB	20	20
Branches of a less significant institution	Supervisory authority of the head office	7	8
Branches of a non-EU institution	CSSF	13	13
Total		127	128

Prudential supervision in the strict sense includes the supervision of solvency, liquidity and internal governance. It does not include the other areas of supervision that fall under the sole competence of the CSSF, namely:

- the supervision of compliance with the professional obligations regarding anti-money laundering and combating the financing of terrorism (AML/CFT);
- the supervision of regulations for consumer protection: MiFID, laws on mortgage credits and consumer credits;
- the supervision of regulations relating to the integrity of the markets: European Market Infrastructure Regulation (EMIR), Securities Financing Transactions Regulation (SFTR) and Benchmark Regulation (BMR);
- the supervision of the obligations deriving from sectoral laws on UCIs, including, in particular, the obligations related to the function of depositary bank of UCIs;
- the supervision of obligations deriving from other European or national regulations, like PSD2, Directive NIS¹ and the law on payment accounts.

¹ Directive (EU) 2016/1148 of 6 July 2016 concerning measures for a high common level of security of network and information systems across the Union.

Number of agents in charge of the off-site supervision of the different areas of supervision

Area of supervision	Full-time equivalents	
	2019	2020
Prudential supervision of significant institutions	17.80	20.50
Prudential supervision of other institutions	25.55	22.75
Monitoring of compliance with the AML/CFT professional obligations	7.00	7.00
Depository bank function	3.75	3.00
Recovery plans	2.80	2.80
Consumer/investor protection	2.00	1.00
EMIR/SFTR	1.00	1.00
Payment services	1.00	1.00
Legal and authorisations	8.25	8.30
Methodology and reporting	8.25	8.00
Risk analysis/stress testing	6.00	5.30
Internal model supervision/Market risk/Interest rate risk/Liquidity risk	9.00	9.00
IT and statistics	1.50	2.00
SSM liaison	1.00	1.00
Secretariat	2.55	2.55

As regards the institutions directly supervised by the ECB, the CSSF is member of 26 Joint Supervisory Teams (JSTs).

Agents in charge of authorisations and validation and supervision of internal models mostly perform tasks under the responsibility of the ECB.

As regards the areas of supervision referred to above, the CSSF agents also participate actively in working groups which meet at European and international level.

1.2. Priorities with respect to prudential supervision and banking risks

The CSSF sets its priorities for the supervision of credit institutions falling within its remit on an annual basis. In order to use the resources as efficiently as possible, the determination of the supervisory priorities is based on an approach taking into account the main risks and major vulnerabilities of the Luxembourg banking centre (risk-based approach).

As member of the Single Supervisory Mechanism (SSM), the CSSF takes into consideration the supervisory priorities defined by the ECB for the supervision of significant institutions as well as the relevant EBA guidelines. In 2020, in response to the economic consequences due to the COVID-19 pandemic, the priorities of the ECB concerned mainly credit risk as well as different aspects related to the resilience of banks.

As the business model of a significant portion of the banks in Luxembourg focuses on wealth management and custody activities, credit risk in general and non-performing loans in particular are not considered as the main risk for the Luxembourg banking centre under normal circumstances. Nevertheless, the COVID-19 pandemic has been an unprecedented event which has affected the real economy and, as a consequence, has impacted the resilience of the banking sector. The uncertainty as to the consequences of the pandemic remains great and its impact for banks is still uncertain in the short and medium term. Thus, the CSSF reacted by including credit risk monitoring in its list of priorities with respect to prudential supervision and banking risks.

In addition to the monitoring of credit risk in the context of the pandemic, the CSSF's priorities for prudential supervision in 2020 were the following.

1.2.1. Conduct risk, including money laundering and terrorist financing

Money laundering and terrorist financing (ML/TF) are risks inherent in the activities of international financial centres such as Luxembourg. In banks, wealth management activities involving international customers are particularly exposed. Within the CSSF, the control of these risks has undergone significant developments over the last years with, in particular, a substantial increase in the number of staff and systems allowing an efficient fight against ML/TF. These developments continued in 2020, in a context of prevention (via targeted communications) as well as sanctioning. Similarly to the previous years, in 2020, the AML/CFT on-site inspections² resulted in the CSSF imposing administrative fines³ on banks which did not comply with their AML/CFT professional obligations.

² For further details on this subject, please refer to point 1.2. of Chapter XX "Financial crime".

³ For further details on this subject, please refer to point 2. of Chapter XVII "Instruments of supervision".

1.2.2. Profitability risk

The profitability risk remains challenging for many banks in Luxembourg. Based on the observations of the CSSF, this risk is mainly linked to the following factors: (i) a business volume sometimes lower than the critical mass, (ii) high pressure on interest margins in the context of historically low interest rates, (iii) ongoing rise in operational costs linked to compliance with regulatory requirements, and (iv) necessary investments in digitalisation projects.

The profitability risk is greater in small banks which often do not have the critical mass to cover their costs. Small banks have a cost-to-income ratio which is, on average, higher than that of bigger banks. In the future, it is probable that the number of credit institutions will continue to decrease and that non-profitable banks will leave the market or be absorbed by larger institutions. However, as the means of action of the supervisor with respect to the profitability risk are limited, the CSSF mainly ensures that this risk does not jeopardise depositors.

1.2.3. Operational risk

The main activity of banks in wealth and asset management (depository banks and private banks) is the custody and management of their customers' financial assets. The main risks linked to this type of banking activity are operational in nature and include, besides ML/TF risks and the other risks mentioned above, IT risk, business continuity risk and risks related to the use of sub-depository institutions.

1.3. Supervision of significant institutions

At the end of 2020, 51 banks established in Luxembourg were directly supervised by the ECB, either because they fulfil the criteria to qualify as significant institution (SI) at solo or consolidated level, or because they were part of a group considered as significant. These banks represented 71.6% of the total assets of the Luxembourg banks.

Supervision of SIs is exercised by JSTs formed of staff members from the ECB and from the national competent authorities. At the end of 2020, the CSSF was a member of 26 JSTs. Twenty-five CSSF supervisors were directly involved in this supervisory system.

SIs established in Luxembourg by category

SSM status	Number of banks	In % of assets
Significant banks, group head in Luxembourg	5	20.9%
Significant banks, subsidiaries of an SI	26	28.6%
Branches of an SI	20	22.1%
<i>Sub-total SIs</i>	<i>51</i>	<i>71.6%</i>
Total Luxembourg banking sector	128	100.0%

The SSM's supervisory approach is described in detail in the document "Guide to banking supervision"⁴.

1.4. Supervisory review and evaluation process (SREP)

Since 2015, a common SREP methodology has been applied to less significant institutions (LSIs). It is based on the EBA guidelines on SREP (EBA/GL/2018/03) and on the methodology applied to SIs by the ECB.

In general, the SREP is carried out annually based on a large range of quantitative and qualitative information sources, among which the prudential reporting and internal reports provided by the bank, the reports of on-site inspections, the ICAAP⁵ and

⁴ www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidetobankingsupervision201411.en.pdf?404fd6cb61dbde0095c8722d5aff29cd. In this regard, see also the annual reports of the ECB published under www.ecb.europa.eu/pub/annual/html/index.en.html.

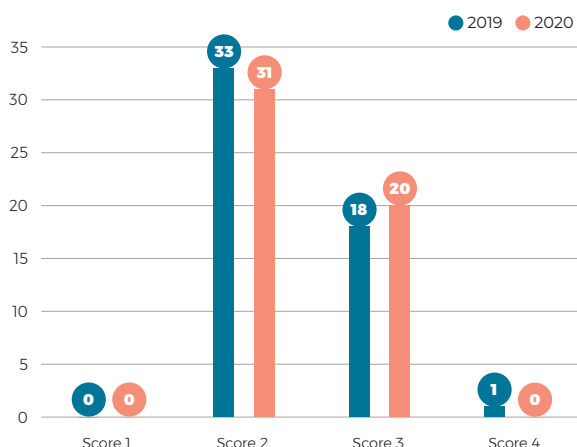
⁵ Internal Capital Adequacy Assessment Process.

the ILAAP⁶ as well as the different stress tests. The SREP is applied, in a proportionate manner, to credit institutions having regard to the nature, scale and complexity of their activities and risks and, if relevant, their situation within the group.

In the light of the implications of the COVID-19 pandemic for credit institutions, in 2020, the SREP focused on the capacity of the LSIs to meet the challenges related to the pandemic, including their business continuity, as well as on the impact of the crisis on their risk profile and their financial soundness. These elements were assessed based on the regular exchanges with banks and the ad hoc information provided by credit institutions to the CSSF.

The distribution of overall SREP scores, which vary on a scale of 1 (low risk for the viability of the institution) to 4 (high risk for the viability of the institution), remained fairly stable from 2019 to 2020 with an average which increased from 2.3 to 2.4 for all LSIs. This increase is mainly attributable to weaknesses in the business models and to growing operational risks.

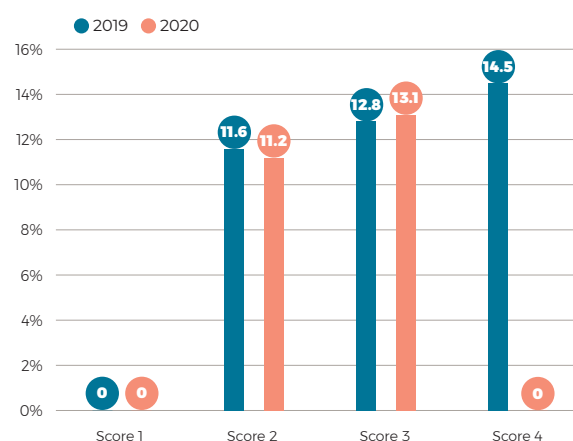
Breakdown of the SREP scores



Based on the conclusions of the SREP, the LSIs were required to implement a range of qualitative and quantitative measures, mainly in relation to capital and liquidity ratios.

The applicable own funds requirements under the CRR should appropriately cover the incurred risks, including in stressed conditions. Where the results of the stress tests suggest that an institution is unable to fulfil the own funds requirements under stress, or where it is extremely sensitive to the assumed scenarios, the CSSF requires additional own funds in the form of Pillar 2 Guidance (P2G) to ensure that the institution remains appropriately capitalised.

Own funds requirements (P1+P2R+buffers+P2G) by SREP score in %



As regards all LSIs, on average, Pillar 1 and Pillar 2 (P2R) capital requirements, combined capital buffers and the non-binding Pillar 2 Guidance (P2G) cumulatively amounted to 11.95% compared to 11.85% in 2019.

Moreover, the CSSF took other supervisory measures to address specific risks and weaknesses, particularly with respect to liquidity, by requiring restrictions for certain economic activities or additional reporting.

⁶ Internal Liquidity Adequacy Assessment Process.

1.5. Authorisations

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

1.5.1. Authorisation of new credit institutions

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

However, the CSSF is still the entry point for the submission of all the authorisation files. Upon receipt of an application, the CSSF analyses it in order to verify compliance with the legal and regulatory requirements, focusing in particular on compliance with the AML/CFT legislation. After the examination of the file, the CSSF drafts 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 2020, the CSSF worked on four authorisation requests for new credit institutions and branches of non-EU banks. One authorisation was granted by the ECB and one by the Minister of Finance during the year. As regards two files, the examination continues in 2021.

1.5.2. Authorisation for acquisitions of qualifying holdings

Like the authorisation of a new institution which requires prior examination of the file by the CSSF, the subsequent acquisitions of shareholdings that reach or exceed 10% of the capital or that give significant influence over the institution concerned (qualifying holding) are also examined by the CSSF and authorised by the ECB in accordance with the applicable legal and regulatory requirements.

In 2020, the CSSF examined 23 qualifying holding files, 13 of which led to an authorisation by the ECB during the year. One file was withdrawn during the examination and the examination of the other files continues in 2021.

1.5.3. Authorisation of directors and managers of banks

In 2020, the CSSF dealt with 58 applications for nomination of new directors and authorised managers in Luxembourg credit institutions. The CSSF verifies the compliance of the candidates, notably in terms of good repute, experience and professional availability, with legal and regulatory requirements. Particular attention is given to compliance with the AML/CFT legislation. Following the examination of the files by the CSSF, the nominations in SIs are transferred to the ECB for authorisation, whereas the nominations in LSIs and third-country branches are directly authorised by the CSSF.

1.6. Depositary bank

The UCITS V Directive and the AIFMD, together with their delegated acts, reinforce the regulatory framework of the depositary activity. The depositary bank's duties include not only the safekeeping of UCI assets, but also the diligence and oversight of third parties involved in the safekeeping, the monitoring of UCI cash flows as well as the conflict of interest and independence management. The depositary bank needs to act independently and in the best interest of the investors. As of 31 December 2020, 48 banks were acting as depositary banks of Luxembourg-domiciled UCIs and pension funds. The CSSF's supervision aims to verify that the depositaries subject to its supervision continuously observe all legal and regulatory provisions relating to their organisation and operation, with the objective to ensure investor protection and stability of the financial system. Prior to starting any depositary business activities for Luxembourg-domiciled UCIs, an administrative authorisation has to be obtained from the CSSF. Any major subsequent change of the elements underlying the initial authorisation as a UCI depositary (e.g. extension of initial authorisation to other investment vehicles and/or any major change in the operational model), as well as any material outsourcing, are also subject to CSSF approval. In 2020, the CSSF processed eight administrative authorisations to act as UCI depositary, including four new requests and four material changes in the business model, as well as seven files relating to the delegation of supporting tasks.

1.7. MiFID

In 2020, the CSSF's work on MiFID covered, in particular, the production of the credit institutions' report on the protection of financial instruments and funds belonging to customers (Grand-ducal Regulation of 30 May 2018). It should be noted that the CSSF authorised the inclusion of this annual report in the long form report.

The CSSF works in close collaboration with ESMA and other national supervisory authorities in order to promote a harmonised supervisory framework, focused on the protection of investors in general and of retail investors in particular.

1.8. EMIR

The European Market Infrastructure Regulation (EU) No 648/2012 (EMIR) aims to improve the transparency of over-the-counter derivatives markets and to reduce the risks associated with these markets. In 2019, Regulation (EU) 2019/834 of 20 May 2019 (EMIR Refit) introduced several changes aiming to eliminate disproportionate costs and burdens especially for smaller financial counterparties.

The objective of the CSSF's work is to continuously improve the accuracy, precision and reliability of the reported transactions via a data analysis module. In 2020, 19 observation letters were sent to banks established in Luxembourg highlighting identified deficiencies. In addition, following a risk-based approach, on-site inspections are being performed in order to ensure compliance with regulatory requirements under EMIR.

1.9. Payment services

The action of the CSSF with respect to banking payment services was punctuated by a series of communications and reminders. In the context of Directive (EU) 2015/2366 of 25 November 2015 on payment services (PSD2), transposed into national law by the Law of 20 July 2018 amending the Law of 10 November 2009 on payment services, it is useful to convey the following points communicated during 2020.

On 3 August 2020, the CSSF released a circular-letter on the requirements with respect to fraud reporting under Article 96(6) of PSD2.

On 26 August 2020, the CSSF published a communiqué addressed to all account servicing

payment service providers (ASPSPs), which put in place a dedicated interface, informing them that it shares the EBA's opinion of 4 June 2020 on obstacles to the provision of third-party providers' (TPP) services. As of 1 January 2021, no obstacle will be tolerated and the CSSF will apply measures in case of irregularity.

Finally, the CSSF would like to remind that, in accordance with Article 3(2) of the regulatory technical standards on strong customer authentication and common and secure open standards of communication (RTS on SCA and CSC), the banks which use the exemption referred to in Article 18 (Transaction risk analysis) of the RTS must also be subject to an audit of the provisions of Article 19 of the RTS (Calculation of fraud rates) by an independent and qualified external auditor during the first year of making use of this exemption and at least every three years thereafter.

1.10. 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 the authorities with instruments which should allow them to deal with failing national or transnational banks and, thus, to limit their systemic impact. Among the arrangements implemented by the BRRD, transposed by the Law of 18 December 2015, is the obligation to establish a recovery plan indicating notably the measures planned by an institution to restore its viability following financial deterioration. At national level, in 2020, the CSSF received 39 recovery plans (including three group recovery plans from groups it supervises on a consolidated basis) of which it assessed the comprehensiveness, the quality and the general credibility. Twenty of these plans are subject to simplified obligations for banks fulfilling certain criteria. Furthermore, the CSSF organised nine meetings during which the respective banks presented their recovery plan.

At international level, the CSSF participated, in its capacity as host authority, in 10 joint decisions on group recovery plans involving less significant banks within the meaning of the SSM. It also contributed to the assessment of recovery plans of some banks under the direct responsibility of the ECB. Finally, it took part in three meetings of the Crisis Management Group organised by the home authorities of systemic banking groups having a material subsidiary in Luxembourg.

1.11. Benchmarks

Regulation (EU) 2016/1011 of 8 June 2016 (Benchmark Regulation – BMR) defines a common framework to ensure the accuracy and integrity of the indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds in the EU. The Law of 17 April 2018 has designated the CSSF as the Luxembourg competent authority to ensure compliance with the BMR by the supervised entities governed by this regulation.

The “Banking supervision” department is in charge of supervising the contributing banks and the LSIs which are using benchmarks. As far as the single local bank acting as contributor is concerned, its compliance with the external audit requirements for contributors to benchmarks was verified. The role taken by this bank also requires the CSSF to participate in the Euribor college which consists of all national competent authorities of banks contributing to Euribor.

1.12. Cooperation in banking supervision

In 2020, the CSSF organised three supervisory colleges concerning banks for which it exercised an ultimate consolidated supervision at European level.

As a large number of banking groups is present in the Luxembourg financial sector through subsidiaries, the CSSF participates, as host supervisor, in many colleges, including colleges organised by supervisory authorities from non-EEA countries. In addition to the colleges, periodical bilateral meetings take place between the CSSF and the Swiss supervisory authority, the FINMA. Cooperation with the Chinese and US authorities is mainly done via the participation in supervisory colleges organised by these authorities.

One of the main objectives of the colleges is the performance of a Joint Risk Assessment based on which 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. Following this assessment, they make a Joint Decision on Capital and Liquidity (for EEA colleges) which is formally communicated to the banking group and its subsidiaries. Moreover, the purpose of the colleges is to promote the exchange of information between authorities, including information on the situation of ML/TF compliance risks.

In accordance with AML/CFT College Guidelines of the EBA, the CSSF performed a mapping of the colleges it will have to put in place as the lead authority before 10 January 2022. Presently, the CSSF foresees to put in place 19 such colleges. Furthermore, the CSSF will have to participate as member in around 35 colleges organised by supervisory authorities of other EU Member States, covering around 50 Luxembourg based banks.

The CSSF closely collaborates 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.

Finally, the CSSF cooperates with the national judicial and law enforcement authorities as well as with the Commissariat aux Assurances 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 Articles 9–1 and 9–1a of the Law of 12 November 2004 on the fight against money laundering and terrorist financing. Moreover, the CSSF consults the intelligence unit in the context of the procedures for authorisation and qualifying holdings, if it deems it necessary.

1.13. Stress testing

Stress tests are exercises aiming to identify sources of risks and vulnerabilities which banks may face, and to determine their impact on banks.

The CSSF is involved in stress tests at three levels.

- At EU level, the CSSF assists the EBA in the development of the methodology of its EU-wide stress test relating to solvency which is carried out every two years.
- At the SSM level, the CSSF assists the ECB in its annual stress test exercise, i.e. in developing a methodology and performing the stress test. In 2020, the ECB carried out an assessment of the banks’ vulnerabilities to measure the potential impact of the COVID-19 pandemic. The CSSF’s assistance consisted of its technical expertise in relation to the five SIs having their group head in Luxembourg.



- At local level, the CSSF carries out solvency tests and other stress tests or sensitivity analyses on an annual or half-yearly basis. The aggregated results of these analyses are regularly presented to international organisations such as the IMF or the OECD which frequently request the CSSF's point of view on the Luxembourg banking sector.

The results of the solvency tests are a source of information to (i) compare, judge and challenge the results of the stress tests carried out internally by banks in the framework of their ICAAP, (ii) help assess the solvency risk of the institutions, and (iii) help assess the situation and future capital requirements of a bank as a preventive approach. The results of the stress tests form a starting point for the determination of the capital levels under Pillar 2 (Pillar 2 Guidance – P2G) for LSIs.

1.14. Intra-group credit risks

One of the main risks monitored by the CSSF is related to the significant exposures of Luxembourg banks to banking entities of their group.

The Luxembourg banking sector is primarily composed of subsidiaries and branches of large international banking groups which carry out activities of private banking and/or custody of financial assets in Luxembourg. These activities generate excess liquidity which is either maintained in Luxembourg as liquidity buffer (often deposited with the BCL) or lent to the parent company.

In total, intra-group exposures represented 30% of the assets of the Luxembourg banking sector at the end of 2020. In line with the European rules in this regard and Article 56-1 of the Law of 5 April 1993 on the financial sector, these exposures often represent a multiple of a bank's own funds. In these cases, the CSSF follows and controls compliance with the legal conditions provided for in the above-mentioned Article 56-1.

2. Developments in the banking sector in 2020

2.1. Development in the number of credit institutions

With 128 entities authorised at the end of the financial year 2020, the number of banks rose by one entity compared to 31 December 2019.

Six banks started their activities in 2020.

Denomination	Start date of the activity	Type of activities
Skandinaviska Enskilda Banken AB Luxembourg Branch	2 January 2020	Private bank (takeover of the activities of Skandinaviska Enskilda Banken S.A.)
CaixaBank Wealth Management Luxembourg S.A.	19 February 2020	Private bank
CIBC Capital Markets (Europe) SA	15 May 2020	Investment bank
Alpha Bank A.E., Luxembourg Branch	19 June 2020	Corporate banking
Elavon Financial Services DAC Luxembourg Branch	1 July 2020	Depository bank
Goldman Sachs Bank Europe SE, Luxembourg Branch	1 November 2020	Private bank

Five banks were deregistered from the official list during 2020.

Denomination	Date of deregistration	Reason
Skandinaviska Enskilda Banken S.A.	2 January 2020	Transfer of activities to the branch of Skandinaviska Enskilda Banken AB
DekaBank Deutsche Girozentrale Luxembourg S.A.	23 April 2020	Transfer of activities to the branch of Dekabank Deutsche Girozentrale
Caixa Geral de Depósitos S.A., Lisboa (Portugal), succursale de Luxembourg	30 April 2020	Cessation of activities
Postbank Luxemburg – eine Niederlassung der DB Privat – und Firmenkundenbank AG	15 May 2020	Merger with Deutsche Bank AG, Luxembourg Branch
Bausparkasse Schwäbisch Hall A.G., Schwäbisch Hall (Allemagne), succursale de Luxembourg	31 December 2020	Cessation of activities

2.2. Development in banking employment

As at 31 December 2020, the number of employees in Luxembourg credit institutions amounted to 26,106 compared to 26,337 as at 31 December 2019, representing a decrease of 231 people on an annual basis. In 48.1% of banks, employment increased whereas in 39.8% of them it decreased.

Compared to the figures of December 2019, the distribution of employment according to men and women remains almost unchanged with 55.3% men and 44.7% women.

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

The 5.1% increase of the total balance sheet is a continuation of the upward trend observed since 2017. The impact of the COVID-19 pandemic was particularly strong in March 2020 when the aggregated balance sheet, amounting to EUR 912 billion, reached levels not seen since 2009. The main reason for this is the increase in deposits from investment funds as the fund managers reallocated the funds' assets in safe reinvestments. The same phenomenon was observed during the global financial crisis of 2008/2009.

As regards entities, 56% of the financial centre's banks, representing 63% of the total balance sheet at the end of 2020, recorded a rise in assets. These notably include the largest banks of the financial centre as well as the banks active in asset management on behalf of private and institutional customers.

With respect to assets, it is worth mentioning the decrease in loans and advances to credit institutions (-5.1%) and loans and advances to customers (-2.5%), as well as the substantial rise of assets held with central banks (+46.1%). As far as loans and advances to credit institutions are concerned, the development results from the drop in intra-group transactions of some major players which now invest a greater part of their banking group's liquidity in the Eurosystem via their Luxembourg entities. As regards loans and advances to customers, it is worth noting the continuous increase of loans granted to households despite the pandemic, as well as the decline of loans and advances to non-financial corporations due to the lack in demand from undertakings which partially postponed investments.

On the liabilities side, the pandemic led to an increase of liquidity at almost all counterparty groups. The biggest increase was recorded for amounts owed to customers, consisting of deposits made by financial and non-financial corporations, private customers and/or retail customers, as well as of current accounts of investment funds (+10.2%).

Capital and reserves increased proportionally to the balance sheet total of Luxembourg banks, continuing to represent 7.0% of the balance sheet total.

Aggregate balance sheet total – in million EUR

ASSETS	2019	2020 ⁷	Variation
Loans and advances to central banks and central governments	119,994	172,171	43.5%
Loans and advances to credit institutions	299,435	284,254	-5.1%
Loans and advances to customers	252,860	246,465	-2.5%
Fixed-income transferable securities	122,194	130,318	6.6%
Variable-yield transferable securities	5,904	6,224	5.4%
Fixed assets and other assets	21,335	23,937	12.2%
Total	821,723	863,368	5.1%

LIABILITIES	2019	2020 ⁸	Variation
Amounts owed to central banks	5,976	9,206	54.1%
Amounts owed to credit institutions	242,069	244,357	0.9%
Amounts owed to customers	416,331	458,678	10.2%
Amounts owed represented by securities	71,007	58,326	-17.9%
Liabilities (other than deposits) held for trading	5,767	7,714	33.8%
Provisions	3,042	3,102	2.0%
Subordinated liabilities	2,809	4,992	77.7%
Other liabilities	14,838	16,361	10.3%
Capital and reserves	59,882	60,630	1.2%
Total	821,723	863,368	5.1%

As regards off-balance sheet exposures, the Luxembourg banking sector had loan commitments and financial guarantees amounting to EUR 168.9 billion as at 31 December 2020 (+12.4% over a year).

7 Preliminary figures.

8 Preliminary figures.

2.4. Development in the profit and loss account

Net profit for the year 2020 dropped by 18.1% compared to the financial year 2019. This drop is largely due to the increase in risk provisioning. The profit before provisions decreased only by 1.1% during the same period. It should be noted that 76% of the banks ended the year 2020 with a positive net profit (80% in 2019).

In 2020, net interest income (-2.4%) recorded a negative development year-on-year. The decrease of this item was shared by 57% of the credit institutions, representing 40% of the aggregated net interest income of the financial centre. This decrease was mainly due to the decline of interbank lending margins.

Net fee and commission income, which mainly results from asset management activities on behalf of private and institutional customers, including the services provided to investment funds, grew by 14.6%. The rise of net fee and commission income was shared by 65% of Luxembourg banks. The extent of the rise resulted from variations in the scope of data collection due to intra-group reorganisations, including the integration of new foreign branches. Excluding these effects, the rise in net fee and commission income would amount to 5%. Indeed, the increase in the average amount of deposited assets and the high volatility in the markets in 2020 led to a rise in the commissions on custody of assets and on securities transactions of customers.

The development of other net income continued to be marked by a strong volatility dominated by

Development in the profit and loss account – in million EUR

	2019	Relative share	2020 ⁹	Relative share	Variation	
					in volume	in%
Net interest income	5,384	45%	5,254	42%	-130	-2.4%
Net fee and commission income	5,132	43%	5,884	47%	752	14.6%
Other net income	1,550	13%	1,438	11%	-112	-7.2%
Banking income	12,066	100%	12,576	100%	510	4.2%
General expenses	-7,285	-60%	-7,849	-62%	565	7.7%
<i>of which: staff costs</i>	-3,545	-29%	-3,744	-30%	200	5.6%
<i>of which: general administrative expenses</i>	-3,740	-31%	-4,105	-33%	365	9.7%
Profit before provisions	4,781	40%	4,727	38%	-55	-1.1%
Net creation of provisions	-441	-4%	-1,042	-8%	600	136.0%
Taxes	-637	-5%	-654	-5%	16	2.5%
Net profit for the year	3,702	31%	3,031	24%	-671	-18.1%

non-recurring results for a limited number of banks. The 7.2% decrease in this item is also partly due to a decline of dividend income in 2020.

General expenses continued their upward trend of the last years with a rise of 7.7% year-on-year (+8.4% in 2019). This growth in general expenses, which concerns both general administrative expenses (+9.7%) and staff costs (+5.6%), was registered by 63% of the banks. However, without considering the effects of the intra-group reorganisations mentioned above, the growth in general expenses would only be 2% in 2020.

Net creation of provisions increased by 136.0%. These provisions were mainly related to credit risk in the context of the COVID-19 pandemic and largely affected universal banks and banks

specialised in corporate financing. Nevertheless, the asset quality in the Luxembourg banking sector remains overall stable, as shown by the non-performing exposure ratio of 0.5% of assets at the end of 2020. However, the application of IFRS 9 led the banks to make provisions on performing loans.

The increase of provisions in the context of the COVID-19 pandemic aggravated the downward trend in bank profitability. Thus, the cost-to-income ratio deteriorated, rising from 61% in 2019 to 62% in 2020. Moreover, 23 banks (16 banks at the end of 2019) recorded a cost-to-income ratio higher than 100%. They represent 5% (2.9% at the end of 2019) of the balance sheet total of the financial centre and 8% (3.2% at the end of 2019) of the overall employment in the banking sector.

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 ¹⁰
Net interest income	4,761	4,960	4,671	4,281	4,066	4,496	4,717	4,886	4,994	5,384	5,254
Net fee and commission income	3,587	3,832	3,727	3,962	4,101	4,720	4,602	4,706	4,975	5,132	5,884
Other net income	1,201	76	1,401	2,213	2,217	2,262	3,038	2,166	1,841	1,550	1,438
Banking income	9,549	8,868	9,799	10,456	10,384	11,478	12,357	11,758	11,809	12,066	12,576
General expenses	-4,609	-4,789	-4,994	-5,198	-5,005	-5,942	-6,040	-6,253	-6,737	-7,285	-7,849
<i>of which: staff costs</i>	-2,497	-2,535	-2,622	-2,745	-2,624	-3,065	-3,109	-3,161	-3,265	-3,545	-3,744
<i>of which: general administrative expenses</i>	-2,112	-2,253	-2,372	-2,453	-2,381	-2,878	-2,931	-3,092	-3,473	-3,740	-4,105
Profit before provisions	4,940	4,080	4,805	5,258	5,379	5,535	6,317	5,505	5,071	4,781	4,727
Net creation of provisions	-498	-1,572	-765	-865	-327	-577	-757	-956	-712	-441	-1,042

¹⁰ Preliminary figures.

2.5. Solvency and liquidity ratios

The banks of the Luxembourg financial centre continued to register high prudential ratios. The total average capital ratio of the banking sector increased from 22.7% to 24.5% during 2020. This increase is due to the rise in original own

funds in the form of retained earnings in the context of regulatory restrictions to distribute dividends implemented during the pandemic. Furthermore, some depositary banks recorded rises in Tier 2 capital (T2) in order to comply with the Minimum Requirement for Own Funds and Eligible Liabilities – MREL.

Elements of own funds

	2019		2020	
	Amount (in million EUR)	Relative share	Amount (in million EUR)	Relative share
Own funds	50,070.1	100.0%	55,397.4	100.0%
Common Equity Tier 1 capital (CET1)	47,781.6	95.4%	49,503.3	89.4%
Additional Tier 1 capital (AT1)	1,195.5	2.4%	1,483.0	2.7%
Tier 2 capital (T2)	1,093.0	2.2%	4,411.1	8.0%

Risk-weighted exposure amounts

	2019		2020	
	Amount (in million EUR)	Relative share	Amount (in million EUR)	Relative share
Total risk exposure amount	220,455.90	100.00%	225,685.90	100.00%
Risk-weighted exposure amounts for credit risk, counterparty risk and dilution risk and free deliveries	193,562.20	87.80%	198,705.82	88.05%
<i>of which: Standardised Approach (STA)</i>	<i>142,318.90</i>	<i>64.60%</i>	<i>143,715.43</i>	<i>63.68%</i>
<i>of which: Internal ratings-based approach (IRB)</i>	<i>51,242.10</i>	<i>23.20%</i>	<i>51,920.62</i>	<i>23.01%</i>
Risk-weighted exposure amounts for operational risk	23,021.90	10.40%	22,415.29	9.93%
Capital ratio	22.70%		24.55%	
Common Equity Tier 1 capital ratio (CET1 ratio)	21.70%		21.93%	

• Liquidity Coverage Requirement (LCR)

As at 31 December 2020, the weighted average of the LCR of Luxembourg banks and Luxembourg branches of banks having their registered office outside the EU amounted to 222% as compared to 183% at the end of December 2019 (comparison made on a similar sample). The regulatory minimum to be observed amounted to 100% at the end of December 2020.

At aggregate level, there was a significant concentration of the liquid assets buffer within Level 1 assets. The short-term deposits made with the BCL still represented the major part of Luxembourg banks' liquid assets.

• 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 118% in December 2020, as against 101% at the end of December 2019 (comparison made on a similar sample). This proxy tool remains very approximate until new reporting tables, accompanying the implementation of the NSFR as a binding regulatory standard as from 28 June 2021, are put in place.

• Asset encumbrance ratio

Luxembourg banks have a low asset encumbrance ratio. As at 31 December 2020, this ratio amounted to 8.58% on weighted and aggregate basis, showing that most of the Luxembourg banks' assets were unencumbered. The slight growth of this ratio, amounting to 7.22% at the end of December 2019, results from the increasing participation of the ECB in longer-term refinancing operations. Only nine banks had an asset encumbrance ratio exceeding 15% due to their business model. This was especially the case of banks issuing covered bonds. As a consequence, these banks were subject to additional reporting requirements.

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

VII. Supervision of PFS

1. Investment firms

1.1. Introduction of a new legal framework applicable to investment firms

Directive (EU) 2019/2034 of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU, which is in the process of being transposed at national level, and Regulation (EU) 2019/2033 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014, which enters into force on 26 June 2021, introduce a new prudential supervisory regime for investment firms which is adapted notably to the nature of the investment firms' activities and to their risk level.

Directive (EU) 2019/2034 and Regulation (EU) 2019/2033 create four main categories of investment firms:

- “class 1” investment firms, considered as fully-fledged credit institutions and treated as credit institutions also with respect to supervision;
- “class 1b” investment firms which, given their activities¹ and due to their size and significance or their affiliation to a group, will remain subject to a certain number of CRD/CRR obligations without however being treated as fully-fledged credit institutions;
- “class 2” investment firms which will be fully subject to the new regime introduced by

Directive (EU) 2019/2034 and Regulation (EU) 2019/2033;

- “class 3” investment firms which will benefit from certain derogations in order to ensure proportionality of the rules applicable to them as they are small and non-interconnected investment firms.

In the context of the transposition of Directive (EU) 2019/2034 into national law and the entry into force of Regulation (EU) 2019/2033, a new prudential reporting will apply to investment firms as from 30 September 2021.

1.2. Development of investment firms in 2020

1.2.1. Development in the number of investment firms

During the year 2020, the number of investment firms decreased to 98 entities (against 99 entities at the end of 2019).

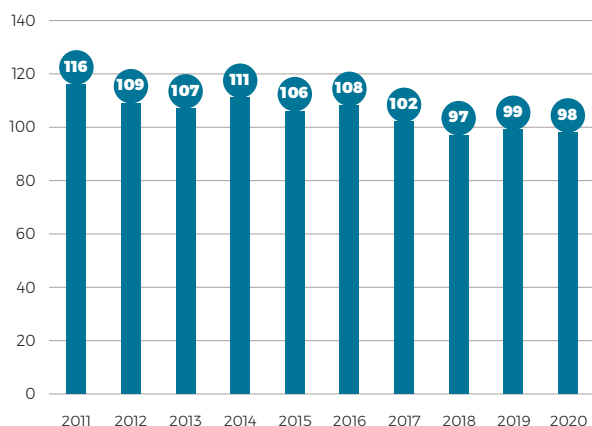
Four entities were authorised as investment firms in 2020, against eight new entities in 2019.

Five entities gave up their investment firm status during the year (six in 2019) for the following reasons:

- change or cessation of activities so 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);
- change into specialised PFS (two entities);
- closing of EU/EEA investment firm branches established in Luxembourg (two entities).

¹ Investment firms carrying out activities of dealing on own account or underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis.

Development in the number of investment firms



The activity of private portfolio manager was the most widespread activity among investment firms with 83 entities authorised in this respect as at 31 December 2020 (against 85 entities as at 31 December 2019). Nevertheless, it is worth mentioning that only one out of the four newly registered entities adopted the status of private portfolio manager.

The number of CRR investment firms falling within the scope of the CRR² remained stable with 24 entities as at 31 December 2020. Among the four investment firms newly authorised in 2020, one falls within the scope of the CRR.

1.2.2. Development in employment

After the fall in employment over the last three years, the total number of staff of investment firms increased in 2020, from 1,688 people as at 31 December 2019 to 1,785 people at the end of December 2020.

The increase in staff related to newly authorised investment firms as well as the upward variations observed in a certain number of entities allowed counteracting the downward trend in the total staff figures due to the deregistration of five 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
2011	116	2,411
2012	109	2,662
2013	107	2,560
2014	111	2,390
2015	106	2,278
2016	108	2,285
2017	102	2,271
2018	97	2,115
2019	99	1,688
2020	98	1,785

It should be noted that certain status renunciations that took place in 2020, including in particular the change of two investment firms into specialised PFS, did not, however, entail a loss of jobs in the financial sector. These transfers of activities did not have an impact on employment in the financial sector as a whole, but only on the breakdown between the different categories of financial players.

It should also be noted that, as at 31 December 2020, about half the investment firms had 10 or fewer employees.

1.2.3. Development of balance sheets and profit and loss accounts

The provisional balance sheet total of all investment firms established in Luxembourg reached EUR 1,249 million³ as at 31 December 2020, against EUR 1,159 million as at 31 December 2019, i.e. an increase of 7.77%. This increase was attributable especially to one investment firm authorised in 2020 and a rise in the balance sheet total of other players already active before 2020, thereby counteracting the decrease in the balance sheet total of some other players.

Investment firms recorded a negative development in their net results over a year. Indeed, provisional net results amounted to EUR 94.0 million⁴ as at 31 December 2020, against EUR 98.5 million as at 31 December 2019, representing a decrease by 4.57%.

² 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.

³ 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.

⁴ Same comment as in the above footnote no 3.

Without attempting an assessment of each individual situation, the CSSF notes that the situation related to the COVID-19 pandemic and the lockdown during 2020 do not, at first sight, seem to have had a significant direct impact on the net results as at 31 December 2020 for the majority of investment firms.

It should also be emphasised that a little under one-third of the investment firms recorded a negative result as at 31 December 2020.

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

(in million EUR)	2019	2020	Variation in %
Balance sheet total	1,159	1,249	+7.77%
Net results	98.5	94.0	-4.57%

1.3. Prudential supervisory practice

1.3.1. Compliance by investment firms with the quantitative standards

• Capital base

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

It should be borne in mind that the subordinated loans or the profits for the current financial year are not to be taken into account for the determination of the minimum capital base of a professional of the financial sector⁵.

Based on the financial data that the investment firms are required to provide to the CSSF on a monthly basis, the CSSF verifies, in particular, ongoing compliance of investment firms with the minimum capital base conditions. In 2020, the CSSF intervened at one investment firm for non-compliance with the legal provisions relating to capital base.

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

• Capital ratios

Investment firms falling within the scope of Circular CSSF 07/290 (as amended by Circulars CSSF 10/451, 10/483, 10/497 and 13/568) defining the capital ratios pursuant to Article 56 of the Law of 5 April 1993 on the financial sector and investment firms falling within the scope of the CRR⁶ must permanently fulfil the capital ratio requirements.

In 2020, the CSSF intervened at seven investment firms for non-compliance with the capital adequacy ratio. In the case of one investment firm, the CSSF had to intervene twice as the non-compliance occurred at two different reference dates. These entities regularised or are in the process of regularising the situation of non-compliance. 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 limits⁷, the CSSF did not have to intervene in 2020 with any CRR investment firm.

1.3.2. Introductory visits

Introductory visits are made at the premises of investment firms that recently received their authorisation and, where appropriate, of existing investment firms that received an authorisation to carry out a new activity in addition to existing authorisations. The purpose of these missions is to verify that the contemplated business plan is being followed and that the systems and infrastructures are correctly implemented. In 2020, the CSSF made three introductory visits which took place via teleconference due to the COVID-19 pandemic.

⁶ CRR investment firms do not fall within the scope of Circular CSSF 07/290 but must comply with the requirements of Directive 2013/36/EU of 26 June 2013 (CRD IV) and Regulation (EU) No 575/2013 of 26 June 2013 (CRR) as regards capital ratios and large exposure limits.

⁷ Large exposure limits are governed by the CRR (Part Four relating to large exposures). However, they do not apply to investment firms that comply with the criteria set out in Article 95(1) or Article 96(1) of the CRR.

2. Specialised PFS

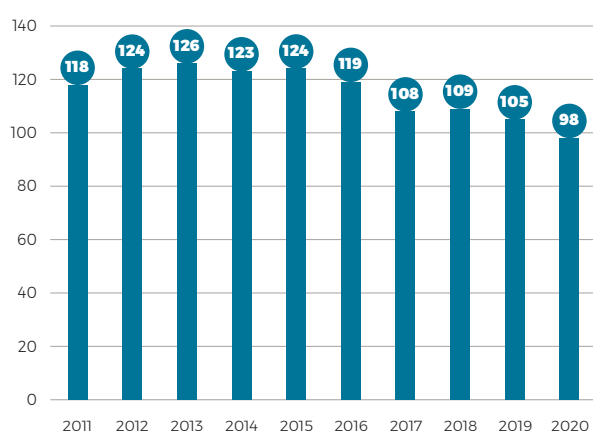
2.1. Development of specialised PFS in 2020

2.1.1. Development in the number of specialised PFS

During the year 2020, the number of specialised PFS decreased and reached 98 entities (against 105 entities at the end of 2019).

In 2020, four entities (six in 2019) were authorised as specialised PFS, including two entities that had been previously authorised as investment firm. However, 11 entities gave up their specialised PFS status during the year (10 in 2019), one of them having been absorbed by another specialised PFS in the context of a merger and another having received an authorisation other than as specialised PFS.

Development in the number of specialised PFS



Among the specialised PFS, the statuses of corporate domiciliation agent and professional providing company incorporation and management services are the most prevalent with 80 and 84 entities, respectively, authorised under these statuses as at 31 December 2020 (2019: 84 and 89 entities, respectively), followed by the status of registrar agent with 64 entities authorised at that date (2019: 63 entities).

2.1.2. Development in employment

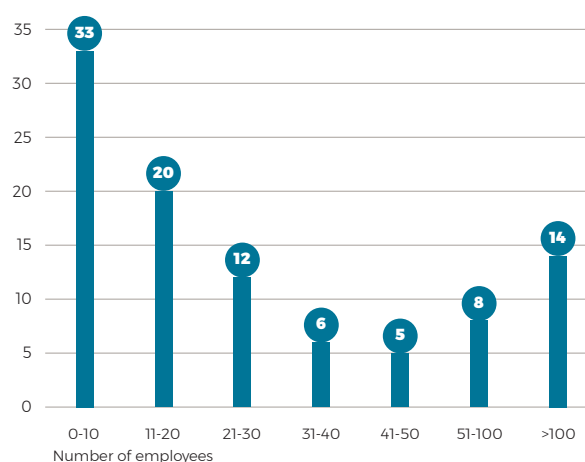
During 2020, the number of people employed by all specialised PFS rose by 293 to a total of 5,476 people, representing an increase of 5.6% as compared to the end of 2019.

Development in employment of specialised PFS

Year	Number of specialised PFS	Total staff
2011	118	3,127
2012	124	3,046
2013	126	3,201
2014	123	3,431
2015	124	3,787
2016	119	3,972
2017	108	4,008
2018	109	4,480
2019	105	5,183
2020	98	5,476

As at 31 December 2020, 14 specialised PFS employed more than 100 people (against 12 at the end of 2019) and 33 specialised PFS employed 10 or fewer people (against 38 at the end of 2019).

Breakdown of the number of employees per specialised PFS



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 81.76 million as compared to 2019 (-1.4%) is mainly attributable to one entity which gave up its authorisation during the year.

Over a one-year period, overall net results of specialised PFS fell by EUR 187.75 million (-66.2%). This variation mainly results from the restructuring and reorganisation of the activities of one specialised PFS during the course of the last quarter of 2019.

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

(in million EUR)	2019	2020	Variation in %
Balance sheet total	5,860.97	5,779.21	-1.4%
Net results	283.42	95.66	-66.2%

2.2. Prudential supervisory practice

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

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 2020, the CSSF identified cases of non-compliance with the legal provisions in this respect by five entities (against four entities in 2019). Their situation was regularised in a satisfactory manner.

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

In 2020, the CSSF intervened three times (against six in 2019) by way of observation letters due to situations of non-compliance in the day-to-day management of specialised PFS, notably linked, among others, to insufficient presence and/or effective involvement of one of the two managers in the day-to-day management of the entity or to the need for reorganisation of the entity's administrative or management body composition.

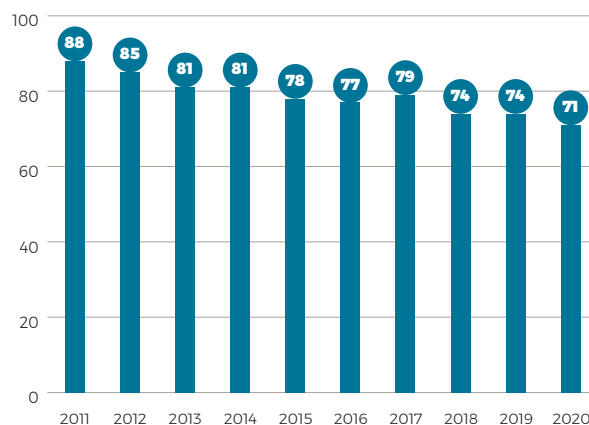
3. Support PFS

3.1. Development of support PFS in 2020

3.1.1. Development in the number of support PFS

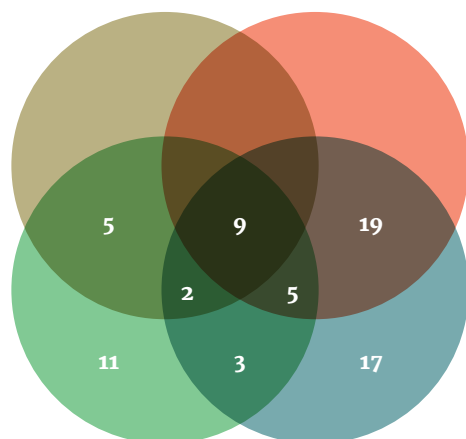
The number of support PFS was 71 as at 31 December 2020.

Development in the number of support PFS



One new support PFS was authorised in 2020. Three support PFS renounced their authorisation and one support PFS was deregistered from the official list following a merger.

Breakdown of support PFS by authorisation



- Administrative agents
- Primary IT systems operators
- Client communication agents
- Secondary IT systems and communication networks operators of the financial sector

As administrative agents are *ipso jure* authorised to carry out the activities of client communication agents, there is no entity that only has 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 operator of the financial sector.

3.1.2. Development in employment

The number of staff of support PFS dropped from 10,005 people as at 31 December 2019 to 8,987 people as at 31 December 2020. One support PFS employing a significant number of staff and which voluntarily gave up its authorisation explains almost alone this considerable reduction (-10.18%).

Development in support PFS employment

Year	Number of support PFS	Total staff
2011	88	8,679
2012	85	9,016
2013	81	8,971
2014	81	9,043
2015	78	9,218
2016	77	9,185
2017	79	9,656
2018	74	9,931
2019	74	10,005
2020	71	8,987

3.1.3. Development of balance sheets and net results

The balance sheet total of support PFS reached EUR 1,616.4 million as at 31 December 2020, against EUR 1,820.4 million as at 31 December 2019, i.e. a decrease of 11.20%.

The net results fell by 35.76%, from EUR 68.2 million as at 31 December 2019 to EUR 43.8 million as at 31 December 2020. This development is mainly due to the decrease of the net result of about 10 support PFS in the context of the COVID-19 pandemic. As regards the remainder of the population, half of the support PFS recorded a profit for 2020 and about 20 of them sustained slight losses.

3.2. Prudential supervisory practice

3.2.1. Qualification of activities and authorisation applications

The qualification of activities under the Law of 5 April 1993 on the financial sector is often the first contact between an entity and the CSSF and allows determining whether a business activity falls under the scope of the aforementioned law and, consequently, requires a ministerial authorisation. The CSSF processes on average several tens of qualifications of activities and related questions per year. When the CSSF qualifies an activity as activity subject to the law, it informs the entity thereof and the authorisation procedure starts.

In 2020, the CSSF received eight applications for authorisation as support PFS and two applications for the extension of authorisation. One of these

applications was withdrawn in the course of the year, one extension of authorisation was finalised and eight other applications are at various stages of the examination procedure.

3.2.2. Main prudential findings

During 2020, 92 changes subject to a notification obligation and a prior authorisation by the CSSF were processed by the department in charge of the supervision of support PFS. Out of these changes, 13 (i.e. 14%) were made without notification or prior authorisation, which represents a slight improvement compared to 2019 when this percentage reached 20%. The CSSF reminded the entities of their obligations in this respect. Well aware of the efforts support PFS are required to make in respect of the regulatory monitoring, the CSSF will follow the behaviour in this matter and apply the administrative measures in a proportionate manner, taking into consideration in particular the activity, risks, governance, internal control and size of the entities concerned.

Moreover, several recurring infringements were noted in the framework of the prudential supervision of support PFS, such as the failure to transmit the prudential reporting or closing documents within the imposed time limit. Although some tolerance exists especially due to the pandemic, the CSSF warns the offenders and sanctions in case of repeated infringements.

Following the circular-letter addressed to support PFS in January 2020, the CSSF still observed many infringements concerning the internal audit, particularly with respect to the permanent nature of the internal audit function within support PFS and the extent of the internal audit's work carried out which still does not sufficiently cover the activities requiring an authorisation. The CSSF will intensify its measures in this context in 2021.

Finally, the COVID-19 pandemic generated sometimes significant delay in the work of the *réviseurs d'entreprises agréés* (approved statutory auditors) and of the outsourced internal auditors. Extensions were granted by the CSSF in order to accompany support PFS in the management of this unprecedented crisis.

3.2.3. Introductory visits

Introductory visits are made at the premises of support PFS that recently received their authorisation and, where appropriate, of existing support PFS that received an authorisation to carry out a new activity in addition to existing authorisations. The purpose of these missions is to verify that the contemplated business plan is being followed and that the systems and infrastructures are correctly implemented. In 2020, the CSSF visited one support PFS. Given the COVID-19 pandemic, this introductory visit took place remotely. A final introductory visit will be scheduled later and will allow the CSSF in particular to visit the premises of the support PFS.

3.2.4. Cyberattacks

Support PFS are no exception and, like the other financial sector players in many countries, they were the targets of an increasing number of cyberattack attempts. As the support PFS provide services to many financial sector entities, the latter can in turn be affected by a cyberattack targeting a support PFS.

In 2020, six support PFS were victims of such attacks which were more or less sophisticated and which sometimes significantly affected the services provided to their clients.

In this context, the CSSF would like to remind the support PFS of the importance to implement cybersecurity hygiene and to comply in particular with the requirements of Circular CSSF 20/750 on requirements regarding information and communication technology (ICT) and security risk management.





VIII. Supervision of payment institutions and electronic money institutions

1. Regulatory framework and supervisory practice

The Law of 10 November 2009 on payment services imposes authorisation, exercise and supervisory conditions on payment institutions and electronic money institutions that provide payment services or that issue electronic money.

The CSSF's prudential supervision aims to verify that payment institutions and electronic money institutions subject to its supervision continuously observe legal and regulatory provisions relating to their organisation and operations, with the objective of ensuring the protection of payment service users and electronic money holders as well as the stability of the financial system. In this regard, the CSSF notably attaches particular importance to the establishment, by these institutions, of stable and performing mechanisms for safeguarding the funds of payment service users and electronic money holders.

During 2020, the CSSF continued its supervisory actions aimed at controlling that the deployment of IT solutions by payment institutions and electronic money institutions ensured the security of the transactions and of the secure access to online payment accounts in compliance with the rules stemming from the transposition of Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (PSD2).

2. Payment institutions

During 2020, two new payment institutions were listed in the public register of payment institutions and two institutions were withdrawn from it. A total of 12 payment institutions incorporated under Luxembourg law were thus listed in the public register of payment institutions as at 31 December 2020 (*idem* as at 31 December 2019). Moreover, there were 11 branches established in other EU Member States by three of these authorised institutions as well as two branches established in Luxembourg by payment institutions authorised in other EU Member States.

The total balance sheet of payment institutions amounted to EUR 2.1 billion as at 31 December 2020, representing a 102% increase compared to the end of 2019 when the total balance sheet reached EUR 1 billion. This significant increase is notably linked to the development of the payment services of two institutions recently established in Luxembourg.

Employment within the payment institutions remained relatively stable and increased by 1% during 2020.



3. Electronic money institutions

A total of nine electronic money institutions were listed in the public register of electronic money institutions authorised in Luxembourg as at 31 December 2020 (against eight as at 31 December 2019). Moreover, there was one branch of an electronic money institution authorised in Luxembourg established in another EU Member State, as well as two branches established in Luxembourg by electronic money institutions authorised in other EU Member States.

The total balance sheet of electronic money institutions amounted to EUR 3.7 billion as at 31 December 2020, representing a 67% increase compared to the end of 2019 when the total balance sheet reached EUR 2.2 billion.

Employment within the electronic money institutions increased by 13% in 2020.

IX. Supervision of investment fund managers and UCIs

1. Key figures for 2020

1.1. Investment fund managers (IFMs)

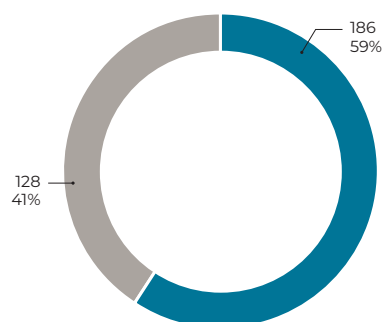
314

authorised IFMs as
at 31 December 2020

€ 5,289.2 bn

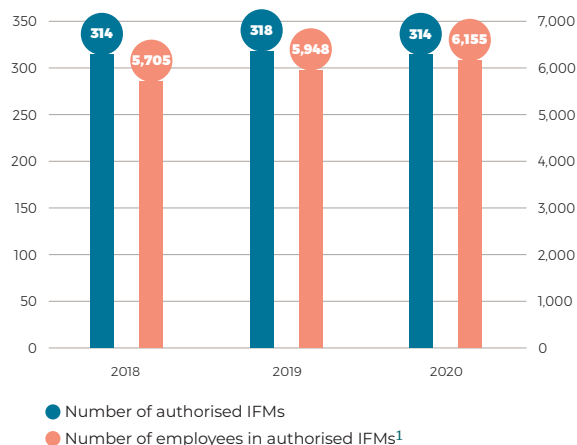
assets under management,
of which 82.7% managed
by authorised IFMs

Breakdown of authorised IFMs by category

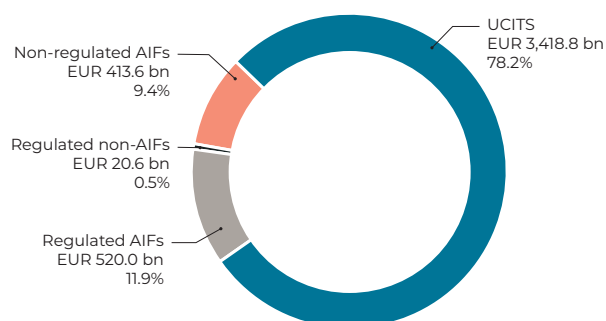


- Management companies subject to Chapter 15 of 2010 Law and, where applicable, to the 2013 Law
- Authorised alternative investment fund managers subject to the 2013 Law

Evolution of the number of authorised IFMs and of their employees



Breakdown of assets managed by authorised IFMs by type of investment vehicle



¹ The total staff figures of authorised IFMs do not include staff of these IFMs' branches.

1.2. Undertakings for collective investment (UCIs)

3,611

UCIs registered on the official list as at 31 December 2020

14,590

fund units

€ 4,973.8 bn

net assets

1.3. Prudential supervision

334

interventions related to off-site supervision of UCIs

46

on-site inspections at IFMs, covering 42% of the total assets managed by authorised IFMs

5

sanctions imposed on IFMs

1.4. AML/CFT

49

face-to-face meetings

13

AML/CFT on-site inspections

1,200

AML/CFT surveys analysed

> 2,000

off-site supervision measures

850

participants in the first virtual AML/CFT conference on collective management

2. Major events in 2020

2.1. COVID-19 pandemic and investment funds in Luxembourg

From the end of February to the end of March 2020, the Luxembourg investment fund sector was impacted by significant adverse market conditions linked to the considerable uncertainties related to the COVID-19 pandemic development. These uncertainties resulted in an important increase in financial markets volatility, associated with a very sharp drop in the valuations of different types of assets, including, in particular, equity and bond indices.

In this context, certain market segments, as for example corporate bonds, high-yield bonds, emerging market bonds or money market instruments, experienced material liquidity stress combined notably with significantly higher transaction costs and bid/ask spreads.

This context of high market, liquidity, credit and operational risks, together with a COVID-19 spread requiring IFMs to activate their business continuity plans and to rely on teleworking in order to protect their employees' health, represented an unprecedented situation for the investment fund industry.

2.1.1. Materialisation of risks for Luxembourg investment funds

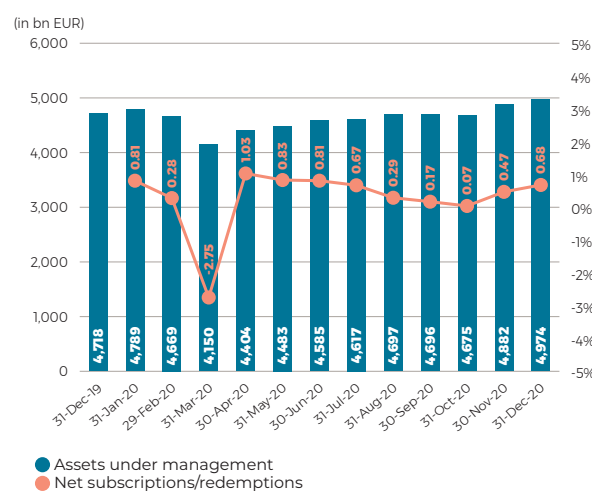
As a result of the COVID-19 related developments, the total net assets of Luxembourg regulated funds recorded a decrease of EUR 519 billion (-11.1%) during the month of March 2020, from EUR 4,669 billion at the end of February to EUR 4,150 billion at the end of March. This decrease represents the sum of negative net capital investments amounting to EUR 128 billion (-2.7%) and of the negative development in financial markets amounting to EUR 391 billion (-8.4%).

The COVID-19 crisis thereby mostly impacted the valuation of assets held by Luxembourg regulated investment funds. Despite the fact that higher levels of redemption requests were recorded, the latter remained overall limited if considering the important movements that could be seen on financial markets.

As a consequence of the important support measures taken by governments, central banks

and supervisory authorities to stabilise financial markets in a context of uncertainties and adverse movements, financial markets performed a swift recovery and stabilisation, which contributed to the positive development of the assets under management of Luxembourg investment funds as from April 2020.

Monthly evolution of assets under management and net subscriptions/redemptions since the end of 2019



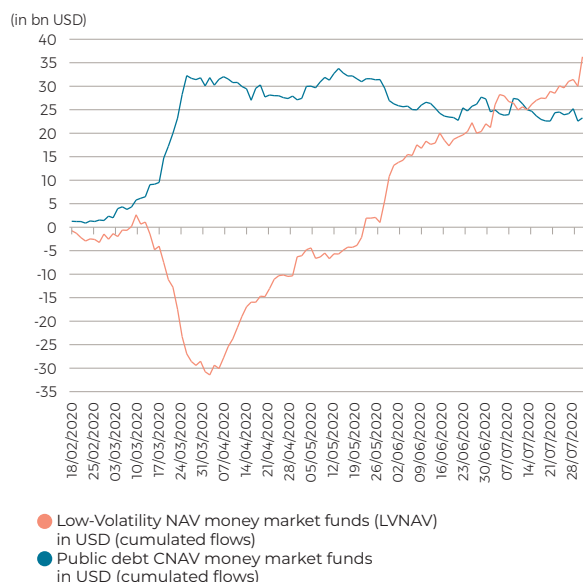
Negative market variations impacted all equity UCI categories during the month of March, with decreases ranging from -6.7% for Japanese equity UCIs to -35.3% for Latin American equity UCIs. The global market equity UCI category, the most important in terms of net assets, recorded a market variation of -10.8%. As far as bond UCI categories are concerned, UCIs investing in emerging markets (-13.7%) and high-yield bonds (-12.9%) recorded the most significant market variations over this period.

As for capital movements, the equity UCI categories registered outflows ranging from -1.7% for global market equities to -6.5% for Japanese equities. For bond UCI categories, the highest levels of redemptions over this period were recorded for high-yield bonds (-8.5%) and emerging market bonds (-7.7%), whereas global market bonds registered redemptions of -4.2%.

In March 2020, money market funds experienced capital inflows for EUR-denominated funds (+14.1%) and global market funds (+3.6%), whereas USD money market funds reported capital outflows of -1.7%. However, the USD money market fund situation conceals the important developments that these funds were confronted with in March: significant redemptions (USD -28.9 billion) for Low-Volatility NAV money market funds (LVNAV) and nearly symmetrical subscriptions (USD + 29.5 billion) in public debt CNAV money market funds, as illustrated in the graph below, which refers to a representative sample of money market funds. This flight-to-quality movement was linked to the strong COVID-19 related uncertainties that investors had to face in March 2020.

No Luxembourg-domiciled LVNAV money market fund had to use gating or to impose liquidity fees, or even suspend redemptions. Moreover, the constant net asset value per unit or share of these funds did never break the 20-basis point collar on the variable net asset value per share or unit.

Cumulated flows of Low-Volatility NAV money market funds (LVNAV) and public debt CNAV money market funds in USD²



² This graph is based on an ad hoc reporting covering 22 money market funds in USD, EUR and GBP, representing around 70% of Luxembourg money market funds in terms of net assets at the end of March 2020.

In March 2020, Luxembourg UCIs were able to make use of the great variety of liquidity management tools (LMT) at their disposal, allowing them to overcome this challenging period and to withstand the turbulences on the financial markets.

Luxembourg UCIs invoked gating in a limited number of cases only and they proceeded to suspensions on an extremely exceptional basis, the most used liquidity management tool having been swing pricing. This tool proved to be particularly important to face the significant increases in transaction costs which investment funds had to cope with during the period of market turmoil and it allowed IFMs to allocate these transaction costs fairly and in an appropriate manner to incoming/outgoing investors.

2.1.2. COVID-19 related initiatives and contributions by the CSSF

With the intensification of the financial markets downturns as of the week of 9 March 2020 linked to the deep concern on the impact of the COVID-19 pandemic on economic developments, the CSSF reinforced its market and risk supervision at national level, notably through a close follow-up of the major IFMs.

Moreover, the contacts with the regulators of other jurisdictions have been intensified, either in the framework of bilateral exchanges, or in the context of the many European and international fora in which the CSSF participates.

• National initiatives

The CSSF's action was in particular based on a very close initial contact with a panel composed of the 60 major IFMs (representing 80 to 85% of the net assets), which has been extended to 122 IFMs (representing around 90% of the net assets), requesting, in particular, daily information and data on the significant developments and issues faced (as, for example, redemptions or liquidity issues) in relation to the funds managed by them as well as on the decisions and measures taken to address them (such as the use of liquidity management tools).

On 9 April 2020, the CSSF also issued a new weekly questionnaire for IFMs in order to collect financial data on UCIs under management (total net assets, subscriptions and redemptions) and requesting an update on the governance arrangements relating to the activities performed in view of the specific

circumstances and risks to which IFMs were exposed.

A daily supervision of money market funds has also been put in place since the beginning of the COVID-19 crisis.

To support the Luxembourg investment fund industry in the challenging environment brought about by the COVID-19 crisis, the CSSF provided a whole set of regulatory clarifications through the publication of FAQs on swing pricing, regulatory VaR breaches and other public-interest topics.

• European and international initiatives

Throughout 2020, the CSSF contributed to European and international cooperation through intensified and frequent exchanges with the national competent authorities of other countries.

The CSSF also actively participated in meetings organised by ESMA, IOSCO and other international bodies on the development of the COVID-19 crisis, the issues and risks the industry had to face and the work relating, for instance, to liquidity risk or the use of liquidity management tools.

2.2. Work on liquidity risk in investment funds

The regulatory framework applicable to investment funds requires from IFMs the implementation of robust liquidity risk management methods in order for them to meet redemption requests by investors and payment obligations resulting from the portfolio transactions carried out by IFMs. This framework meets the objectives of financial stability, investor protection and orderly functioning of financial markets as defined by financial regulation.

An extensive work programme has been implemented over the last years in the different international fora (FSB, IOSCO, ESRB, ESMA) as regards liquidity risk management in open-ended investment funds, and this, in particular, as a consequence of the significant increase in assets under management associated with a search for yield in a low-interest rate environment and the materialisation of liquidity risk for individual investment funds.

With the COVID-19 pandemic and the developments on the financial markets, liquidity risk in investment

funds was, once again, a topic on the agenda of European and international regulators with an intensification of the work carried out in 2020.

2.2.1. Common Supervisory Action - UCITS' liquidity risk management

On 30 January 2020, ESMA launched a Common Supervisory Action (CSA) with national competent authorities, including the CSSF, on the supervision of UCITS' managers liquidity risk management across the EU. This CSA, which had already been planned in 2019 by ESMA, aimed at assessing whether market participants adhere to the liquidity risk management rules in their day-to-day business.

The exercise comprised two stages. First, the CSSF requested quantitative data from 155 UCITS managers based in Luxembourg to get an overview of the liquidity risks faced. Then, it focussed on 51 UCITS managers and on a sample of more than 400 UCITS to carry out more in-depth analyses.

This exercise revealed that the liquidity risk management processes of UCITS managers established in Luxembourg are overall compliant with the regulations in force. Nevertheless, it also allowed identifying the need for improvement of certain practices observed, in particular as regards the regulatory provisions concerning pre-investment liquidity controls to be implemented, as provided for in Article 26(4) of CSSF Regulation No 10-04.

Moreover, additional efforts are still needed as regards the description of the liquidity risk management processes that is integrated in the internal procedures, including the quality and reliability control arrangements of the data used.

Lastly, certain aspects of UCITS managers' governance still need to be improved. On the one hand, the documentation on the liquidity risk assessment performed when launching new products must be more exhaustive. On the other hand, the relevance of the thresholds used in the escalation process must be reviewed. Indeed, the CSSF noted that a rather small number of liquidity threshold crossings have been reported to the senior management during the period of high market volatility related to the COVID-19 pandemic. In addition, the control arrangements of the liquidity risk management process by level 2 and level 3 control functions (in particular the

compliance and internal audit functions) must be strengthened and carried out more frequently. Finally, the procedures must further describe the process and include, where applicable, a written explanation of the liquidity risk in the different contractual documents received by investors, in particular the Key Investor Information Document (KIID).

2.2.2. ESRB regulatory measures as a response to the COVID-19 pandemic

On 6 May 2020, the ESRB (European Systemic Risk Board) published a recommendation to the attention of ESMA and national competent authorities to focus on liquidity risk in investment funds and to perform a related analysis, whose conclusions were to be reported to the ESRB.

Finalised in November 2020, the ESMA report, which included a specific analysis of the investment funds exposed to corporate debt and real estate assets after the impact of the COVID-19 pandemic, seeks primarily to assess the preparedness of these types of funds to potential future adverse shocks.

For Luxembourg, the analysis covered 204 investment funds exposed to corporate debt, managed by 57 Luxembourg IFMs (representing a total of EUR 740.2 billion net assets as at 31 December 2019), as well as 17 open-ended real estate funds, managed by 13 Luxembourg AIFMs (representing around EUR 53 billion net assets as at 31 December 2019). In both cases, the scope was limited to funds with more than EUR 1 billion of assets under management.

The CSSF's conclusion was that the Luxembourg investment funds under review are relatively well prepared to potential future adverse shocks. The analyses notably revealed that only a limited number of the analysed funds had to be suspended, mostly as a consequence of valuation issues, while the vast majority of the funds was able to meet redemptions requests and maintain its portfolio structure.

However, these results must be interpreted with caution since the COVID-19 related shock was concentrated over a short period of time, amid significant support measures by governments, central banks and supervisory authorities.

In its report to the ESRB, ESMA, in cooperation with the national competent authorities, notably identified the following priority areas to ensure continuity in the work performed:

- ongoing supervision by IFMs and national competent authorities of the alignment of the funds' investment strategy, liquidity profile and redemption policy;
- ongoing supervision by national competent authorities of the liquidity risk assessment by IFMs, with a particular attention, in this context, that all factors impacting this assessment are taken into account by IFMs (for instance margin calls);
- provision, in the context of the AIFMD review, of additional specifications on how liquidity profiles should be established on the asset and liability side and reported by AIFMs as part of the AIFM reporting;
- increased availability and use of liquidity management tools, as indicated in ESMA's letter to the European Commission with regard to the review of the AIFMD;
- performance of further supervisory activities by national competent authorities at the level of valuation processes in a context of valuation uncertainty.

2.2.3. Ad hoc survey on real estate funds

In June 2020, in the context of the prudential supervision of real estate investment funds (REIFs) and the specific risks to which these funds were exposed as a consequence of the COVID-19 related market conditions, the CSSF launched an ad hoc survey addressed to the 20 largest IFMs (18 Luxembourg IFMs and two non-Luxembourg IFMs) managing Luxembourg regulated REIFs (i.e. 43 REIFs, representing around EUR 76 billion net assets as at 31 December 2019) in order to gather relevant information on the key characteristics of these regulated REIFs on liquidity management, the valuation issues encountered and the use of leverage as well as any other major issue having an impact on all types of REIFs (regulated or not) managed by these IFMs.

The main findings of this survey, which covered the period from March to June 2020, were the following:

- the amount of subscription requests was overall higher than the amount of redemption requests for the REIFs surveyed;
- 40% of the IFMs of the sample had not included provisions for valuation under stressed market conditions in their valuation policy;
- 28% of the REIFs under review experienced material distortions with respect to incoming cash-flows (e.g. non-payment of rents);
- 19% of the REIFs under review using leverage experienced difficulties with meeting covenants obligations linked to significant loans for these REIFs.

2.2.4. Regulatory developments - liquidity risk

On 16 July 2020, ESMA published its Guidelines on liquidity stress testing in investment funds (ESMA Ref. 34-39-897) which have been implemented in Circular CSSF 20/752 of 29 September 2020.

An annual update of the guidelines on money market funds stress tests has been published by ESMA on 16 December 2020.

2.3. Brexit

The beginning of the year 2020 was marked by the entry into force, on 1 February 2020, of the withdrawal agreement between the EU and the UK which sets the conditions of the orderly withdrawal of the UK from the EU, in accordance with Article 50 of the Treaty on the EU.

This agreement notably provided for a transition period, from 1 February 2020 to 31 December 2020, during which the EU considered the UK as a Member State, with the exception of the participation in EU institutions and governance structures. The EU and the UK worked during this period on the negotiation of the trade and cooperation agreement.

The work of the CSSF in this context focussed on two major areas: (i) ensuring the preparedness of the players concerned at the end of the transition period, and (ii) defining the access to the Luxembourg market for service providers

established in the UK in order to preserve its orderly functioning.

• Anticipating the end of the transition period

The CSSF published a series of communications reminding the market that, as from 31 December 2020, EU law would cease to apply to UK entities providing their services in Luxembourg and inviting the players concerned to use the transition period to finalise their preparations.

Thus, UCIs and/or their IFMs authorised under the UCITS Directive or under the AIFMD established in the UK have been requested to anticipate the end of the transition period and the loss of their existing passporting rights under the aforementioned directives, and, in particular, to provide an alternative (i) to the lapse of their passporting rights applicable to cross-border management, and (ii) to the lapse of their passporting rights applicable to the cross-border distribution of UCI shares or units in Luxembourg.

In this context, it appears that only a small proportion of IFMs concerned regularised their situation, either by notifying the CSSF of their intention to cease the provision of cross-border marketing activities on the Luxembourg territory, or by submitting the appropriate notification under Article 36 or Article 42 of the AIFMD.

• Providing a framework governing the access to the Luxembourg market to preserve its orderly functioning

In its press release 20/26, the CSSF reiterated that Luxembourg managers may still delegate portfolio management services to a third party established in a country outside the EU, provided certain conditions are met, notably the existence of cooperation agreements between the CSSF and the supervisory authority of the country concerned.

In 2019, the CSSF ensured the fulfilment of the cooperation condition through the signature of a multilateral memorandum of understanding (MMoU), initiated by ESMA, between the EU supervisory authorities and the UK Financial Conduct Authority (FCA). This agreement, which was initially drawn up to anticipate the UK leaving the EU without a withdrawal agreement, has been confirmed by ESMA to come into effect at the end of the transition period.

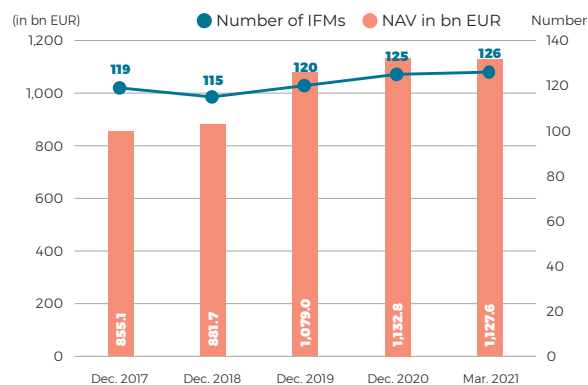
In parallel, and in order to provide a framework governing the access to the Luxembourg market by service providers established in the UK, the CSSF published Circular CSSF 20/743, amending Circular CSSF 19/716, in order to clarify the procedures that third-country firms must comply with to provide, in Luxembourg, investment services or to perform investment activities, and to propose ancillary services to investment services in accordance with Article 32-1 of the Law of 5 April 1993 on the financial sector. It should be noted that third-country firms acting based on a delegation contract for one or several IFMs established in Luxembourg must also apply the provisions set out in Circular CSSF 20/743.

In this context, the publication of CSSF Regulation No 20-09 of 14 December 2020 on the equivalence of the UK with respect to supervision and authorisation rules allowed UK service providers to access the Luxembourg market. Henceforth, the firms established in the UK providing investment services to Luxembourg UCIs may benefit from the regime laid down in the second subparagraph of Article 32-1(1) of the aforementioned Law of 5 April 1993 (known as “national MiFIR regime”).

The national MiFIR regime allows offering greater legal certainty to entities established in the UK and providing investment services to Luxembourg UCIs, in particular entities acting as portfolio managers under a delegation contract concluded with an IFM authorised in Luxembourg. However, these delegates are only concerned by the national MiFIR regime if the service performed is effectively provided on the territory of Luxembourg, in accordance with Part III of Circular CSSF 19/716, as amended, which allows preserving some flexibility in the access to the Luxembourg market for these providers.

Based on the data available, the number of delegations to portfolio managers established in the UK appears to be rather stable.

Evolution of the number of Luxembourg IFMs relying, by way of delegation, on a UK-based portfolio manager



Generally speaking, the level of preparation of the relevant market players is adequate, even though some efforts still need to be done, notably on certain marketing aspects. In 2021, the CSSF will continue its work in order to monitor the situation and to continue cooperating with the UK supervisory authorities.

• Establishment of UK market players in Luxembourg in the context of Brexit

As a consequence of the UK's withdrawal from the EU, a number of groups of UK origin introduced either a new application file for the establishment of an IFM in Luxembourg, or an application file for the extension of their activities and services provided in Luxembourg. As the effective date of the withdrawal of the UK from the EU was uncertain, a significant number of applicants already anticipated, in 2019, the effects of Brexit on their business continuity. For this reason, the number of authorisation files linked to Brexit decreased in 2020. During the last quarter of 2020, about 10 market players actually started their activities as foreseen in the business plans attached to the authorisation files.

In the context of the relocation of UK market players to the EU, the authorisation files have been presented since 2017 on an anonymous basis within ESMA's Supervisory Coordination Network (SCN). Among these files, a significant number of IFMs were already active in Luxembourg, either via investment funds, or via other entities.

The SCN was established in 2017 within ESMA to provide a forum for discussing matters linked to the relocation of entities established in the UK to

the EU. Its main mission was to foster exchange and convergence among national regulators, in particular on topics related to minimal substance requirements, sound organisation and delegation for entities seeking partial or total relocation of their activities, and to prevent any situation of regulatory arbitrage between regulators. The CSSF participated in the meetings of the SCN, which were usually held on a monthly basis. The SCN's mandate came to an end in 2020. The SCN was considered as an ideal forum which enabled setting up an inventory of the Brexit files submitted across the EU and fostering convergence between regulators as regards authorisation and their supervisory approach.

In the context of the bilateral relations between Luxembourg and the UK, Luxembourg-based managers intending to continue providing activities in the UK as from its withdrawal from the EU have been invited to register under the Temporary Permissions Regime with the FCA.

2.4. Environmental, Social, and Corporate Governance (ESG)

As regards ESG in the investment funds area, 2020 and 2021 are characterised by the alignment of IFM and investment fund activities as investment products with the regulatory expectations of the different levels of EU legislation in the area of sustainable finance.

Step-by-step compliance with Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (Disclosure Regulation) and, at a later stage, also with Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation) are a supervisory priority for the CSSF in this area.

Compliance with these requirements appears to be particularly complex, as the two regulations are not specifically addressed to the asset management sector and as regulations and their relevant technical standards come into force step-by-step and according to an evolving agenda. After it has been clarified, in October 2020, that the Disclosure Regulation would enter into force on 10 March 2021, the CSSF published a communiqué³ which

provided explanations on the procedures to follow, in particular as regards disclosure requirements in the pre-contractual documentation of UCITS and AIFs. This communiqué also introduced a fast-track procedure for the submission of amendments to the pre-contractual documents for existing UCITS and AIFs to the CSSF, in order to ensure that the amendments required from all investment funds may be implemented before the application date of 10 March 2021.

Compliance with all the aspects of the different levels of legislation concerning the Disclosure Regulation and Taxonomy Regulation remains a priority in the supervisory action of the CSSF for the coming years. In this context, the CSSF is working in close cooperation with EU bodies to ensure a consistent implementation of the regulation throughout the different Member States and a smooth functioning of passporting rights available to IFMs.

2.5. AIFMD review

On 22 October 2020, the European Commission launched a public consultation on the review of the AIFMD, which ended on 29 January 2021, and in which the CSSF participated through the submission of proposals recasting certain articles of that Directive. The CSSF noted that the regulatory framework of AIFMD, including the applicable provisions on delegation, is functioning properly. For this reason, most comments referred to the update, clarification or simplification of certain provisions of that Directive. However, the CSSF also expressed its point of view on the risks resulting from the introduction of the depositary passport and from the opening of the AIF environment to a larger pool of investors.

³ www.cssf.lu/en/2020/12/communication-on-regulatory-requirements-and-fast-track-procedure-in-relation-to-regulation-eu-2019-2088-on-the-sustainability-related-disclosures-in-the-financial-services-sector/.

3. Prospects for 2021

3.1. Common Supervisory Action by ESMA on costs and fees of UCITS

Since 2019, ESMA has been carrying out Common Supervisory Actions (CSA) to promote supervisory convergence, based on the EU's strategic supervisory priorities and on the needs identified by its permanent committees. These supervisory actions are coordinated between national authorities and defined according to an area of focus and a common methodology.

After having identified costs and performance of retail investment products as one of the strategic supervisory priorities of the EU at the end of 2020, ESMA launched a Common Supervisory Action with national competent authorities on the supervision of costs and fees of UCITS across the EU on 6 January 2021. This exercise also aims at ensuring that management companies using techniques and instruments employed by UCITS for the purpose of an efficient portfolio management comply with the regulatory requirements set out in Circular CSSF 14/592 implementing the ESMA Guidelines on ETFs and other UCITS issues (ESMA/2014/937).

In the context of this CSA, the CSSF's 2021 supervisory work will consist in assessing the compliance of supervised entities with the cost-related provisions in the UCITS framework and the obligation of not charging undue costs to investors.

The CSSF launched the first phase of this CSA with a sample of Luxembourg-based UCITS managers, requesting them to fill out a questionnaire for all the UCITS they manage. This questionnaire refers in particular to the establishment and implementation of the pricing process, the regulatory documents communicated to investors and the relevant control arrangements. The analysis of the answers will allow identifying the supervised entities that do not meet the CSSF's expectations, which may result, where appropriate, in the CSSF imposing injunction measures, or even sanctions, if regulatory breaches or vulnerabilities are confirmed.

3.2. Revision of the long form report for investment funds and of the management letter, and its impact on IFMs and UCIs

The purpose of the revision of the long form report and of the management letter is to improve the risk-based supervision for IFMs and UCIs and the channels for the electronic transmission of documents to the CSSF.

The CSSF will publish specific regulatory texts detailing these revisions and their practical arrangements in 2021.

3.2.1. Revision of the UCI long form report

Over the last twenty years, legal, regulatory and prudential provisions applicable to IFMs and UCIs have become increasingly stringent. As such, IFMs had to constantly tighten the requirements on, inter alia, financial soundness, governance, substance, organisation, internal control and supervision of delegates.

In this context, the CSSF deemed it useful to revise the long form report as provided for in Circular CSSF 02/81 and to implement new prudential supervisory tools for IFMs and UCIs.

To that end, it is planned to introduce self-assessment questionnaires to be filled out on an annual basis by IFMs and UCIs (UCIs governed by Part I and Part II of the 2010 Law, SIFs and SICARs). It is also envisaged that the *réviseurs d'entreprises agréés* (approved statutory auditors) mandated by IFMs and UCIs issue a report in which they describe their analysis and controls performed in accordance with agreed-upon procedures on certain questions of the self-assessment questionnaire.

Moreover, in the context of its AML/CFT supervision, the CSSF introduced an external AML report to be filled in by the *réviseur d'entreprises agréé* for the entities that complete, on an annual basis, the AML Survey (also RBAC questionnaire). The purpose of this new report is to facilitate the work of the *réviseurs d'entreprises agréés* by providing a common methodology and optimising the supervision of the relevant entities via the use of a technological tool allowing a more detailed analysis.

3.2.2. Revision of the management letter issued by the *réviseurs d'entreprises agréés* of IFMs and UCIs

For the purpose of harmonising practice and optimising the prudential supervision of IFMs and UCIs, it is planned to develop the regulatory framework relating to the management letter issued by *réviseurs d'entreprises agréés* of IFMs and UCIs. These developments, which do not modify the nature of the auditors' work, mainly concern the layout and format of the document, and will allow the CSSF to obtain the necessary information to improve the risk-based supervision of these entities.

3.3. Revision of the G2.1 reporting

In 2020, the CSSF launched a project redrafting the prudential reporting to be transmitted by IFMs on a quarterly basis, in accordance with Circulars CSSF 10/467 and CSSF 15/633.

This project was undertaken as a consequence of the legal and regulatory developments requiring an update of the reporting tables in force since 2010. The review process was also initiated with a view to strengthening the ongoing supervisory measures related to IFMs, which necessarily implies that further and more granular information needs to be collected. Hence, the reporting tables will be further developed, in particular as concerns retrocessions, and new tables will be inserted to collect the financial and non-financial information required for the supervision of IFMs. As concerns accounting information (balance sheet and profit and loss accounts), convergence with the statutory format of annual accounts currently applicable in Luxembourg and with the Luxembourg chart of accounts will be favoured.

The CSSF will also provide the industry with precise guidance on how to fill in the tables.

The obligation to transmit this new reporting will be laid down in a unique circular which will replace Circulars CSSF 10/467 and 15/633 with an expected implementation in 2022.

The CSSF involved representatives of the investment fund industry in its prudential reporting redrafting process. In this context, some market players expressed their need to collect statistical information in order to have a more detailed view of certain types of assets, in particular in the areas of Real Estate, Debt and Private Equity. The CSSF

intends to support this request, which will be carried out as a separate data collection project, out of the scope of the quarterly prudential reporting.

4. Prudential supervisory practice

The CSSF's prudential supervision aims to ensure that IFMs and UCIs subject to its supervision continuously observe all legal, regulatory or 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 with the supervised entities.

4.1. Off-site supervision of IFMs

4.1.1. Supervision based on quarterly and annual financial information (G2.1 reporting)

In the framework of its prudential supervision, the CSSF noted shortcomings as regards the transmission of financial information that must be submitted to the CSSF on a quarterly and annual basis in accordance with Circulars CSSF 10/467 and 15/633.

The CSSF stresses that any IFM that does not comply with the applicable legal requirements risks a reminder from the CSSF which may lead to sanctions and other administrative measures pursuant to Articles 148 and 149 of the 2010 Law and to Article 51 of the 2013 Law.

4.1.2. Supervision based on closing documents

In the framework of its prudential supervision, the CSSF observed shortcomings as regards the transmission of closing documents by the IFMs.

In this context, the CSSF recalls that the closing documents that must be transmitted are listed under point 3 of Annex 2 to Circular CSSF 18/698 and that the conditions governing their electronic transmission are specified in Circular CSSF 19/708. This Annex also lists the documents that must be transmitted by electronic means only as well as the type of document, the relevant nomenclature and the format.

Thus, closing documents must be provided yearly, within five months following the end of the IFM's financial year, except for the audited annual report and the management letter which must be submitted within one month after the ordinary general meeting that approved the IFM's annual accounts and seven months after the closing date of the IFM's financial year at the latest. The person filing the documents is responsible for the content and format of the documents and hard copies are no longer accepted by the CSSF.

The CSSF stresses that any IFM that does not comply with the applicable legal requirements risks a reminder from the CSSF which may lead to sanctions and other administrative measures pursuant to Articles 148 and 149 of the 2010 Law and to Article 51 of the 2013 Law.

4.2. Off-site supervision of UCIs

4.2.1. Supervision based on annual reports, management letters and long form reports

In the framework of the review of annual reports, management letters and long form reports⁴, the CSSF had to intervene at the level of certain funds and/or their IFMs and had to take decisions in the form of injunctions, formal requests and recommendations regarding the *dirigeants* (management body of the fund) of certain UCIs and/or their IFMs. These interventions and decisions aimed notably at addressing the deficiencies raised by the *réviseurs d'entreprises*

agrés (approved statutory auditors) in the annual reports, management letters and long form reports.

In 2020, the CSSF sent 334 letters and emails with the aim of analysing the deficiencies identified during the review of these documents, following up on the measures implemented and/or requiring corrective measures in order to remedy these deficiencies.

The CSSF's interventions concerned, inter alia, investment valuation, compliance with investment restrictions and policies, AML/CFT arrangements, costs/fees, governance as well as transparency and information to be disclosed in the funds' annual reports.

In addition to these formal interventions regarding more critical files and pursuant to a risk-based supervision, the CSSF also intervened via email or telephone call to clarify or deal with less critical deficiencies.

The following chart highlights, per type of closing document, the number of documents received in 2020 in which one or several exceptions were noted by the *réviseur d'entreprises agréé* and which were subject to a review and/or intervention by the CSSF.

Number of closing documents with or without exceptions noted in 2020

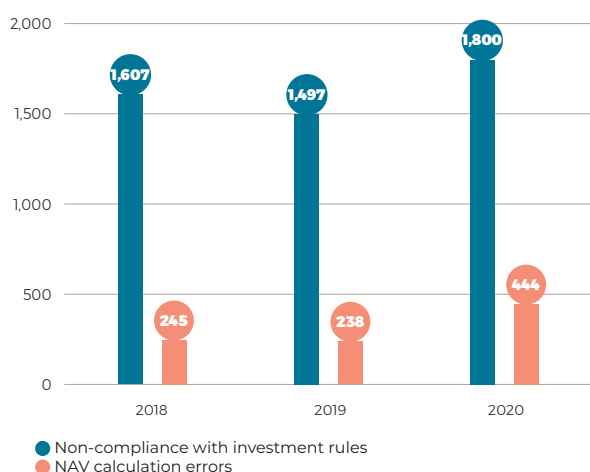


⁴ While the annual reports and management letters concern UCI(TS), SIFs and SICARs, the long form reports only concern UCIs subject to the 2010 Law, i.e. UCITS Part I and UCIs Part II.

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

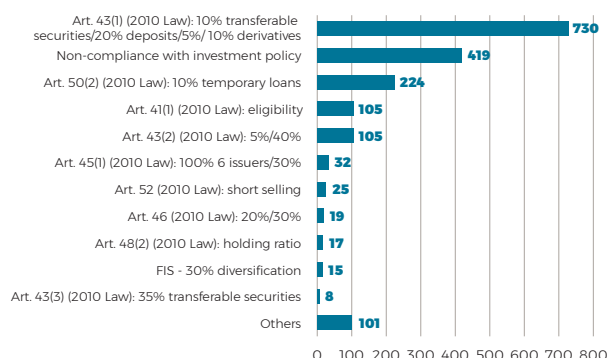
In 2020, the CSSF received 2,244 declarations on the basis of Circular CSSF 02/77, compared with 1,735 declarations in 2019, representing an increase of 29.3%. This significant rise is partly due to the high volatility in financial markets in the first half of 2020 linked to the COVID-19 crisis.

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



As in the previous years, the simplified procedure provided for in Circular CSSF 02/77 could be applied in most cases of NAV calculation errors and non-compliance with investment rules. As regards the compensation procedures for investment funds and investors that exceed the tolerance thresholds laid down in Circular CSSF 02/77 (“normal procedures”), the CSSF received 166 notifications in 2020 against 78 in 2019, which is a 112.8% growth.

Breakdown of the instances of non-compliance with investment rules in 2020



Failure to observe the legal limits of diversification, holding and borrowing was the main source of non-compliance with investment rules with 1,276 cases (945 cases in 2019, i.e. +35%), followed by 419 cases of breaches of limits/investment policy rules defined in the sales documents (437 cases in 2019, i.e. -4.1%) and 105 cases of legal constraints breaches as regards asset eligibility (115 cases in 2019, i.e. -8.7%).

Compensation in relation to correction of NAV calculation errors or instances of non-compliance with investment rules⁵

(in EUR)	Investors		
	2018	2019	2020
Total amount of compensation following NAV calculation errors	40,167,579.9	5,806,656.7	11,811,192.3
Total amount of compensation following non-compliance with investment rules	0.0	0.0	0.0

(in EUR)	UCIs/Sub-funds		
	2018	2019	2020
Total amount of compensation following NAV calculation errors	16,153,598.6	4,037,199.2	11,846,992.7
Total amount of compensation following non-compliance with investment rules	7,650,066.8	3,943,713.5	6,802,825.3

⁵ The data as at 31 December 2020 are incomplete as the final compensation amounts had not yet been finalised for some files.

In 2020, there has been an increase in compensation amounts compared to 2019 which is partly due to the higher number of notifications received in the context of the COVID-19 crisis. Nevertheless, in general, the total amount of compensation remained moderate as compared to the total amount of assets under management.

4.2.3. Developments concerning the practice and application of Circular CSSF 02/77

In July 2020, the CSSF published an FAQ⁶ providing further guidance regarding the rules laid down in Circular CSSF 02/77. This document covers various questions which notably relate to the application of materiality thresholds, the method to determine the financial impact (i.e. the “economic method”) and the active/passive nature of the investment breaches.

The CSSF also consulted the representatives of the Luxembourg fund industry regarding its expectations with respect to the notification process and timeline under Circular CSSF 02/77. Following these consultations, the CSSF published additional guidance in February 2021⁷. At the same time, the CSSF adjusted the notification form⁸ in order to facilitate the completion of the form and processing of the information provided.

4.2.4. Supervision based on the other reports and information received on a regular or ad hoc basis by the CSSF

• Techniques and instruments used by UCITS for the purpose of efficient portfolio management

The CSSF published on 18 December 2020 the main observations and recommendations in relation to the study regarding the assessment of remuneration practices and associated operational controls relating to the techniques and instruments used by UCITS for the purpose of efficient portfolio management⁹.

In this context, the main recommendations concern the requirements in terms of transparency, identification and management of conflicts of interest, best execution controls (procedures and controls), critical assessment of the fees charged and the applicability of the investment restrictions to cash collateral.

The CSSF also published on the same date an FAQ on the use of securities financing transactions by UCITS¹⁰.

• Eligibility of investments in loans by UCITS

In the context of prudential supervision of funds subject to Part I of the 2010 Law (UCITS), the CSSF assessed the eligibility of investments in loans included in the portfolios of certain UCITS and that are in most cases classified as money-market instruments eligible under the “trash” ratio. Following this assessment, the CSSF concluded that investments in loans are not eligible for UCITS and, therefore, decided to prohibit this type of investment in the future.

In June 2020, the CSSF formally informed by mail the main IFMs concerned and managing Luxembourg UCITS that hold investments in loans in their portfolios of its analysis and conclusions in this matter as well as of the remedial measures to be taken with regard to the disinvestment from current positions in the best interest of investors and the update of prospectuses so that they no longer allow for investments in loans. Based on the feedback received, the CSSF concluded that the remedial measures should be finalised by 31 December 2020 at the latest with regard to the disinvestment by taking into account the best interest of investors and by 31 March 2021 at the latest with regard to the prospectus transparency.

A new Q&A was published on 7 August 2020 to inform all market players of the CSSF’s position and of the required compliance deadlines.

• Brexit

In October 2020, i.e. two and a half months before the end of the transition period provided for in the framework of Brexit, the CSSF performed a representative survey with a sample of 25 IFMs in order to assess, for UCITS under management,

6 www.cssf.lu/en/Document/faq-regarding-circular-cssf-02-77/

7 www.cssf.lu/wp-content/uploads/Additional_explanations.pdf.

8 www.cssf.lu/en/Document/notification-form-in-accordance-with-circular-cssf-02-77/.

9 www.cssf.lu/en/Document/cssf-thematic-review-efficient-portfolio-management-by-ucits-revenues-costs-fees-results/.

10 www.cssf.lu/en/Document/cssf-faq-use-of-securities-financing-transactions-by-ucits/.

their forecasted compliance with the investment rules laid down in the regulatory texts and sale prospectuses and which were impacted by the withdrawal of the UK from the EU at the end of 2020.

The analysis of the feedback allowed establishing that, except for some minor adaptations that were ongoing, IFMs were generally well prepared to ensure continuous compliance of investments for UCIs under management.

• ESMA Data Quality Engagement Framework

In May 2020, ESMA, assisted by the national competent authorities, developed a Data Quality Engagement Framework (DQEF) with a view to improving the quality of data reported by AIFMs pursuant to Annex IV of Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing the AIFM directive (AIFMD).

Collectively validated by ESMA and the national competent authorities within a dedicated working group established under the Data Standing Committee (DSC), the DQEF allowed implementing a common approach for the systematic verification and communication to the AIFMs of data quality issues in order to be able to implement corrective measures. Based on this, the CSSF set up additional controls for AIFMD reports in order to deploy, at the national level, a series of new quality checks based on all the data as of 31 December 2019.

At the end of 2020, ESMA drew up an initial report on the DQEF which welcomed the significant improvements of data quality allowing, inter alia the CSSF, to strengthen its supervisory capacity with respect to prudential risk inherent in the alternative investment fund sector.

In addition to improving data quality, the DQEF also had a long-term impact by making AIFMs more aware of the expectations regarding the errors detected in AIFMD reports (for example, AIFMs were encouraged through this exercise to implement data quality checks on their side), but also by strengthening the ties between AIFMs and their national competent authorities through more efficient and regular exchanges of information. The CSSF thus contacted, on a bilateral basis, certain AIFMs where clarifications on transmitted data was deemed necessary.

Finally, the DQEF also allowed highlighting certain inaccuracies in the existing regulations. In this context, the CSSF had several exchanges with ESMA in order to obtain clarifications for all AIFMs at European level. These discussions are still in progress.

For the coming years, the procedure at European level provides for a renewal of the DQEF while providing the possibility for modifications or improvements through additional tests. Ensuring the continuity of this initial effort is indeed one of the key elements to generate a positive and lasting impact on the quality of the data produced for the AIFMD reports. The DQEF will also be the guarantor of convergence, at the European level, of processes allowing to handle issues that could hinder the exercise of efficient supervision. The global experience gained over the first DQEF year and the positive feedback from the different national competent authorities are all additional elements that speak for the continuation of this exercise.

As a conclusion, ESMA and the national competent authorities consider that the DQEF is useful and that it allowed to significantly improve the quality of the data produced by the AIFMs. To continue improving the data quality of AIFMD reports, ESMA and the national competent authorities plan to pursue the application of the DQEF with the necessary adjustments concerning processes and the content of tests, by integrating new tests when possible and necessary. The next DQEF execution stage is planned to take place between April and October 2021.

There are also plans that this experience should serve as a model for the implementation of the common improvement framework for the data quality of money market fund reports (DQEF MMFR) under Article 37 of Regulation (EU) 2017/1131 of 14 June 2017 on money market funds. The new control framework for MMFR reporting will be implemented in the course of 2021.

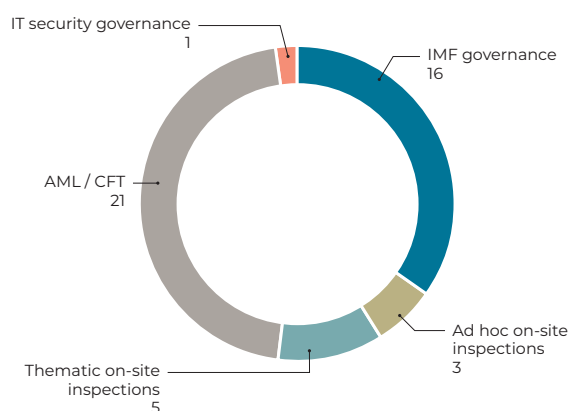
4.3. On-site supervision

The “UCI on-site inspections” department carries out in-depth reviews of the IFMs’ business models and governance as well as AML/CFT inspections. The “Prudential supervision and risk management” department performs thematic on-site inspections on risk management, procedures related to Circular CSSF 02/77 and money market UCIs.

In the context of the COVID-19 pandemic, inspections took place remotely, mainly through videoconferencing, as of March 2020.

AML/CFT on-site inspections are described in point 1.2. of Chapter XX “Financial crime”.

Themes of the 46 on-site inspections performed in 2020 at IFMs

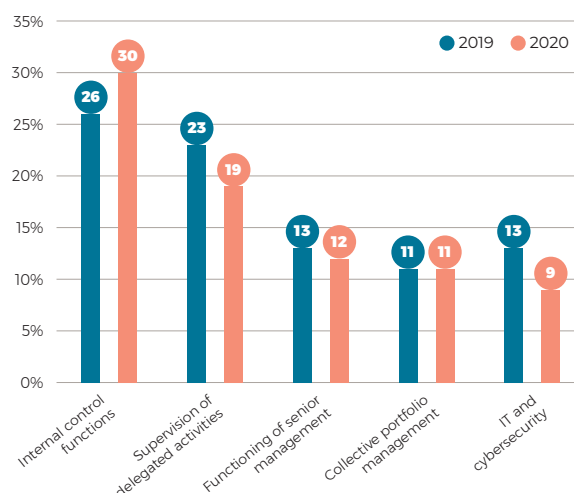


The five thematic controls focussed on compliance with the Benchmark Regulation (BMR), and the three ad hoc controls aimed to analyse specific issues linked to IFMs and certain managed funds.

The inspected authorised IFMs managed about 42% of total assets under management of the Luxembourg authorised IFMs. Among those, 17 inspected authorised IFMs managed assets amounting to over EUR 10 billion.

Moreover, 12 on-site inspections were carried out at UCI service providers: nine at depositary banks and three at professional depositaries of assets other than financial instruments. For further details on these on-site inspections, please refer to point 1.9. of Chapter XVII “Instruments of supervision”.

Main categories of observations following on-site inspections

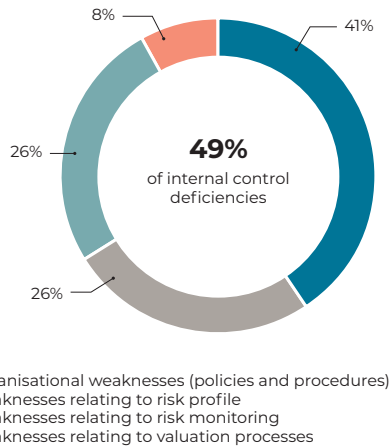


In the context of the on-site inspections relating to governance of IFMs, the CSSF noted that the requirements provided for in Circular CSSF 18/698 were generally understood by IFMs, in particular as regards the functioning of the governing bodies. However, there were still deficiencies as regards the provision of all the preparatory documents before the meetings of the executive boards and the drafting of minutes.

30% of the observations related to the internal control functions, most of which to the risk management function. Indeed, the CSSF observed that certain IFMs had not defined risk profiles for all the managed funds. Moreover, the existing risk profiles did not systematically include all the significant risks to which the managed funds were exposed. The CSSF also noted that the liquidity risk supervisory process was occasionally incomplete to the extent that the analyses did not take into account the possible relevance of the use of historic subscription and redemption data of managed funds.

In addition, there were delays within several IFMs in executing the control plan of the compliance function.

Risk management

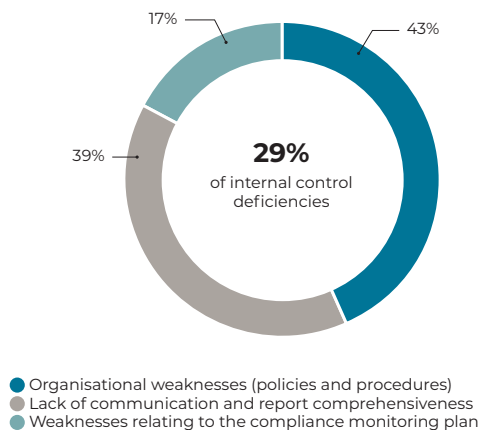


Furthermore, the CSSF noted that certain delegates did not transmit the key performance indicators (or not frequently enough) to the IFMs, which did not allow the latter to have comprehensive management information.

In addition, the security of IT systems is and will remain one of the priorities of the CSSF in the coming years, in particular as regards data protection and safeguarding, notably with the implementation of data backup solutions in adequacy with the activity level of the IFMs.

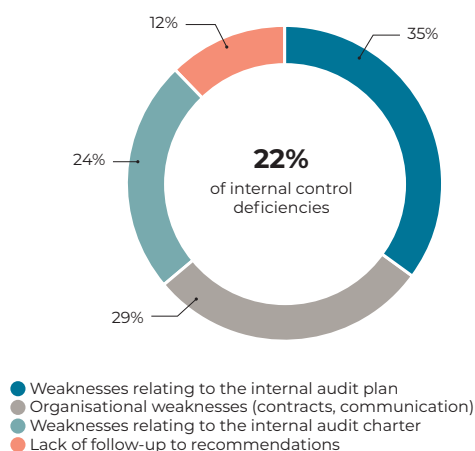
The thematic inspections in relation with the Benchmark Regulation, relating more specifically to the obligations of authorised IFMs as users of benchmarks, allowed identifying the following deficiencies:

Compliance



- shortcomings in terms of frequency and documentation of controls relating to the follow-up of ESMA's benchmark register;
- insufficient robustness of contingency plans that must be set up and updated by the users of benchmarks;
- insufficient formalisation and documentation regarding the choice of benchmarks or measures to be taken in the event of substantial changes to or cessation of a benchmark;
- missing information in fund prospectuses concerning contingency plans and administrators of benchmarks;
- no updates to the fund prospectuses where the administrator of the benchmark is listed in ESMA's register.

Internal audit



Following on-site inspections, the CSSF imposed administrative fines on five IFMs amounting to a total of EUR 152,700.



X. Supervision of securitisation undertakings

Following the deregistration of three multiple-compartment securitisation undertakings from the official list of authorised securitisation undertakings during the year, 30 securitisation companies were registered on the official list as at 31 December 2020, against 33 entities as at 31 December 2019. The balance sheet total of authorised securitisation undertakings amounted to EUR 41.9 billion at the end of 2020, representing a decrease of EUR 5.8 billion against 2019.

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

In general, the securities issued by securitisation undertakings are bonds and subject to foreign law. It is also possible for some securitisation undertakings to issue warrants.

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.

XI. Supervision of pension funds

1. Development of pension funds in 2020

1.1. Major events in 2020

As at 31 December 2020, 12 pension funds subject to the Law of 13 July 2005 on institutions for occupational retirement provision were registered on the official list of pension funds, of which two adopted the legal form of pension savings company with variable capital (SEPCAV) and 10 adopted the form of pension savings association (ASSEP).

During the year, the CSSF authorised eight new pension schemes within existing pension funds, seven of which were notified in accordance with Article 11 of Directive (EU) 2016/2341 of 14 December 2016 in order to carry out a cross-border activity on behalf of a sponsoring undertaking established in another EU Member State.

The CSSF expects a slow growth of the pension fund sector in 2021, in particular through the continuing development of the cross-border activities.

1.2. Pension funds activities

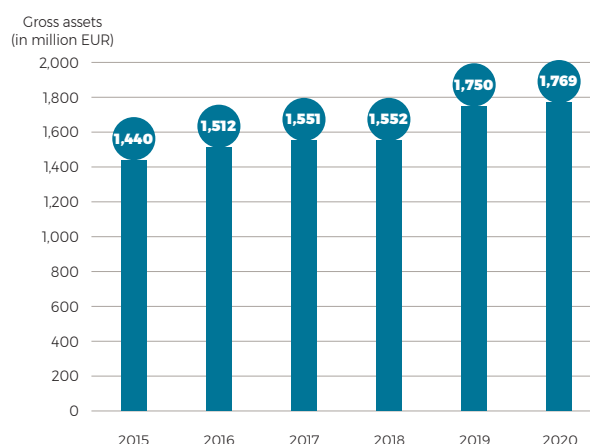
The pension funds supervised by the CSSF manage one or several pension schemes set up by Luxembourg companies and provide services to foreign companies for their employees.

As at 31 December 2020, three pension funds managed cross-border pension schemes, a number which remained unchanged compared to 31 December 2019. These pension funds provided their services to sponsoring undertakings established in Germany, Belgium, Spain, Italy, Ireland, the Netherlands and Portugal as well as to non-EU and British sponsoring undertakings.

1.3. Development of pension fund assets

At the end of 2020, gross assets of pension funds amounted to EUR 1,769 million against EUR 1,750 million at the end of 2019, representing a 1.1% growth.

Development of pension fund assets

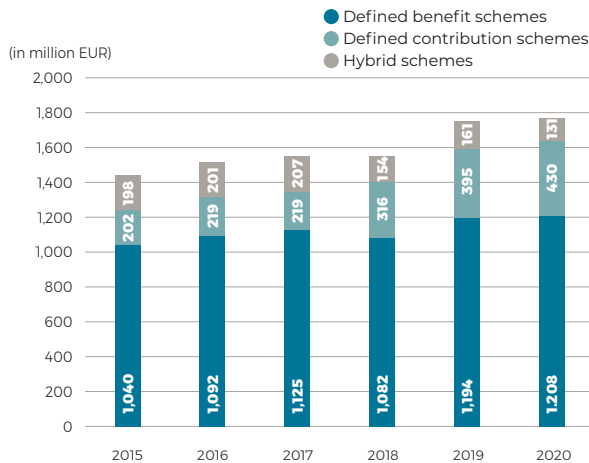


The assets of cross-border pension schemes amounted to EUR 665 million at the end of 2020 against EUR 660 million as at 31 December 2019, i.e. an increase of 0.8%.

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

As at 31 December 2020, gross assets of the defined benefit schemes amounted to EUR 1,208.5 million and represented 68.3% of overall gross assets of pension funds. The assets of the defined contribution schemes and hybrid schemes totalled EUR 560.5 million.

Breakdown of assets between defined benefit schemes, defined contribution schemes and hybrid schemes



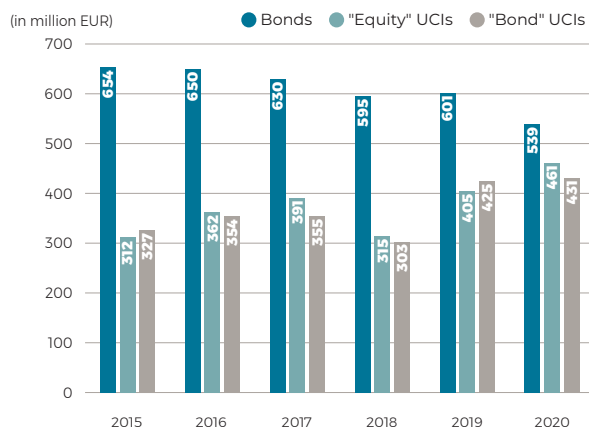
1.5. Allocation of pension fund assets

In 2020, pension funds mainly invested in investment funds with a total of EUR 1,000.7 million, exposed for:

- 46.1% (i.e. EUR 461.1 million) to the equity market;
- 43.1% (i.e. EUR 431.5 million) to the bond market;
- 10.8% (i.e. EUR 108.1 million) to mixed funds, money market funds and funds with alternative investment policies.

The total amount of direct investments of pension funds in bonds represented EUR 539.2 million, i.e. 30.5% of the total gross assets of pension funds.

Allocation of pension fund assets

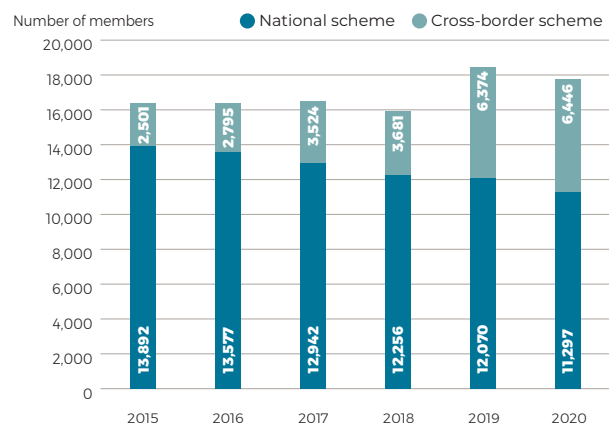


1.6. Development in the number of pension fund members

At the end of 2020, the pension funds had 17,743 members against 18,444 as at 31 December 2019. This decrease results, in particular, from the transfer of two national schemes to the insurance sector.

An analysis of the population of members of pension funds supervised by the CSSF shows that the proportion of international members (6,446 members as at 31 December 2020) is rising compared to the previous years, reflecting the ongoing process of globalisation of certain pension funds via schemes offered in multiple host countries. Eight new pension schemes with foreign sponsoring undertakings (including non-EU Member States) were authorised in 2020.

Development in the number of pension fund members



2. Development of liability managers in 2020

In 2020, the official list of professionals authorised to act as liability managers for pension funds subject to the Law of 13 July 2005 did not change and the number of liability managers remained at 18 as at 31 December 2020.



XII. Supervision of securities markets

1. Application of the prospectus regulation

In the framework of Regulation (EU) 2017/1129¹, the CSSF contributes, through various ESMA working groups, to the development of implementing measures regarding the regulation, of amendments to the regulation and of ESMA publications in order to promote common positions between competent authorities in the application of said regulation.

In order to support the economic recovery following the COVID-19 pandemic, the European Commission published, on 24 July 2020, a proposal to amend Regulation (EU) 2017/1129 by introducing a new type of simplified prospectus, an EU Recovery prospectus as well as targeted measures for financial intermediaries. Regulation (EU) 2021/337² was published in the Official Journal of the EU on 26 February 2021.

Delegated Regulation (EU) 2020/1272 of 4 June 2020³ and Delegated Regulation (EU) 2020/1273 of 4 June

2020⁴ amended and corrected the delegated acts adopted pursuant to Regulation (EU) 2017/1129.

Finally, on 16 December 2020, the European Commission adopted a delegated act supplementing Regulation (EU) 2017/1129 which specifies the minimum content of the information to be included in the documents to be published, in order to benefit from an exemption from the obligation to publish a prospectus in connection with a takeover by means of an exchange offer, a merger or a division. As a consequence, Delegated Regulation (EU) 2021/528⁵ was published in the Official Journal of the EU on 26 March 2021.

As regards the application of Regulation (EU) 2017/1129, ESMA updated its Q&A document in 2020 and published, on 15 July 2020, its final report on the guidelines relating to the requirements in the annexes to Delegated Regulation (EU) 2019/980⁶ which are applicable as from 5 May 2021.

Following the entry into force of Regulation (EU) 2017/1129 on 21 July 2019, one of the main

- 1 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.
- 2 Regulation (EU) 2021/337 of 16 February 2021 amending Regulation (EU) 2017/1129 as regards the EU Recovery prospectus and targeted adjustments for financial intermediaries and Directive 2004/109/EC as regards the use of the single electronic reporting format for annual financial reports, to support the recovery from the COVID-19 crisis.
- 3 Delegated Regulation (EU) 2020/1272 of 4 June 2020 amending and correcting Delegated Regulation (EU) 2019/979 supplementing Regulation (EU) 2017/1129 with regard to regulatory technical standards on key financial information in the summary of a prospectus, the publication and classification of prospectuses, advertisements for securities, supplements to a prospectus, and the notification portal.

- 4 Delegated Regulation (EU) 2020/1273 of 4 June 2020 amending and correcting Delegated Regulation (EU) 2019/980 supplementing Regulation (EU) 2017/1129 as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.
- 5 Delegated Regulation (EU) 2021/528 of 16 December 2020 supplementing Regulation (EU) 2017/1129 as regards the minimum information content of the document to be published for a prospectus exemption in connection with a takeover by means of an exchange offer, a merger or a division.
- 6 Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Regulation (EC) No 809/2004.

challenges of 2020 as regards prospectuses was to accompany the filing entities and issuers through the application of this new regulation. Indeed, most of the issuers had updated their base prospectuses in 2019 before July and thus before the entry into force of the new regulation. A large number of issuers therefore applied the provisions of the new regulation for the first time when they updated their base prospectuses in 2020. In general, the filing entities adapted very well to the new regulation and the files received were, overall, of very good quality.

In this context, it is noteworthy that the number of requests for advice rose further by 6.06% in 2020 compared to 2019 (210 requests in 2020 against 198 in 2019). Most of the requests concerned the use of the supplement, the financial statements to be included in the documents and the use of complex structures in future prospectuses.

In 2020, the CSSF observed a growing interest in SPAC structures (Special Purpose Acquisition Company). Owing to the nature of these structures, the issuers concerned are unable to perform a definitive identification of their targets before the approval of their prospectuses and, consequently, to provide the usual information required under Article 6 of Regulation (EU) 2017/1129. One of the main objectives of the prospectus regulation is the protection of investor interests, notably through the provision of the necessary information which is material to an investor for making an informed assessment of the situation at the time of the investment. As regards SPAC structures where the sole financial situation of the issuer before acquisition is not enough to allow assessing the investment in question, the CSSF considers that it is nevertheless possible to approve such a prospectus where the issuers concerned are able to implement and describe, in their prospectus, a set of specific measures that allow protecting investor interests and providing present and future information necessary to fulfil the objectives of the prospectus regulation. Among these measures, there are for instance the disclosure of a clear and detailed investment policy, as well as the setting-up of an escrow account allowing investors to withdraw by requiring a reimbursement following the final identification of the targets.

Finally, one of the main challenges the teams in charge of reviewing the prospectuses for securities had to face in 2020 was managing the crisis linked to the COVID-19 pandemic. Indeed, as from the first days of lockdown in March 2020, the teams

endeavoured to process the files as efficiently as before. All the agents were working remotely for long months and despite this, the speed and quality of the reviews remained the same.

2. Implementation of the e-prospectus application

Throughout 2020, a dedicated team focused on the implementation of the new e-prospectus application dedicated to the filing of the documents to be published by the issuers when securities are offered to the public or admitted to trading on a regulated market in accordance with Regulation (EU) 2017/1129 and the Luxembourg Law of 16 July 2019 on prospectuses for securities. The main work concerned the setting-up of a portal dedicated to issuers, their counsellors (lawyers, legal services) or filing entities, allowing not only the direct submission of documents through this application, but also the entry of various metadata required under the prospectus regulation.

The e-prospectus application allows the transmission of prospectuses, final terms, notifications in accordance with Articles 25 and 26 of Regulation (EU) 2017/1129 as well as all the relevant metadata in a secured manner and ensuring identical data quality at all times.

In this context, the major challenge for the coming months will certainly be to accompany the filing entities when using this new application. To this end, a specific mailbox was set up: e-prospectus.support@cssf.lu.

Feedback from the users being very positive in general, the CSSF, which is always open to its interlocutors and keen to optimise its processes, will, however, seek to gradually improve the use and functioning of the e-prospectus application. To this end, it will collect and analyse the feedback from the filing entities and implement appropriate measures to fine-tune the application.

Finally, it needs to be noted that since 1 January 2021, the ESEF (European Single Electronic Format) Regulation has not been without effect on the filing of prospectuses for securities as the e-prospectus application had to be adapted in order to receive and process XHTML files.



3. Enforcement of information published by issuers

Within the context of its mission of supervising securities markets, the CSSF is in charge of examining the information published by issuers of securities. Through this activity, generally known as enforcement, the CSSF notably ensures that the financial information complies with the relevant reporting framework, i.e. the applicable accounting standards. Moreover, since the entry into force of the Law of 23 July 2016 on the disclosure of non-financial information and diversity information by certain large undertakings and groups, transposing Directive 2014/95/EU of 22 October 2014, this control also extends to non-financial information referred to in this law. Beyond the legal and regulatory requirements, the examination of the financial and non-financial information contributes to the investors' protection and confidence in the financial markets.

3.1. Enforcement of financial information

In its communiqué of 22 February 2021, the CSSF presented the results of its 2020 enforcement campaign for financial information published by issuers of securities for 2019 and the first half of

2020. The main observations of these reviews refer to the issues linked to the application of IFRS 3 "Business combinations", IFRS 15 "Revenue from contracts with customers" and IFRS 16 "Leases", whose application became mandatory for the annual periods beginning on 1 January 2019. Although this work had already been anticipated in the past year, the communiqué, published on 13 November 2020, specifically presented the results of the thematic review initiated in 2020 in order to capture the first impacts of the COVID-19 pandemic on financial information in the first half of 2020.

As regards the 2021 campaign, the CSSF published a communiqué on 9 December 2020 that informed on the priorities for its enforcement campaign of financial information published by issuers of securities under its supervision. These priorities, which include those discussed at European level and communicated by ESMA, often represent challenges for issuers when preparing their financial information, but also for the CSSF during its controls. In this context, the effects of the COVID-19 pandemic on the activities and situation of issuers, and, consequently, on their financial statements for 2020, appear to be the major elements to be monitored. The 2021 campaign will thus prioritise the review of these impacts

on the financial information of issuers under the supervision of the CSSF, by notably covering the issues regarding the valuation of financial and non-financial assets.

Finally, following Luxembourg's decision to use the option to defer by one year, until 1 January 2022, the mandatory application of the requirements linked to the European Single Electronic Format (ESEF), issuers have an additional year to prepare for the obligation to prepare their annual reports in XHTML format and, if they include consolidated IFRS financial statements, the latter must be marked up with XBRL tags. The issuers wishing to do so may already apply these requirements on a voluntary basis for their 2021 disclosures.

3.2. Enforcement of non-financial information

In 2020, the CSSF also undertook reviews within the scope of application of the Law of 23 July 2016. Indeed, the priorities for the 2020 campaign notably included the analysis of the information provided on environment and climate-change related issues, key performance indicators, supply chains or the use of reference frameworks.

Moreover, the CSSF assessed compliance with the principle of materiality and completeness of the presented non-financial information. As a reminder, this information must be presented in a balanced and accessible way.

The CSSF also conducted a thematic review on climate-related information disclosed by the issuers. This review allowed, for a selection of issuers under its supervision, assessing compliance of the implementation and application of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) as integrated in the (non-binding) guidelines of the European Commission. The results of this work were presented in the communiqué of 22 December 2020.

The CSSF will continue to monitor the application of the requirements of Directive 2014/95/EU, commonly referred to as Non-Financial Reporting Directive (NFRD), in its 2021 campaign, whose identified and communicated priorities notably cover the review of the business models as well as social and staff issues at the issuers concerned. The effects of the COVID-19 pandemic on financial matters and the risks linked to climate change will also remain two points of attention.

Through its participation in the Narrative Reporting Working Group within ESMA, the CSSF will continue to be actively involved in the development of the legal framework of non-financial information, the two main topics being the review of the NFRD and the adoption of the delegated act supplementing the requirements of Article 8 of Regulation (EU) 2020/852 (Taxonomy Regulation).

4. Work relating to MiFID II/MiFIR in the context of the supervision of securities markets

4.1. Data quality

For the purpose of the supervision of securities markets, the CSSF mainly relies on the transaction reports in financial instruments which it receives on a daily basis from Luxembourg credit institutions and investment firms as well as from other European financial institutions (via their national regulators). To ensure efficient market supervision, it is therefore essential that the supervised entities transmit accurate and complete transaction reports. Any error in a report is likely to trigger "false" alerts that must nevertheless be reviewed, thus causing the CSSF to waste crucial time that could have been dedicated to real alerts. Therefore, and considering more than 2,700 e-mails, the exchanges with Luxembourg entities concerning the quality of the transaction reports transmitted to the CSSF have once again been intense in 2020.

In 2021, the CSSF will continue to invest a lot of resources into monitoring the completeness and the quality of the transaction reports. To this end, it published in the beginning of 2021 the key messages communicated to the supervised entities during its review campaigns of the quality of transaction reports in 2020 and announced several review campaigns to be carried out in 2021.

Further to its ongoing efforts regarding the quality of transaction reports, the CSSF will also focus on the quality of pre-trade and post-trade transparency data. It should be noted that in a press release dated 13 November 2020, ESMA defined this subject as Union Strategic Supervisory Priority⁷ and the CSSF will take part in any common action that will be launched in 2021 in this respect.

7 Internet link: [esma71-99-1438_press_release_union_strategic_supervisory_priorities.pdf](https://esma.europa.eu/press-material/press-releases/press-release-union-strategic-supervisory-priorities) (europa.eu).



4.2. Virtual assets

The legal qualification, by the players concerned, of the different virtual assets taking into account their characteristics remains a major challenge and also raises many questions with regard to the applicable laws and regulations governing securities markets, notably with regard to MiFID II/MiFIR. Indeed, these laws and regulations determine the scope of application of the notion of financial instrument which is a key notion in order to assess whether the European regulatory framework applies to service providers in relation to virtual assets.

In this context, the CSSF pays particular attention to the regulatory developments at European level, namely the proposal for a European regulation on markets in crypto-assets (MICA)⁸.

For that purpose, the CSSF also closely follows the work regarding the proposal of a European regulation aiming to implement a pilot regime for market infrastructures based on distributed ledger technology⁹.

5. Market abuse

5.1. Review of the Market Abuse Regulation: ESMA report of 23 September 2020

In 2020, the CSSF actively participated in ESMA's work which resulted in the publication, on 23 September 2020, of ESMA's MAR Review report. This report is the result of a public consultation launched by ESMA in 2019, the opinions expressed by the Securities and Markets Stakeholder Group (SMSG), a consultative body established within ESMA, as well as the work of the Market Integrity Standing Committee (MISC) within ESMA.

ESMA's report deals with a number of various topics which often appear highly technical. For example, there is the definition of inside information (notably in relation to the pre-hedging practice), the binding or non-binding character of the regime applicable to market soundings or the many questions raised in relation to the regime applicable to the notifications of managers' transactions (minimum thresholds, implementing measures for closed periods, etc.).

The report also addresses certain subjects that go far beyond the traditional core of market abuse (i.e. insider dealing and market manipulation), notably a possible extension of the Market Abuse Regulation to FX spot markets, the possibility for supervisory authorities of financial markets to exchange information with tax authorities or the creation of new binding standards aiming to sanction unfair behaviour in financial markets. As regards these satellite topics, the report sometimes underlines the need for additional analyses, sometimes the need to implement legislative changes at European level.

5.2. Suspicious transaction and order reports (STORs)

Suspicious transaction and order reports (STORs), referred to in Article 16 of the Market Abuse Regulation, are one of the main tools available to the CSSF and its European counterparties to oversee the integrity of financial markets and investor protection in these markets. These reports play a fundamental role in practice, which explains the considerable place they traditionally take in the CSSF's activities.

⁸ Internet link: EUR-Lex – 52020PC0593 – EN – EUR-Lex (europa.eu).

⁹ Internet link: EUR-Lex – 52020PC0594 – EN – EUR-Lex (europa.eu).

5.2.1. Statistical and thematic information on STORs received by the CSSF in 2020

In 2020, the different categories of professionals established in Luxembourg sent 55 STORs to the CSSF. Most of these reports were related to suspicions of insider dealing. The other reports were related to suspicions of market manipulation.

The CSSF analyses these reports from a point of view of quality and completeness of the transmitted information. In a second step, insofar as they relate to financial instruments admitted to trading or traded on a foreign trading venue, they are transmitted to the foreign competent authorities within the scope of international cooperation and exchange of information between supervisory authorities, in accordance with the relevant European and national standards.

At the same time, in 2020, the CSSF received 29 STORs from its European counterparties. The vast majority of these reports were transmitted to the CSSF by the UK and German supervisory authorities. They mostly relate to debt instruments issued by issuers that have their registered office in Luxembourg and admitted to trading or traded on a trading venue located either in Luxembourg or abroad. Around half of these reports concerned suspicions of insider dealing while the other ones concerned suspicions of market manipulation. The CSSF opened inquiries where appropriate.

5.2.2. Thematic STOR reviews

• 2019/2020: Banks and investment firms

In February 2021, the CSSF published the general findings and observations in relation with a thematic STOR review of more than 70 credit institutions and investment firms established in Luxembourg. Overall, the results of this review are satisfying. More detailed information is available on the CSSF website.

• 2021: Investment fund managers (IFMs)

A peer review conducted in 2019 under the aegis of ESMA and which dealt with the processing and use of STORs by the national competent authorities of Member States¹⁰ noted in general a certain lack

of attention of IFMs as regards their professional obligations with respect to the detection and reporting of transactions and orders likely to constitute market abuse¹¹. Owing to the size of the investment fund industry in Luxembourg, this observation is of major significance for the CSSF.

The CSSF has already taken measures to bring this subject to the attention of the investment fund industry stakeholders, notably within the scope of its regular exchanges with the ALFI and within the IFM committee. A thematic review is being prepared and will endeavour to duly take into account the diversity of legal, operational and other structures specific to the sector.

5.3. Cooperation and exchange of information with foreign supervisory authorities

In 2020, the CSSF opened more than 40 inquiries relating to requests for assistance from its foreign counterparties, mainly under IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information and under the Multilateral Memorandum of Understanding providing a legal framework for cooperation arrangements and exchange of information between competent authorities and ESMA. Most of the requests for assistance were from the French, Italian and Belgian supervisory authorities.

About half of these requests related to inquiries into insider dealing carried out by the requesting foreign authority. The other requests related either to inquiries into market manipulation or to very diversified subjects. As regards the latter, the CSSF noted, in 2020, a growing complexity of the requests for assistance, notably those received from third-country regulators. In some cases, the CSSF could not provide a favourable answer to the request for assistance from the foreign authority as the request was not made within the scope of the missions conferred on the CSSF.

¹⁰ ESMA, Final Report – Peer Review on the collection and use of STORs under the Market Abuse Regulation as a source of information in market abuse investigations (12 December 2019 / ESMA42-111-4916).

¹¹ Cf. paragraph 96 of the aforementioned report.



XIII. Supervision of market infrastructures

1. Supervision of central securities depositories

In accordance with Article 1(1) of the Law of 6 June 2018 on central securities depositories and implementing Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (hereinafter CSDR)¹, the CSSF is the competent authority in charge of exercising the duties under CSDR for the authorisation and supervision of the central securities depositories (hereinafter CSDs) established in Luxembourg.

In the framework of CSDR, the CSSF contributes, through different ESMA working groups, including a joint working group with the ECB (T2S), to the development of implementing measures regarding CSDR and of ESMA publications in order to promote common positions between competent authorities in the application of CSDR.

In Luxembourg, one bank currently exercises an activity which requires authorisations under CSDR. In this concrete case, three authorisations are required: the authorisation to exercise the activity of CSD (Article 16 of CSDR), the authorisation of an interoperable link (Article 19 of CSDR) and the authorisation to provide, under the banking licence, ancillary banking services to the CSD participants (Article 54 of CSDR).

With the extent and complexity of CSDR and the relevant technical standards, developed by ESMA and the EBA in ad hoc collaboration with the ESCB (European System of Central Banks), the CSSF identified around 1,500 requirements and concrete

conditions to be verified and assessed during the processing of the applications for authorisation.

In April 2020, the CSSF granted the first authorisation as CSD under Article 16 of CSDR² to an entity previously authorised, under Article 26 of the Law of 5 April 1993 on the financial sector, as professional depository of financial instruments.

As regards the supervision of the authorised CSDs, the CSSF must carry out a review and evaluation at least on an annual basis in accordance with Article 22 of CSDR. This annual review will be performed alongside a prudential supervision of the authorised CSDs.

In 2020, the CSSF received two notifications as the competent authority of the host Member State and sent 24 notifications as the competent authority of the home Member State, in accordance with Article 23 of CSDR in relation to the freedom to provide services in another Member State.

On 8 May 2020, Delegated Regulation (EU) 2020/1212 amending Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014 with regard to regulatory technical standards on settlement discipline entered into force, thereby deferring the date of entry into force of Delegated Regulation (EU) 2018/1229 to 1 February 2021. An additional extension, until 1 February 2022, was adopted by the European Commission on 23 October 2020 and published on 27 January 2021.

In March 2020, the arrival of the COVID-19 pandemic had disruptive effects on the markets,

¹ CSDR introduced the licence of CSD in a harmonised manner at EU level.

² In accordance with the procedure laid down in Article 17 of CSDR.

provoking, inter alia, a rise in settlement fails within the European CSDs. The substantial growth in settlement fails was caused by a sharp rise in settlement activity, a lack of securities at the settlement date, a reduction in operational capacities due to the adjustment to generalised teleworking as well as an extension of the time required for CSDs and their participants to settle the settlement fails.

In this context, the CSSF strengthened the supervision of the evolution of settlement fails at the entities operating a securities settlement system established in Luxembourg, in close cooperation with ESMA. Since the start of the health crisis, given the rise in settlement fails, a daily reporting on the volume of fails was established between these entities and the CSSF and, subsequently, ESMA, via continuous sharing of the data received. During the summer 2020, the situation gradually improved so that the details concerning settlement fails were transmitted again on a weekly basis. Given the deferral of the entry into force of the regulation on settlement discipline, ESMA and the authorities competent for CSDs agreed to implement enhanced monitoring of settlement fails, in order to ensure a gradual transition to this new regime applicable as from 2022.

2. EMIR

In the framework of Regulation (EU) 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR), the CSSF contributes, through different ESMA working groups, to the development of implementing measures regarding EMIR and of ESMA publications in order to promote common positions between competent authorities in the application of EMIR.

On 17 December 2020, ESMA notably published the final report on the regulatory technical standards on data reporting to trade repositories and procedures applicable to trade repositories under “EMIR Refit”³ following the consultation performed in the spring of 2020.

³ Regulation (EU) 2019/834 of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories.

In the context of Brexit, the CSSF published a press release on 10 November 2020 concerning the transition period with regard to the reporting requirements provided for, inter alia, under Article 9 of EMIR. During the year, the CSSF completed the process allowing access to data from trade repositories registered by ESMA for the purpose of Brexit.

EMIR allows benefiting from intragroup exemptions according to Articles 4(2), 9(1) and 11(5) to 11(10). In 2020, the following notifications were submitted and accepted by the CSSF:

- six notifications covering six counterparty pairs concerning the intragroup exemption from the clearing obligation under EMIR, according to Article 4(2) of EMIR;
- nine notifications covering 58 counterparty pairs concerning the intragroup exemption from the reporting obligation under EMIR, according to Article 9(1) of EMIR;
- two notifications covering two counterparty pairs concerning the intragroup exemption from the exchange of collateral obligation under EMIR, according to Article 11 of EMIR.

Delegated Regulation 2021/236 of 21 December 2020, published on 17 February 2021, reintroduces the possibility to benefit from an intragroup exemption from the exchange of collateral where one of the counterparties is established in a third country in respect of which no equivalence decision has been adopted by the European Commission until 30 June 2022.

The CSSF received 10 notifications informing it that clearing thresholds have been exceeded for counterparties (FC+ or NFC+), according to the obligations provided for in Articles 4a and 10 of EMIR. This brings the number of counterparties established in Luxembourg that exceed or that have decided not to monitor the clearing threshold to 1,115.

The CSSF receives 7.5 million reports per day from trade repositories for a total exceeding 2.2 billion transactions in 2020⁴. These reports concern about 11,000 counterparties established in Luxembourg

⁴ This number tends to decrease after Brexit. Since January 2021, the CSSF receives approximately four million reports per day.

which are exposed to around one million derivative contracts. The notional amount is about EUR 8,000 billion, i.e., based on ESMA estimates, around 1.1% of the total notional amount of the EEA before Brexit.

In 2020, the CSSF focused on certain elements of the reporting requirements under Article 9 of EMIR by initiating a Data Quality Action Plan (DQAP). The main objective is to enhance data quality by liaising with entities whose reported data quality raises several questions.

As regards the reports made in 2020, the CSSF contacted 24 entities representing 186 counterparties in order to discuss questions relating to the reported data. In general, the measures allowed enhancing data quality for these counterparties even though implementation is still ongoing in many entities. The CSSF will monitor their progress.

In the context of this exercise, the CSSF focused in particular on the entities whose reports could not be reconciled with those of their counterparties and on the entities that did not report their trade terminations (zombie trades).

The results show that the quality of the data reported needs improvement, notably in terms of completeness and timeliness of the reports on quantitative data (i.e. contract value, variation margin and notional amount).

As in each year since 2015, the CSSF participated in the ESMA EMIR Data Quality Review. In 2020, 13 counterparties were contacted according to common EU criteria. The conclusions of this exercise are in line with the observations in the DQAP. Moreover, the CSSF followed up on the review performed in 2019.

In 2021, the CSSF intends to pursue the DQAP with a view to enhancing reported data quality in the framework of the requirements under Article 9 of EMIR. It will focus in particular on the quantitative fields, the data relating to the maturity date as well as on duplicate reporting. The CSSF can solicit entities for quality issues with respect to all the fields submitted to reporting obligations.

3. Transparency of securities financing transactions

In the framework of Regulation (EU) 2015/2365 of 25 November 2015 (Securities Financing Transaction Regulation – SFTR)⁵, the CSSF contributes, through different ESMA working groups, to the development of implementing measures regarding SFTR and of ESMA publications in order to promote common positions between competent authorities in the application of SFTR. In accordance with Article 1 of the Law of 6 June 2018 on transparency of securities financing transactions, the CSSF is the competent authority regarding SFTR for financial counterparties subject to its supervision as well as for non-financial counterparties.

As regards the application of SFTR, ESMA published on 6 January 2020 guidelines on reporting under Articles 4 and 12 of SFTR and, on 5 November 2020, Q&As on SFTR data reporting which will be updated on a regular basis. Circular CSSF 20/739 of 9 April 2020 was published in the framework of the guidelines published by ESMA.

In order to adopt an approach consistent with that of the other European authorities with respect to SFTR supervision, the CSSF decided not to prioritise the supervision of reporting obligations between 14 April and 13 July 2020 due to the COVID-19 pandemic. Since 11 January 2021, the reporting obligation under SFTR applies to all entities that fall under the scope of SFTR and the CSSF set up an IT solution to retrieve SFTR data of trade repositories authorised by ESMA. In 2021, the CSSF will focus on the supervision of data quality reported by the entities.

In the context of Brexit, the CSSF published a press release on 10 November 2020 concerning the transition period with regard to the reporting requirements provided for, inter alia, under Article 4 of EMIR. During the year 2020, the CSSF completed the process allowing access to data from trade repositories registered by ESMA for the purpose of Brexit.

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.



XIV. 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, reference is made to point 3. of Chapter VII “Supervision of PFS”.

1. Major events in 2020 and challenges for 2021

1.1. Digital resilience

In response to the health crisis, the entities of the financial sector had to adapt quickly to encourage remote working. The IT teams and information systems were under severe strain to support this sudden change in the way of working. In 2020, the financial sector also demonstrated its capacity to adapt to this unprecedented crisis, notably through a rapid increase in the digitalisation of certain processes.

This ever-increasing reliance of the financial sector on information and communication technologies further confirms the need for their reliable and secure functioning or, in other words, the need for digital resilience.

A more sustained supervisory and regulatory framework in terms of digital resilience in the financial sector was initiated in 2020. Indeed, several regulatory changes have been introduced by the CSSF in addition to an ambitious proposal for a European regulation aiming to strengthen and harmonise the requirements relating to digital resilience and a new version of the Network and Information Systems Directive (NIS Directive).

Consequently, on 15 July 2020, the CSSF published CSSF Regulation No 20-04 on the definition

of essential services according to the Law of 28 May 2019 transposing Directive (EU) 2016/1148 of 6 July 2016 concerning measures for a high common level of security of network and information systems across the EU. Based on this definition of essential services, the CSSF officially designated the Operators of Essential Services (OES) notifying them of this decision by email. The OES thus designated and the Digital Service Providers have been informed of the regulatory requirements to be complied with, both as regards security measures and reporting of security incidents.

On 25 August 2020, the CSSF published Circular CSSF 20/750 implementing the EBA Guidelines on information and communication technology (ICT) and security risk management (EBA/GL/2019/04). The circular specifies that the content of the Guidelines also reflects the CSSF’s expectations as regards the risk management measures and the control and security arrangements referred to in the Law of 5 April 1993 on the financial sector and in the Law of 10 November 2009 on payment services.

On 24 September 2020, the European Commission published a proposal for a regulation entitled Digital Operational Resilience Act (DORA). This regulation aims to develop a single regulatory and supervisory framework for digital resilience in the financial sector. This project is significant both with regard to the covered scope and the proposed measures. The themes proposed are ICT governance, ICT risk management, ICT-related incident reporting, digital operational resilience testing (i.e. advanced intrusion testing simulating actual cyberattacks, like for example presented in the TIBER-EU framework), management of risks associated with ICT third-party service providers (in particular through the creation of an oversight framework for designated critical providers) and information sharing. The CSSF



has since assisted the Ministry of Finance in reviewing and proposing improvements to this proposal. The estimated date of entry into force of the regulation is at the end of 2021 and its implementation date one year later (except for the digital operational resilience tests whose date of application is three years after the date of entry into force).

On 16 December 2020, the European Commission published a proposal for a new directive (the so-called NIS2 Directive) concerning measures for a high common level of security of network and information systems across the EU, repealing the previous version (Directive (EU) 2016/1148 - NIS1). This proposal updates the existing legal framework taking into account the increased digitalisation of the EU internal market, the evolution of cybersecurity threats, as well as the findings of the European Commission following its assessment of the implementation of the first directive in the Member States. The future NIS2 Directive is expected to enter into force by mid 2022, and to be transposed within 18 months.

For 2021, the CSSF will continue to follow the development of important ongoing European projects and will work towards proper awareness, understanding and implementation of the current requirements relating to ICT and security risk management.

1.2. PSD2 requirements relating to payment security and access to payment accounts

The regulatory technical standards (RTS) for strong customer authentication (SCA) and common and secure open standards of communication entered into force in September 2019.

Regarding the SCA, after having considered the specific difficulties related to e-commerce card payments, the EBA has granted a certain flexibility to the supervisory authorities for this type of payments to bring the market into compliance until 31 December 2020. The CSSF has put in place a monitoring of the migration plans of the market participants and supports the market in this

ultimate compliance through regular monitoring and reporting.

Significant progress was already achieved in 2020. The ecosystem relating to e-commerce card transactions being a complex issue, the adaptation of the information systems of some actors of the e-commerce payment chain has not yet been fully finalised. This observation is true in many EU countries. At the beginning of 2021, the CSSF will ensure, like its peers and the EBA, the proper achievement by the market of the last steps necessary to finalise compliance.

Concerning the interfaces for access to payment accounts by third-party payment service providers, on 4 June 2020, the EBA published an opinion to clarify whether certain market practices constitute obstacles to the provision of services by third-party providers under PSD2. The CSSF has therefore informed the concerned institutions (i.e. payment service providers offering payment accounts and interfaces for access or payment initiation) to take into account the EBA opinion and to adapt the design of their interface where appropriate. In 2021, the CSSF will follow up with these institutions to ensure that their interfaces comply with the EBA's opinion.

1.3. Adaptation of the CSSF expectations and practices as regards IT outsourcing planned for 2021

During 2020, the CSSF reflected on the objectives and organisation of its IT risk supervisory activity, also in light of recent and forthcoming regulations in this field and has defined a new strategy. The implementation of this strategy should start in 2021, notably with the replacement of the prior authorisation requirement by a prior notification in case of material IT outsourcing and a risk-based treatment of these notifications.

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 implies taking 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 267 requests in 2020, i.e.:

- a total of 33 applications for authorisation (IT-related part) for different types of entities (credit institutions, electronic money institutions, payment institutions, PFS);
- a total of 234 requests for advice or authorisation relating to IT projects submitted by supervised entities (most of them concerned outsourcing, remote access, security of online services or major system changes) and specific IT issues (for example critical items of a management letter from a *réviseur d'entreprises agréé* (approved statutory auditor)).

It should be noted that about 40% of the requests for advice or authorisation originated 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 1.10. of Chapter XVII "Instruments of supervision".



XV. 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 ensure that risks are managed in an efficient and lasting manner. In 2020, the CSSF thus continued to carry out reviews in order to ensure compliance with the legal and regulatory requirements applicable to remuneration policies and practices.

Moreover, the CSSF pursued its annual benchmarking exercise of the remuneration practices at national level. In this context, the CSSF noted that credit institutions distributed higher variable remunerations than the previous year, amounting, on average, to 44% of the fixed component of the remuneration in 2020 for performance year 2019 (against 38% in 2019 for performance year 2018), that the proportion of the variable remuneration paid out in financial instruments amounted to 38% on average (against 35% in 2019) and that the deferred part of variable remuneration amounted, on average, to 32% (against 26% in 2019). This increase is in part due to the relocation of activities of some credit institutions to Luxembourg in response to Brexit.

In 2020, the CSSF continued receiving higher ratio notifications from credit institutions and CRR investment firms, for the purpose of paying variable remuneration exceeding 100% of the fixed component. In this context, the CSSF ensures compliance with the notification procedure set out in Article 38-6(g) of the Law of 5 April 1993 on the financial sector and clarified in Circular CSSF 15/622.

With reference to recommendations published in 2020 in the COVID-19 context, the CSSF expects credit institutions to be extremely moderate when paying out variable remuneration until September 2021. The CSSF pays particular attention to the application of these recommendations, especially when analysing the aforementioned notifications and the associated exceptional variable remuneration levels.

Due to the adoption of the regulatory packages CRD V/CRR 2 – IFD/IFR and the new associated prudential regime for credit institutions and investment firms, the EBA proceeded, in 2020, with updating and drafting guidelines and delegated regulations in the areas of remuneration and governance.





XVI. Public oversight of the audit profession

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

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 2020, the CEAOB issued two comment letters addressed to the IAASB (International Auditing and Assurance Standards Board) regarding, on the one hand, the revision of ISA 600 “Audits of group financial statements” and, on the other hand, the consultation on fraud and going concern.

Two further comment letters were issued by the CEAOB to put emphasis on the provisions of Regulation (EU) No 537/2014 that should be taken into account in the revision project of the IESBA (International Ethics Standards Board for Accountants) code of ethics published in 2020, in particular the fee-related provisions and those related to the provision of non-audit services.

The CEAOB also commented on the potential revisions of the non-financial reporting directive (NFRD) and on the audit of financial statements in the European Single Electronic Format (ESEF) from an audit regulatory point of view.

Finally, the following ongoing projects are worth mentioning:

- drafting of a comment letter on the application of the proposal for a regulation on digital

operational resilience for the financial sector (DORA) to the audit profession;

- drafting of guidelines on the appointment of statutory auditors and, in particular, on the circumstances requiring a formal selection procedure, the timeframe for carrying out the selection process and the specificities of the selection process for multi-PIE¹ groups (Article 16 of Regulation (EU) No 537/2014);
- analysis of the level of materiality applied by audit firms (Article 11 of Regulation (EU) No 537/2014), the aim of which is to compare the audit network methodologies with the results observed by competent national authorities during their inspections and to achieve a better understanding of the interactions between the audit committees and the auditors, or, in the absence of interaction, on how the level of materiality is determined by the auditor.

2. Quality assurance review

2.1. Scope

By virtue of the Law of 23 July 2016 concerning the audit profession (Audit Law), *réviseurs d'entreprises agréés* (approved statutory auditors) and *cabinets de révision agréés* (approved audit firms) are subject to a quality assurance review of the audit engagements, organised according to the terms laid down by the CSSF in its capacity as oversight authority of the audit profession.

The population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* that carry out statutory audits is as follows (as at 31 December 2020):

¹ Public-Interest Entity.

- number of *cabinets de révision agréés*: 54, including 11 that audit PIEs;
- number of approved independent *réviseurs* (auditors): seven, none of whom audits PIEs.

Based on the data collected through the “Annual Annexes” for the year 2020, the audit engagements break down as follows between *cabinets de révision agréés* and independent *réviseurs d’entreprises agréés*:

- 82% of the audit engagements are carried out by the “Big 4”²;
- 11% of the audit engagements are carried out by medium-sized audit firms³;
- 7% of the audit engagements are carried out by the other audit firms and independent *réviseurs*.

2.2. Activity programme for 2020

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, being three years for firms that audit PIEs and six years for the other ones. This programme was based on the information transmitted by firms and *réviseurs* through the “Annual Annexes” relating to their activity.

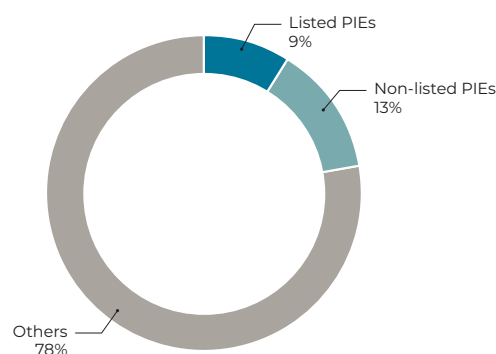
Under the 2020 programme, one independent *réviseur* and 24 firms were reviewed, eight of which audit PIEs and 13 are members of an international network. The quality assurance reviews focussed on:

- the understanding and documentation of the organisation, policies and procedures established by the reviewed firms in order to assess compliance with the International Standard on Quality Control (ISQC1);
- the review of a sample of audit files relating to audit engagements of the financial years 2020 (one reviewed file) and 2019 (or 2018, 2017, 2016, where appropriate);
- the setting-up of a specific follow-up for professionals for which material weaknesses were noted in the previous financial years.

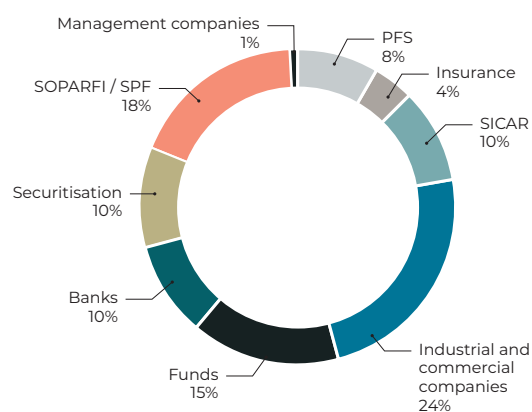
The independent *réviseur* and the 24 reviewed audit firms reported⁴ a total of 9,192 audit engagements, including 427 in relation to PIEs. Under the 2020 review programme, 165 mandates were reviewed, 37 of which concerned PIEs.

The quality assurance reviews started in January 2020 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 7,472 hours.

Breakdown of audit files reviewed by the CSSF in 2020 per entity type



Breakdown of audit files reviewed by the CSSF in 2020 per sector



² PwC, KPMG, Deloitte, EY.

³ Firms that carry out over 100 audit engagements (as at 31 December 2020, three firms are concerned).

⁴ Based on the statements of *cabinets de révision agréés* as at 31 December 2020.

2.3. Conclusions of the 2020 quality assurance review campaign

The 25 reviews carried out in 2020 were subject to an inspection report.

In particular, out of these 25 reviews, the CSSF carried out a specific follow-up of 12 *réviseurs d'entreprises agréés* due to previous campaign conclusions. The specific follow-up was maintained for three of them.

For the 2020 campaign (specific follow-ups excluded), the following conclusions were transmitted to the *réviseurs d'entreprises agréés*:

- a training plan was given to one *réviseur d'entreprises agréé*;
- the audit files of one *réviseur d'entreprises agréé* must, prior to the signature of any audit report, be subject to an engagement quality control review of the statutory audit by a second *réviseur d'entreprises agréé* who has not participated in carrying out the reviewed statutory audit;
- eleven *réviseurs d'entreprises agréés* are subject to a specific follow-up.

2.4. Major issues identified during the quality assurance reviews of 2020

2.4.1. Review of the internal quality control systems

In 2020, the CSSF's work focussed on the internal processes of the *cabinets de révision agréés* allowing a timely follow-up on the population of PIEs in order to comply with the requirements of Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of PIEs and, in particular, the following articles:

- Article 4(2): Fee Cap, date on which the follow-up has to start and any derogations requested or granted;
- Article 13(2)(f): list to be included annually in the transparency report of PIEs for which the statutory auditor or the audit firm carried out statutory audits during the preceding financial year (its accounting year);

- Article 14: information for competent authorities on the revenue generated from services provided to PIEs;
- Article 17 and, by extension, Article 41 on the rotation of the audit firm and on the rotation of key audit partners.

The CSSF noted that this process is not sufficiently centralised within the *cabinets de révision agréés* to enable the provision of non-conflicting information in relation to the objectives pursued by the European regulation and recommended that they address this issue.

2.4.2. Audit files

Contrary to the trend observed in the past years, the number of observations made and the number of significant shortcomings identified following the quality inspections both rose in 2020, although the number of reviews performed was substantially the same as in 2019. This cannot be exclusively ascribed to the COVID-19 health crisis and to the occasionally difficult conditions under which audits and remote staff management had to be performed. Indeed, as regards the audited files, the financial year closings analysed (mostly as at 31 December 2019) as well as the interim audit involvement for testing the efficiency of the internal controls for the year 2019 and preparing the final involvement were not yet heavily impacted by the pandemic. Thus, further efforts will be required from *cabinets de révision agréés* to increase the quality of the audits performed.

The following graphs summarise the observations made during the quality inspections.

Main observations issued on the files

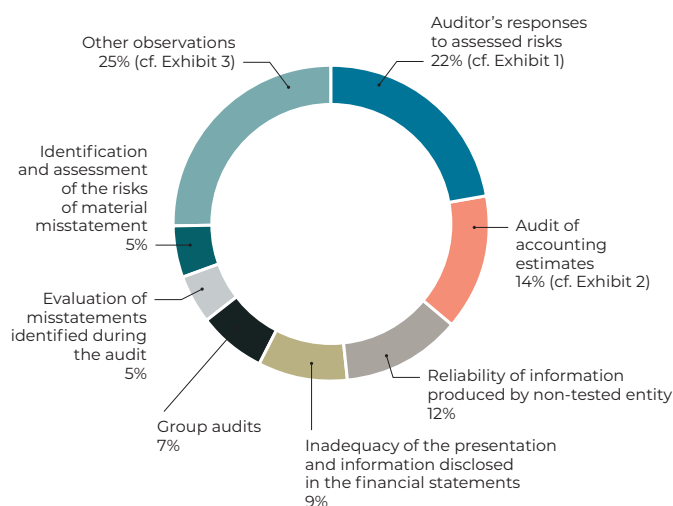
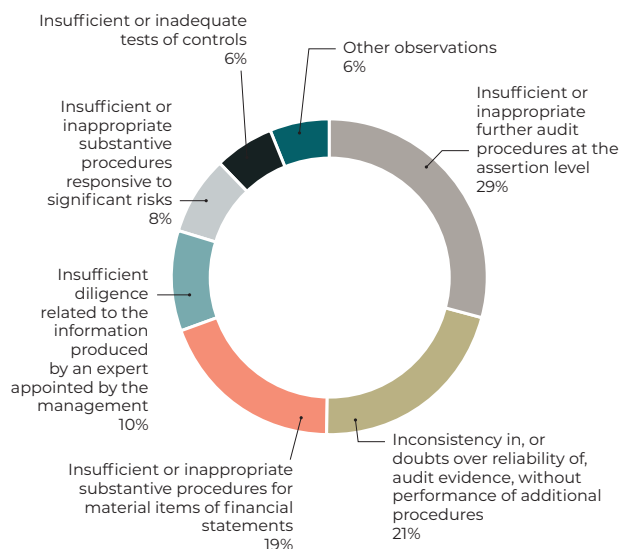
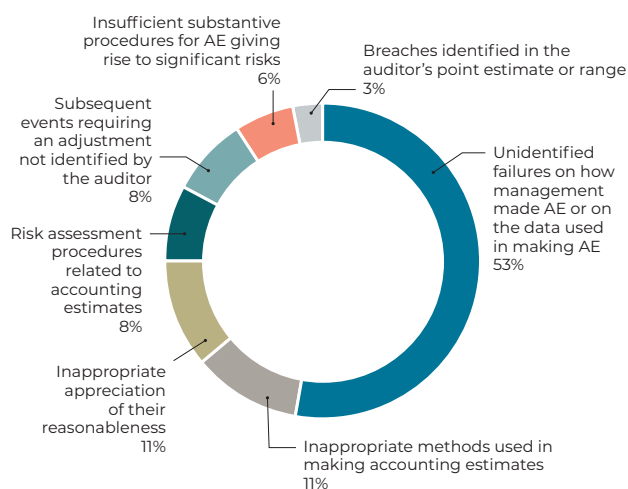


Exhibit 1: Auditor's responses to assessed risks**Exhibit 2: Audit of accounting estimates (AE)****Exhibit 3: Other observations issued on the files**

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 the activity by way of free provision of services.

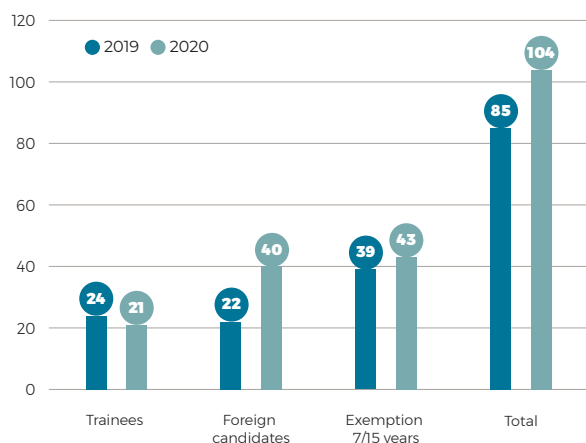
The commission met eight times in 2020 and analysed the files of 104 candidates, against 85 in 2019, representing a 22% increase.

In 2020, the access to training was refused to four candidates (4%) as the number of subjects to be completed based on their administrative certificate was greater than four.

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



85% of the candidates come from the “Big 4”. As regards the nationality, most of the candidates come from France (42%), followed by Germany (11%), Belgium (9%) and Luxembourg with 8%. The remaining 30% originate from various other countries.

3.1.2. Examination of professional competence in 2020

The CSSF administrates the examination of professional competence in accordance with Articles 5 and 6 of the Grand-ducal Regulation of 14 December 2018 determining the requirements for the professional qualification of *réviseurs d'entreprises*.

In this context, the CSSF granted, based on the decision of the examination jury, the title of “*réviseur d'entreprises*” (statutory auditor) to eight out of the 26 candidates registered for the written and oral exams of the examination of professional competence.

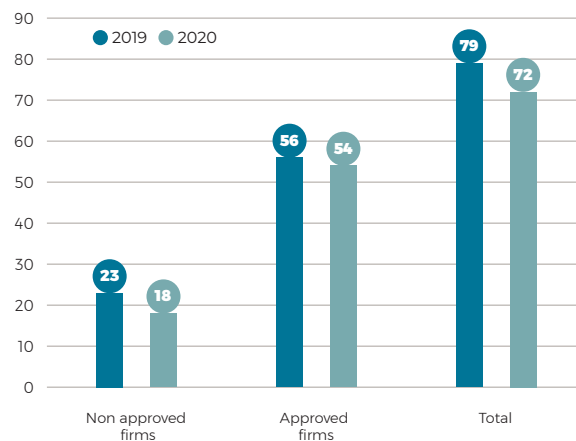
3.2. Public register

The public register of *réviseurs d'entreprises agréés*, *cabinets de révision agréés* and third-country auditors and audit entities is available on the CSSF website (<https://audit.apps.cssf.lu>).

3.2.1. National population as at 31 December 2020

• 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 72 as at 31 December 2020, against 79 as at 31 December 2019.



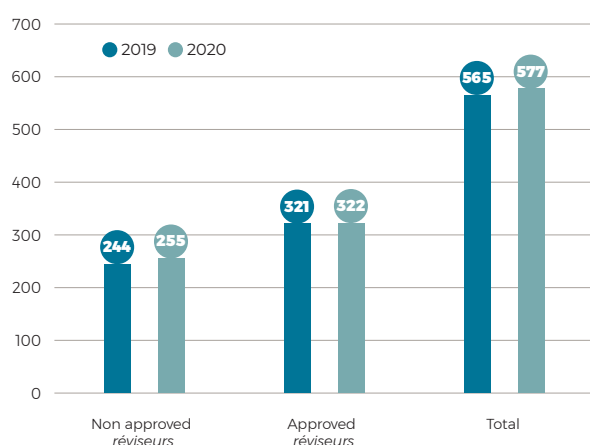
The following firm was approved in 2020:

- ACE Alpha conseil et expertise S.à r.l.

In 2020, seven firms gave up their title of “*cabinet de révision*” (audit firm) and three firms gave up their approval.

- **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 577 as at 31 December 2020, against 565 as at 31 December 2019.



In 2020, the CSSF granted the title of “*réviseur d'entreprises*” (statutory auditor) to 34 people and approved 23 *réviseurs d'entreprises*.

During the year under review, 22 *réviseurs d'entreprises* gave up their title.

The population consists of 69% men and 31% women. The average age of the *réviseurs* is 43.95 years for women and 46.39 years for men.

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

The total number of trainee *réviseurs d'entreprises* amounted to 61 as at 31 December 2020, against 65 as at 31 December 2019.

The population consists of 61% men and 39% women. The average age of trainees is 29.47 years for women and 29.26 years for men.

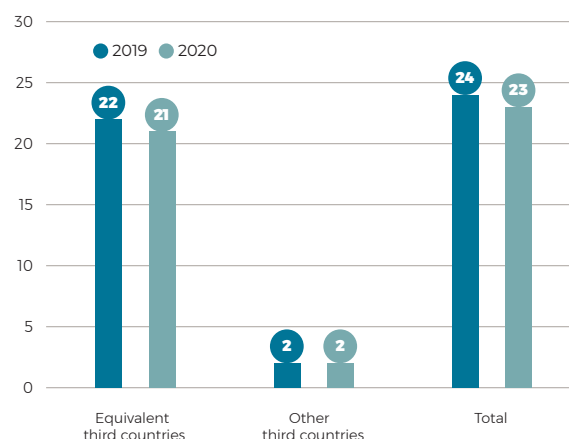
It should be pointed out that 74% of the population of trainees comes from the “Big 4” firms.

3.2.2. Third-country auditors and audit firms

The number of third-country auditors and audit entities that provide an auditor's report on the annual or consolidated financial statements of a company incorporated outside an EU Member State, whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange, decreased by one entity in 2020. This entity did not renew its registration with the CSSF, as its activities no longer fall within the scope of the amended Directive 2006/43/EC.

The public register listing all registered third-country auditors is available on the CSSF website.

Breakdown of registered third-country auditors



4. Cooperation agreements

The CSSF did not sign any new cooperation agreement in 2020. The agreements previously concluded are available on the CSSF website.



XVII. Instruments of supervision

1. On-site inspections

The “On-site inspection” (OSI) department, with a strength of 80 people as at 31 December 2020, is in charge of coordinating all on-site inspections conducted by the CSSF with regard to banks¹, payment institutions, electronic money institutions, UCIs as well as their management companies, investment firms, specialised PFS, support PFS, pension funds, securitisation undertakings and financial market participants. Moreover, the OSI department coordinates on-site inspections of Luxembourg significant banks with the “On-site inspection” department of the ECB. It should be noted that, besides the OSI department, other CSSF departments also carry out targeted on-site inspections.

On-site inspections are in-depth investigations which provide a better understanding of the functioning and activities of the supervised entities and allow the assessment of the risks to which these entities are exposed and their compliance with the laws and regulations. In general, on-site inspections are proposed, on an annual basis, by the supervisory departments which have developed a risk-based approach in this field to determine which professionals must undergo an on-site inspection. Subsequently, an annual planning is established and validated by the Executive Board of the CSSF. Any change, insertion or deletion in this annual planning must be subject to a formal validation.

The year 2020 was marked by the COVID-19 pandemic which brought with it many challenges including conducting missions at professionals confronted with a lockdown and the related technical and human problems. Due to these particular circumstances, the CSSF and the ECB, and all the other parties involved, were forced to develop alternative ways and methods to ensure the continuity and quality of the on-site inspections which were not conducted on site as usual but remotely as from March 2020.

The pandemic thus required a large capacity for adaptation and flexibility of the CSSF, but also of professionals. The means of communication and the way to conduct on-site inspections have changed accordingly. The communication and follow-up were enhanced and the technical means were adapted (for example, through the use of a secure exchange platform (Managed File Transfer – MFT), the organisation of telephone conferences including screen shares, etc.).

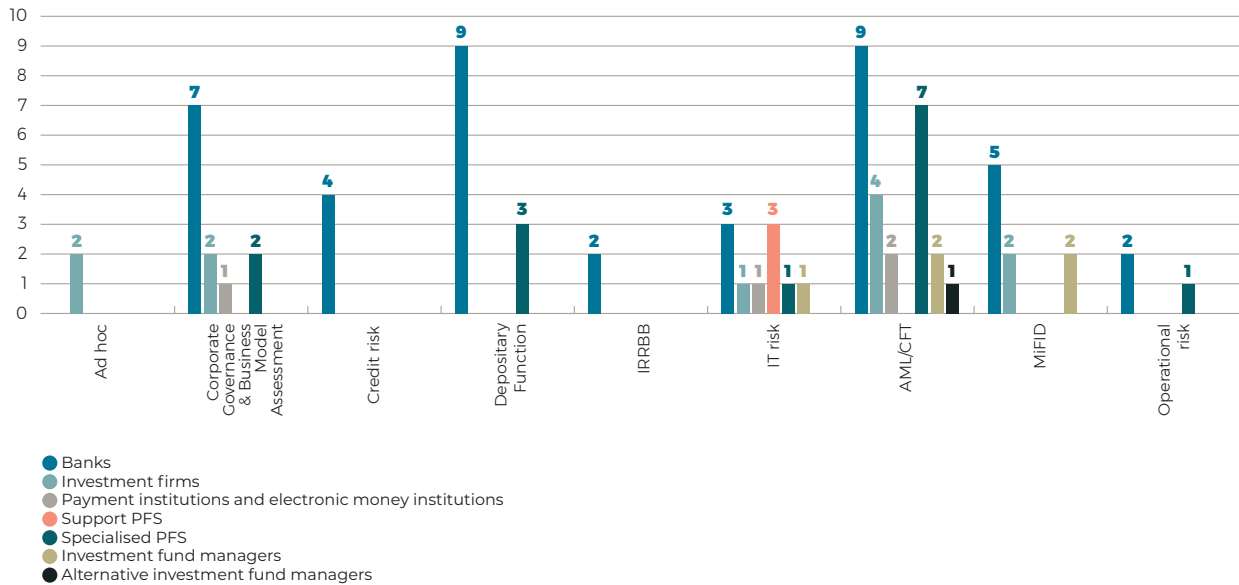
The teams in charge of on-site inspections² are set up based on the nature, scale and scope of the missions and generally involve the participation of the agents of the OSI department and off-site supervisory departments.

After each on-site inspection, the team in charge draws up an internal report on the controls performed and on the weaknesses identified during the on-site inspection. The observations are then shared with the professionals during a fact validation meeting. Generally, on-site inspections are followed by an observation letter that is sent to the inspected professional. In the event of

¹ This includes less significant banks which are not directly subject to the 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.

Breakdown of the on-site inspections carried out in 2020 by topic and type of entity (excluding UCI departments)



more serious failures, the CSSF analyses whether it needs to launch an injunction procedure or a non-litigious administrative procedure in order to impose an administrative sanction pursuant to the sectoral laws in force. The sanctions and means of administrative police are described in detail in point 2. of this chapter.

Since the entry into force of the Grand-ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF, a lump sum is billed for every on-site inspection relating to a specific topic. This lump sum amounts to EUR 25,000 for banks, to EUR 1,500 for agents acting on behalf of a payment institution or electronic money institution and to EUR 10,000 for the other entities.

In 2020, 121 (on-site) inspections were conducted by the CSSF departments or with their participation. This slight decrease compared to 2019 may be seen in relation to the COVID-19 pandemic and the organisational changes resulting therefrom. Among the missions conducted, 42 were performed by the UCI departments and are described in point 4.3. of Chapter IX “Supervision of investment fund managers and UCIs”. The other 79 missions concerned the following topics.

1.1. Ad hoc on-site inspections

Ad hoc on-site inspections are intended for the investigation of a given situation or a specific, or even worrying, issue 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 inspections may vary significantly and, consequently, determine the composition and size of the on-site inspection teams.

In 2020, two ad hoc on-site inspections were performed. In addition, several ad hoc missions initiated in 2019 continued through 2020. They concerned, in particular, governance and anti-money laundering and countering the financing of terrorism.

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 how interest rate risk arising from non-trading activities is managed and to assess the stress test results. They are performed based on the methodology covering the interest rate risk prepared by the ECB.

In 2020, the CSSF carried out two IRRBB missions, including one at a significant bank in the framework of the SSM. These missions revealed that interest rate risk management had not yet been considered adequately, notably with respect to the implementation of the EBA requirements.

The shortcomings notably concerned a lack of involvement of the supervisory bodies and the risk control function in the IRRBB management, an incomplete risk identification, a risk quantification that does not include all the IRRBB components, a modelling risk not adequately controlled and mitigated and, finally, data quality problems.

1.3. “Operational risk” on-site inspections

“Operational risk” on-site inspections, excluding internal models, aim to verify how operational risk is identified, controlled, managed and measured. They also include outsourcing-related inspections. They are performed based on the methodology covering operational risk prepared by the ECB.

In 2020, the CSSF carried out two missions with regard to the outsourcing of fund administration activities. The CSSF also contributed to a mission at a significant bank established abroad and having a subsidiary in Luxembourg. This mission was still ongoing at the beginning of 2021.

As regards outsourcing, the CSSF identified a certain number of shortcomings with respect to the initial risk assessment and the materiality assessment of the outsourced projects. Moreover, the implementation of the EBA guidelines is still incomplete regarding, for example, the development of an exit plan or an exit strategy for the outsourcing of critical or important functions, the outsourcing policy, the definition of key performance indicators or the maintenance of the outsourcing register.

It should be noted that the CSSF participated in the ECB drafting team whose purpose was to update the inspection methodology according to the new EBA guidelines applicable since 2019.

1.4. “Credit risk” on-site inspections

The purpose of “Credit risk” on-site inspections is to verify the soundness and prudence of credit risk management within credit institutions. They are performed based on the methodology covering the credit risk prepared by the ECB.

In 2020, the CSSF carried out four “Credit risk” missions, including one at a significant bank in the framework of the SSM. Two missions were still ongoing at the beginning of 2021. These missions covered various subjects such as mortgages, corporate banking loans and lombard loans.

As regards the weaknesses identified, the CSSF often noted that the Risk Appetite Statement was incomplete with the absence of an adequate limit-system and that the credit granting process suffered from deficiencies, in particular for the identification and management of debtors with financial difficulties.

Finally, as regards more specifically IFRS 9, shortcomings were identified at the level of the management’s involvement in the IFRS 9 implementation, the governance of credit granting models (model discrimination, absence of back testing, solvency analysis, etc.) and the provisioning policies. At the level of Significant Increase in Credit Risk, the assessment did not necessarily lead to a transfer between stages or considered only days past due, while other information was available without undue costs or efforts. An underestimation of the LGD, incomplete information in the FINREP, as well as days past due unrecognised in time at accounting and credit monitoring level were also observed.

1.5. “Anti-money laundering and countering the financing of terrorism” (AML/CFT) on-site inspections

AML/CFT on-site inspections are described in detail in point 1.2. of Chapter XX “Financial crime” which relates more particularly to the CSSF’s supervision with respect to AML/CFT.

1.6. “Corporate Governance” on-site inspections

“Corporate Governance” on-site inspections aim to assess the quality of the governance framework set up by the professionals pursuant to the legal and regulatory requirements. Thus, may be subject to such an inspection: the overall internal governance arrangements, the “head of group” function carried out by a Luxembourg entity over its subsidiaries and/or branches, the organisation and efficiency of the internal control functions of an entity, the remuneration policies or the outsourcing organisation.

In 2020, 12 “Corporate Governance” on-site inspections were carried out at credit institutions, whether supervised by the CSSF or directly by the ECB, as well as at investment firms, electronic money institutions, payment institutions and specialised PFS.

The controls were performed on the functioning of, and the collaboration between, the Board of Directors, the authorised management, their committees and the internal control functions. On-site inspections were also carried out on the inspected entities’ compliance with the outsourcing regulatory requirements, as well as the remuneration policies and practices.

The major weaknesses, by recurrence or severity, that were observed in 2020 at the level of the Boards of Directors and their specialised committees, concerned deficiencies relating to the management of existing and potential conflicts of interest and the responsibility they are required to take under the regulations. In this field, discrepancies were raised as regards the assessment of the internal control system, and in particular the critical assessment of the quality of the work submitted by the authorised management and the internal control functions. Deficiencies were also observed during the process for the initial and ongoing assessment of the suitability, succession and performance of the inspected entities’ key functions. Weaknesses regarding the definition, approval and implementation of the remuneration policy or business strategies of the inspected entities were also identified.

At the level of the authorised management and the management committees, the main gaps identified relate to their functioning and responsibilities. They concerned, in particular, the supervision of the

business and financial activities of the inspected entities, including their subsidiaries and branches, as well as the internal governance arrangements. The formalisation and communication of the management decisions or the monitoring of the proper implementation of the recommendations issued by the control functions were among the most observed weaknesses.

Deficiencies were also identified in the governance of the outsourced activities and functions, be it at the level of the prior identification of risks, the assessment of their materiality level, the drafting of framework contracts and procedures, or even during the supervision of the activities and functions which are outsourced by the inspected entities.

The results of the controls showed that shortcomings relating to the assessment of the performance and remuneration of the internal control functions, at the level of the “head of group” as well as within subsidiaries and branches, may impact the independence, the objectivity and the authority of these functions.

In 2020, an increasing number of deficiencies was observed at the level of the Compliance function compared to the other internal control functions, and in particular in cases it is the “head of group” function. Indeed, the Compliance function did not systematically draw up a control plan according to a risk-based approach, which prevented the coverage of all compliance risks and sometimes resulted in carrying out first line controls. Shortcomings and delays in implementing the control plan, in following up on the identified weaknesses and in the content of the reports to governing bodies were also identified and are highlighted by the lack of resources detected during several on-site inspections. Finally, it was noted that the compliance charter, the policies and procedures covering the compliance fields and the register of conflicts of interest are incomplete or not updated on a regular basis.

As regards the risk control function, an absence of involvement was observed at the level of making key decisions as well as the clear definition of its responsibilities. In addition, weaknesses relating to the risk management strategy, the system of limits and the risk control plan were observed within the inspected entities.

Deficiencies were also observed as regards the timely communication of the weaknesses or risk appetite indicators identified by the risk control function.

Lastly, it should be noted that the organisation and the performance of the risk control function are not only assessed during corporate governance controls but also during controls relating to specific risk types (for example credit risk, operational risk, etc.) as regards their potential implications for governance aspects.

As for the third line of defence, the CSSF found that some internal audit plans were incomplete or prepared without considering a risk-based approach. Several on-site inspections also revealed gaps in the quality of the internal audit function's work, be it at the level of the scope of the work performed, the comprehensiveness of the identified weaknesses or the communication, to the governing bodies, of delays or time extensions in the implementation of remediation measures.

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 an institution's business and risk strategies are linked while pursuing its medium- and long-term financial interests. The main purpose of these missions is to better understand the sources of income and to identify vulnerabilities as regards profitability. Thus, this is an in-depth assessment of the viability and sustainability of an entity.

In 2020, the CSSF carried out this type of mission at two credit institutions.

The missions highlighted weaknesses in the governance of the strategy of a subsidiary established in Luxembourg. It appeared in particular that the Board of Directors neither reassessed nor approved the entity's strategy and financial projections. The CSSF also observed discrepancies between the business plan and the strategy of the entity, as well as that of the group.

Moreover, the internal control functions were not involved in the process of defining the strategy which, in addition, was not communicated internally.

The absence of detailed management information and analyses of reliable performance factors resulted in an inability to quantify the influence of the pricing strategy on the profitability of the clients or services and the sustainability of revenues. Moreover, the local governance of the approval and the pricing of new products and services had not been implemented.

Finally, it was pointed out that the financial planning of an entity was exclusively based on assumptions developed at the level of the parent entity without the local management committee's intervention. As a result of the weaknesses relating to the absence of performance indicators and consistent financial projections, an entity was unable to assess the viability and sustainability of its business model.

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 as regards investor protection and the related organisational measures.

In 2020, the CSSF carried out nine "MiFID" on-site inspections at credit institutions, investment firms, management companies authorised under Chapter 15 of the Law of 17 December 2010 relating to UCIs and alternative investment fund managers within the Law of 12 July 2013.

Six out of nine inspections had a reduced scope which allowed focusing on a MiFID theme or on a group of themes according to the risk assessment of the off-site supervisory departments. These inspections notably covered the suitability assessment of investment products or services, the provision of information to clients or the MiFID organisational requirements.

Major weaknesses identified during MiFID controls carried out in 2020 mainly concerned the following MiFID themes: product governance, suitability assessment of investment products or services, identification and management of conflicts of interest, inducements and provision of information to clients.

In respect of the suitability assessment of investment products or services, the CSSF would like to stress that failures to comply with the obligations already provided for in the MiFID regime applicable before 2018 were again identified during certain “MiFID” on-site inspections conducted in 2020, as well as failures to comply with the new obligations introduced by the MiFID II regime applicable to date. The most significant shortcomings were the following:

- deficiencies in the clients’ risk profiling and investment strategy, following the suitability assessment and, in particular, the use of discharges to be signed by clients in case of incompatibility between the risk profile and investment strategy or insufficient verification of the justifications put forward by clients as regards such inadequacy;
- deficiencies in the update of the information collected on clients for suitability assessment needs;
- missing or incomplete suitability statement or periodic assessment and, in particular, absence of explanations provided to clients on how the advice provided matches their preferences, their characteristics and their investment objectives;
- incomplete financial instruments classification (complexity, types of risk);
- deficiencies in the control framework (first or second line of defence) in place to monitor the suitability assessment process;
- insufficient framework regarding equivalent investments (taking into consideration their costs and their complexity level) and investment switching in order to ensure that a sufficient assessment of the respective costs and benefits is systematically carried out.

1.9. “Depository” on-site inspections

In 2020, the CSSF conducted 12 on-site inspections regarding the “Depository” function: nine at banks and three at specialised PFS.

In the framework of these inspections, the CSSF verified whether the supervised entities carry out the depository function in compliance with the existing laws and regulations. The on-site inspections covered, in particular, the procedures and controls implemented to ensure the safekeeping of the different types of assets, the due diligence processes with respect to the different types of parties involved in the safekeeping of assets, respectively in the management of UCIs, the process of acceptance of new depository mandates, the monitoring of the delegated activities as well as the specific oversight duties. The CSSF reiterates that the depository must act in the interest of the investors and independently.

The CSSF identified some significant weaknesses in the ownership verification for other assets which had not yet been rigorously and systematically carried out, in particular where the underlying assets are held by financial or legal structures established for the purposes of investing in the underlying assets. During these inspections, the CSSF stresses, in particular, that the AIF’s investment policy is considered as a key criterion in the depository’s decision whether or not to apply the look-through principle when verifying the assets’ ownership, and not exclusively the criterion of direct or indirect control by the AIF or the AIFM acting on behalf of the AIF.

As regards the other oversight duties, the CSSF noticed that some depositories limited their monitoring to exercising standardised controls of the tasks under the direct responsibility of the management of the UCI, without taking into consideration the specific characteristics of the different UCIs and their investments, or the quality of the controls performed and the processes in place at the UCI and its service providers.

Finally, the CSSF revealed a certain number of deficiencies that were directly related to the governance of the depository function, notably as regards the management of conflicts of interest, the policy on the outsourcing of supporting tasks, the execution of an escalation procedure in case anomalies were identified and the supervision exercised by the internal control functions on the activity.

1.10. “IT risk” on-site inspections

A specialised team of the “Supervision of information systems and support PFS” department is in charge of conducting IT on-site inspections at the supervised entities. In 2020, this team performed, on behalf of the CSSF, five on-site inspections at a bank, a payment institution and three support PFS. It also performed one on-site inspection at a significant bank abroad in the framework of the SSM. Moreover, it cooperated with other CSSF teams in carrying out three inspections: a “Governance” inspection at a management company, an “Operational risk” inspection on the outsourcing management at a specialised PFS and an ad hoc inspection at an investment firm. Moreover, a member of the team contributed to a mission on cybersecurity at a significant bank abroad.

The main shortcomings, in terms of frequency or seriousness, identified in 2020 during the “IT risk” on-site inspections concerned:

- IT security, including in particular the management of the configurations applied to the IT systems in order to protect them from malicious events, the privileged access control, the management and remediation of critical vulnerabilities as well as the monitoring of the events related to IT security;
- the management of IT projects as well as the related risks;
- the management of IT risks, with a very low, or even no risk coverage by the second line of defence;
- internal audit, notably the low coverage of IT activities as well as the low quality of audit work and competence issues to assess related risks;
- continuity of activities as a whole (governance, plans and tests);
- outsourcing, in particular the contractual aspect and operational monitoring, often due to overconfidence in parent undertakings.

2. Decisions as regards sanctions and administrative police taken in 2020

In 2020, the CSSF took the following decisions with respect to sanctions and administrative police. It should be noted that the total amount of administrative fines imposed by the CSSF in 2020 amounted to EUR 6,061,700 and there were five withdrawals of natural persons’ professional repute.

2.1. Credit institutions

In 2020, the CSSF imposed four administrative fines on credit institutions pursuant to Articles 63 and 63-2 of the Law of 5 April 1993 on the financial sector, and based on Article 51 of the Law of 12 July 2013 on alternative investment fund managers.

Two fines, amounting to EUR 4,600,000 and EUR 170,000, respectively, were imposed for non-compliance with the AML/CFT professional obligations. Another fine, amounting to EUR 133,700, was imposed due to shortcomings in relation to the depositary bank function. One bank had to pay a fine of EUR 41,050 for non-compliance with the market abuse professional obligations³.

In one case, the CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector due to non-compliance with the professional obligations relating to the function of depositary bank.

2.2. Investment firms

In 2020, the CSSF imposed five administrative fines on investment firms as legal persons.

Three fines were imposed in accordance with Article 63 of the Law of 5 April 1993 on the financial sector, including two on the same investment firm, for the following reasons:

- non-compliance with several professional obligations relating to the implementation of robust internal governance and AML/CFT arrangements (EUR 25,000) and failures to comply with certain professional obligations as regards AML/CFT, MiFID regulation and cooperation with authorities and internal governance (EUR 150,000);

³ Cf. also point 2.6 below.

- non-compliance with certain professional obligations under MiFID regulation and as regards AML/CFT (EUR 35,000).

Another investment firm had to pay a fine of EUR 30,000, in accordance with Article 63-2a of the Law of 5 April 1993 on the financial sector for non-compliance with certain professional obligations under the MiFID regulation.

Furthermore, the CSSF imposed an administrative fine of EUR 106,000 on an investment firm, in accordance with Articles 63 and 63-2a of the Law of 5 April 1993 on the financial sector and Article 8-4 of the Law of 12 November 2004 on the fight against money laundering and terrorist financing. The sanction was tied to serious failures to comply with the professional obligations under the MiFID regulation, as regards internal governance and AML/CFT.

In five cases, 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:

- shortcomings identified as regards the AML/CFT regulation applicable;
- high number of shortcomings identified by the internal auditor within the context of the 2018 financial year closing and non-compliance with the MiFID regulation;
- high number of weaknesses identified by the external *réviseur* (auditor) and by the internal auditor within the context of the 2018 financial year closing;
- shortcomings identified in the internal governance.

In 2020, the CSSF transmitted two reports to the State Prosecutor pursuant to Article 74-2(4)(2) of the Law of 7 March 1980 on judicial organisation and two reports pursuant to Article 23(2) of the Code of Criminal Procedure and Article 74-2(4)(2) of the Law of 7 March 1980 on judicial organisation.

The CSSF reported 55 cases to the Prosecutor's Office, over the course of the year, regarding entities which claimed to be established in Luxembourg and offering investment services without authorisation. The rise in the number of cases since 2018 (13 cases in 2018 and 45 cases in 2019) can be mainly explained by the emergence of fake websites meant to mislead potential investors.

2.3. Specialised PFS

In accordance with the provisions of Article 63(2) of the Law of 5 April 1993 on the financial sector, the CSSF imposed an administrative fine of EUR 190,000 on a specialised PFS for breach of the AML/CFT professional obligations.

In two cases, the CSSF used its right of injunction in accordance with Article 59 of the aforementioned law, including one for non-compliance with the AML/CFT professional obligations and the other due to the absence of prior communication to the CSSF of a change in the shareholding (breach of Article 18(5) of the Law of 5 April 1993 on the financial sector).

Furthermore, the CSSF reported suspicious transactions four times, in 2020, pursuant to Article 23(2) of the Code of Criminal Procedure and pursuant to Article 74-2(4)(2) of the Law of 7 March 1980 on judicial organisation.

2.4. Support PFS

Pursuant to Article 63 of the Law of 5 April 1993 on the financial sector, the CSSF imposed an administrative fine on three support PFS amounting to EUR 30,000, EUR 8,500 and EUR 1,250, respectively, due to insufficient capital base, non-compliance with an injunction, change in the shareholding without prior notice and repeated delays in submitting the prudential reporting.

2.5. Investment fund managers (IFMs)⁴ and investment funds

In 2020, the CSSF imposed an administrative fine amounting to EUR 27,000 on an IFM. This fine was imposed following an on-site inspection conducted by the CSSF at the IFM which revealed occasional breaches of the provisions of the 2010 Law governing the general requirements for procedures and organisation as well as the requirements for the delegation of functions.

Moreover, the CSSF imposed an administrative fine of EUR 23,000 on an IFM following an on-site inspection performed by the CSSF at the IFM which revealed certain occasional breaches (i) of the provisions of the 2010 Law governing the general requirements for procedures and organisation, and (ii) of the provisions of the 2013 Law governing conflicts of interest during the alternative investment fund management and requirements for the delegation of functions.

Another administrative fine of a total amount of EUR 45,000 imposed on an IFM resulted from an on-site inspection performed by the CSSF at the IFM which revealed occasional breaches (i) of the provisions of the 2010 Law governing the general requirements for procedures and organisation, the requirements for the delegation of functions as well as the AML/CFT arrangements, and (ii) of the provisions of the 2013 Law governing the requirements for risk management and assessment as well as the compliance with all the regulatory requirements applicable to the conduct of the IFM's business activities in the best interests of alternative funds or alternative funds' investors.

The CSSF imposed an administrative fine of a total amount of EUR 31,000 on an IFM, which resulted from an on-site inspection performed by the CSSF at the IFM which revealed occasional breaches (i) of the provisions of the 2010 Law governing the general requirements for procedures and organisation, the requirements for the delegation of functions as well as the risk management arrangements, and (ii) of the provisions of the 2013 Law governing the requirements for risk management and assessment as well as the compliance with all the regulatory requirements applicable to the conduct of the IFMs' business activities in the best interests of alternative funds or alternative funds' investors.

An administrative fine of a total amount of EUR 26,700 imposed on another IFM resulted from an on-site inspection performed by the CSSF which revealed occasional breaches of the provisions of the 2013 Law governing the requirements to act in the best interests of AIFs or investors of AIFs they manage and the integrity of the market, the identification of conflicts of interest during the management of AIFs and the information to be provided to investors, respectively.

In 2020, an IFM had to pay a fine amounting to EUR 10,000 following closet index tracking investigations carried out by the CSSF in relation to a compartment of an investment company subject to the provisions of Part I of the 2010 Law and which designated the IFM as management company. These investigations highlighted, over the period starting at the end of 2012 until the beginning of 2017 when the compartment was absorbed by another compartment of the same investment company, breaches, in the IFM's management of the compartment, of legal provisions governing the requirements for transparency at the level of the prospectus and the Key Investor Information Document (KIID), rules of conduct by charging the compartment and its unit-holders with undue costs as well as the IFM's internal control arrangements.

⁴ It should be pointed out that some of these administrative fines are still subject to reviews (*recours gracieux* or *recours administratif*) which are pending before the administrative courts.

In accordance with the provisions of Article 148(4)(e) of the 2010 Law and Article 51(2) of the 2013 Law, the CSSF imposed an administrative fine of EUR 240,000 on an IFM. This fine was imposed following an on-site inspection at the IFM which highlighted certain breaches (i) of the provisions of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, in particular at the level of the process for a new client to enter into a business relationship, the account opening process for a new investor, the risk-based approach, ongoing due diligence, internal organisation and cooperation with the FIU, and (ii) of the provisions of the 2010 Law as well as the provisions of the 2013 Law governing the specific organisational requirements for the organisation of the portfolio management function, assessment function, UCI administration function, but also the requirements for the delegation, the rules of conduct in place for its activities as well as the requirements for the organisation and conflicts of interest.

In accordance with the provisions of Articles 3(1)(1) and 3(1)(4)(c) of the Law of 15 March 2016 on OTC derivatives, central counterparties and trade repositories, and by taking into account the provisions of Article 3(3) of this law, the CSSF imposed an administrative fine of EUR 20,000 on an IFM for non-compliance with the requirements relating to the reporting of details of any derivative contract concluded as well as any amendment to, or termination of, the contract to a registered or recognised trade repository, and for provision of inaccurate information to the CSSF.

Also, in accordance with the provisions of Article 8-4(2)(b) of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, the CSSF issued two reprimands against one investment company with variable capital and one registered alternative investment fund manager. These reprimands were issued due to the submission, outside the requested deadlines, by the fund of the 2019 AML/CFT questionnaire available online and administered by the CSSF.

Moreover, the CSSF imposed an administrative fine of EUR 4,000 on a natural person for filing an incomplete declaration of honour.

In 2020, the CSSF decided to withdraw one UCITS and six SIFs from the official list for non-compliance with the legal provisions.

2.6. Securities markets

The review of financial reports under the Transparency Law led the CSSF to issue, pursuant to Article 25 of the aforementioned law, one administrative fine amounting to EUR 10,000, mainly due to delays in the disclosure and filing of an annual financial report.

In 2020, the CSSF imposed one administrative fine amounting to EUR 41,050 on a credit institution under Article 12 of the Law of 23 December 2016 on market abuse. The fine was imposed for certain breaches, identified following an ad hoc on-site inspection, of Article 16(2) of the Market Abuse Regulation and the regulatory technical standards set out in Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 supplementing Regulation (EU) No 596/2014 with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions.

2.7. Audit profession

Pursuant to the provisions of Article 43(1)(f) of the Law of 23 July 2016 concerning the audit profession (Audit Law) and taking into account the provisions of Article 44 of this law, the CSSF imposed administrative fines on five *réviseurs d'entreprises agréés* (approved statutory auditors) amounting, as the case may be, to EUR 5,000, EUR 8,000, EUR 10,000, EUR 28,000 and EUR 52,000. These administrative fines were imposed based on the provisions of Article 40(2) and points (a) and (b) of Article 43(2) of the Audit Law for professional misconduct and negligence which led to the infringement of the legal and regulatory requirements relating to statutory audits.

Pursuant to the provisions of Article 43(1)(f) of the Audit Law, the CSSF issued an administrative fine of EUR 1,500 against one *réviseur d'entreprises agréé*. This fine was issued in accordance with the provisions of Article 43(2)(a) of the Audit Law for infringement of the legal and regulatory requirements relating to ongoing training.



XVIII. 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 which counted 16 people as at 31 December 2020.

The Resolution Board met twice in 2020 and also took decisions by written procedure.

In line with the distribution of responsibilities, particularly between the Resolution Board and the Single Resolution Board (SRB), the RES department is in charge, among other things, at individual and group level, as concerns credit institutions and investment firms falling within the scope of the BRRD Law or Regulation (EU) No 806/2014 (the SRM Regulation), of submitting the following for decision to the Resolution Board:

- adoption of resolution plans and resolvability assessments;
- measures to address or remove impediments to resolvability;
- appointment of a special manager;
- assurance regarding a fair, prudent and realistic valuation of the assets and liabilities;

- application of simplified obligations or granting waivers, among others, to the obligation to draft a resolution plan;
- setting of the minimum requirement for own funds and eligible liabilities, in particular its level;
- adoption of resolution decisions and application of resolution tools in accordance with the relevant procedures and safeguards;
- writing-down or conversion of relevant capital instruments;
- execution of the instructions issued by the SRB.

Moreover, the RES department represents the CSSF as resolution authority within international fora, such as the SRB and the EBA.

As far as the EBA is concerned, the RES department is represented in the Resolution Committee (ResCo) which is a permanent internal committee of the EBA, set up in January 2015, for the purposes of taking decisions and fulfilling tasks conferred on the EBA and the national resolution authorities under the BRRD. The voting members are the directors of the national resolution authorities within the EU. In addition, the RES department participates in the work of the Subgroup on Resolution Planning and Preparedness (SGRPP), a subgroup of the Resolution Committee.

With respect to the SRB, 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 2020 for the adoption by the SRB, which met in extended executive session, of resolution plans of several banking groups which included Luxembourg banking subsidiaries and of

resolution plans of Luxembourg banking groups or systemic banks.

Moreover, the agents of the RES department participate in the work of the following permanent working sub-committees of the SRB: Resolution and its sub-structures, Contributions, Data collection, Administrative and Budget and Legal Network. The CSSF also participates in the SRB ICT Network.

The RES department continues its collaboration with the SRB for the drafting of resolution plans for Luxembourg significant banks under the competence of the SRB. In this context, frequent meetings, videoconferences and information exchanges take place with the representatives of the SRB, the CSSF's "Banking Supervision" department and the relevant banks. The RES department also participates, within the Internal Resolution Teams coordinated by the SRB, in drafting resolution plans for significant banking groups in the Banking Union which have Luxembourg subsidiaries.

In a cross-border context outside the SRB, the RES department heads four resolution colleges (three colleges relating to banks for which the CSSF is the group-level resolution authority and one "European" college relating to sister banks in several EU Member States 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 of the aforementioned resolution plans for less significant banks have been adopted by the Resolution Board.

Two CSSF-CODERES circulars were published in 2020 concerning, on the one hand, the raising of 2020 contributions for the Single Resolution Fund and, on the other hand, the collection of information for the calculation by the SRB of the 2021 contribution to this fund.

Furthermore, with regard to the measures adopted within the context of the COVID-19 pandemic, a communiqué was published concerning

the information request under Commission Implementing Regulation (EU) 2018/1624 of 23 October 2018 (CIR).

In a year that was marked by the health crisis, the RES department worked relentlessly to ensure the continuity of the CSSF's mission as resolution authority. Consequently, the department's members worked remotely, on a rotational basis, and nearly all meetings with external entities (authorities, institutions, etc.) were held via videoconference or teleconference without adversely affecting the quality of the deliverables.



XIX. Protection of depositors and investors

The Council for the Protection of Depositors and Investors (CPDI) is the internal executive body of the CSSF in charge of managing and administering the Fonds de garantie des dépôts Luxembourg (FGDL) and the Système d'indemnisation des investisseurs Luxembourg (SIIL). The FGDL is an *établissement public* (public body) separated from the CSSF and established by Article 154 of the Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law). The missions of the CPDI are defined in Part III "Protection of depositors and investors" of the BRRD Law.

The CPDI is assisted in the performance of its duties by the "Depositor and Investor Protection" department (PDI department) of the CSSF which counts five agents. In general, the PDI department performs the operational tasks of the FGDL and of the SIIL.

• Activities of the CPDI and of the PDI department

The CPDI met five times in 2020. Under its management, the PDI department, in particular:

- implemented a fairer method for calculating the contributions to the FGDL (cf. Circular CSSF-CPDI 20/21) which takes into account the annual change in covered deposits for each FGDL member institution individually;
- collected data about covered deposits through four circulars and verified the data received;
- inspected the arrangements for producing the Single Customer View (SCV)¹ at three FGDL member institutions;

- developed and distributed to the member institutions an IT tool allowing them to verify that their SCV file complies with the format defined in Circular CSSF 13/555;
- performed a test of cooperation with the French deposit guarantee scheme in the framework of the stress tests provided for in the EBA Guidelines (EBA/GL/2016/04);
- continued the negotiation of bilateral agreements with its European counterparts under the Guidelines EBA/GL/2016/02 on cooperation agreements between deposit guarantee schemes in order to resolve certain operational issues of cross-border reimbursement and transfers of contributions between the deposit guarantee schemes as provided for in Articles 183 and 189 of the BRRD Law;
- assisted the Management Committee of the FGDL in its initiative to provide the FGDL with a syndicated credit line allowing it to meet its commitments in case its financial means were insufficient;
- contributed to the work initiated by the EBA, the European Commission and the Council aiming at recasting the crisis management framework;
- continued the management of the reimbursement campaign of the depositors of ABLV Bank Luxembourg S.A. (in liquidation) (cf. below).

• FGDL interventions

As a reminder, the CSSF determined the unavailability of deposits at ABLV Bank Luxembourg S.A. on 24 February 2018, and the Luxembourg *Tribunal d'arrondissement* (District court) ordered the bank's liquidation on 2 July 2019. Since March

¹ The SCV file is a database that each member institution must be able to provide to the CPDI, in accordance with Article 169 of the BRRD Law, in case the deposits become unavailable.



2018, the FGDL has been reimbursing the covered deposits of depositors who transmitted the necessary information and whose eligibility was confirmed by the CPDI. In accordance with Article 176(8) of the BRRD Law, the depositors have ten years, following the date the unavailability has been determined, to request reimbursement of their deposits by the FGDL, even in the absence of a claim accepted by the liquidators. Thus, several depositors have been reimbursed in 2020, bringing the total amount of deposits reimbursed by the FGDL to EUR 9.8 million.

Furthermore, no other intervention took place either with respect to deposit guarantee or investor compensation.

• Financing of the FGDL

As at 31 December 2020, the FGDL counted 99 member institutions. As mentioned above, the method for calculating the contributions to the FGDL has been adapted in order to apportion the burden caused by the global increase of covered deposits on the member institutions at the origin of the increase. The previous method, although compliant with the EBA Guidelines, benefited the institutions whose deposits rose, so that they paid

less than the target rate on their covered deposits, at the expense of the other institutions.

Given that in 2018, the FGDL reached, for the first time, the target level of 0.8% of covered deposits in accordance with Article 179(4) of the BRRD Law, the collection of EUR 15.0 million (EUR 13.5 million in 2019) was sufficient in order to maintain the target level which increased due to the 5% growth in the covered deposits in 2019.

The target level being reached, the condition to start collecting contributions for the buffer of additional financial means laid down in Article 180 of the BRRD Law was met. Thus, the FGDL collected the second of the eight tranches, i.e. EUR 34.9 million (EUR 31.8 million in 2019), so as to build up this buffer which must reach 0.8% of the covered deposits in 2026.

As at 31 December 2020, the available financial means of the FGDL in terms of target level amounted to EUR 265.6 million, whereas the buffer of additional financial means of the FGDL amounted to EUR 66.4 million. The covered deposits rose by 11% over a year to EUR 37.1 billion as at 31 December 2020.



XX. Financial crime

1. CSSF supervision for combating money laundering and terrorist financing

The following developments present the CSSF's involvement in the fight against money laundering and terrorist financing (AML/CFT) at national and international level throughout 2020.

The COVID-19 pandemic has severely affected the entire financial world which is facing new targeted criminal threats of which the CSSF warned the professionals subject to its supervision, at a very early stage, notably through the publication of a specific circular analysing the impacts of the COVID-19 pandemic on the fight against financial crime and against money laundering and terrorist financing (ML/TF). It is true that the health crisis has given rise to new vulnerabilities in terms of financial crime, in particular frauds, also due to changes in the way of working and the use of new remote connection technologies.

The CSSF's commitment to combating new types of financial crime is part of a global fight approach, alongside other national or international authorities, against these particular fraud patterns that may impact the financial sector.

1.1. Off-site supervision

1.1.1. Credit institutions

The functions of the "AML/CFT off-site" division, which was created in 2019 to centralise the banks' AML/CFT supervisory activities, continued to evolve in 2020 according to the regulatory requirements and given the growing interest in the fight against money laundering and terrorist financing.

In particular, the AML/CFT colleges to be set up in accordance with the "AML/CFT Colleges Guidelines" published by the Joint Committee of the European Supervisory Authorities required the recruitment of additional resources in the "AML/CFT off-site" division to meet the regulatory expectations.

Indeed, the mapping established in 2020 in accordance with the "AML/CFT Colleges Guidelines" shows that AML/CFT colleges involving about 20 Luxembourg banks will have to be set up every year by the CSSF as main supervisory authority. Moreover, the CSSF will have to participate in approximately 35 AML/CFT colleges set up by other competent EU authorities and covering nearly 50 Luxembourg banks.

However, the AML/CFT colleges do not only concern banks. Unlike prudential colleges, other types of supervised entities, as, for instance, investment firms or insurance companies belonging to the same group, may also be part of the scope of colleges if the conditions laid down in the "AML/CFT Colleges Guidelines" relating to cross-border institutions are met.

While foreign authorities competent for the AML/CFT supervision will be full members of the AML/CFT colleges to be set up by the CSSF as main supervisory authority, other authorities may, subject to the agreement of all the members, participate as observers, like the ECB for significant institutions or the Financial Intelligence Unit.

The first colleges will take place in 2021 and will be held, given the COVID-19 pandemic, in the form of videoconferencing.

The ongoing supervision exercised by the “AML/CFT off-site” division continued uninterrupted during the health crisis, complying with all the key steps. As the annual conference of the bank sector had to be postponed, the division members participated in webinars, meetings and working groups throughout the year. The meetings of the Expert Workgroup Private Banking were thus held by videoconference and at a slightly reduced frequency, considering the difficulties related to the health crisis.

1.1.2. Investment firms

The control of compliance with the professional AML/CFT obligations by investment firms is an integral part of the supervisory framework put in place by the CSSF. The AML/CFT supervision is based on a multiannual control programme which combines off-site and on-site supervisory measures. A dedicated team has been set up within the “Supervision of investment firms” department for a centralised management of the aspects of the off-site AML/CFT supervision of investment firms.

The off-site supervision includes, inter alia, the analysis of the long form reports drawn up by the *réviseurs d’entreprises agréés* (approved statutory auditors) and the analysis of the reports drawn up by the internal control functions (compliance function, internal audit function and risk control function). A total of 34 deficiency or injunction letters were sent to investment firms with respect to shortcomings identified in these reports.

Moreover, an annual AML/CFT questionnaire, which enables the CSSF to collect quantitative and qualitative data from each entity, is sent to investment firms. Consequently, each investment firm was subject to a risk assessment in terms of AML/CFT.

In 2020, 11 interviews with the Chief Compliance Officers of investment firms were held to discuss specific AML/CFT focus points, resulting, in particular, from the answers provided in the AML/CFT questionnaires. Following these interviews, deficiency letters were sent to three investment firms and a non-litigious administrative procedure was initiated against one investment firm.

1.1.3. Specialised PFS

The control of compliance with professional AML/CFT obligations by specialised PFS is an integral part of the supervisory framework put in place by the CSSF. The AML/CFT supervision is based on a multiannual control programme which combines off-site and on-site supervisory measures.

Consequently, the “Supervision of specialised PFS” department set up, in 2019, a dedicated team to centrally manage the aspects of the AML/CFT off-site supervision of specialised PFS. This team comprised three agents as at 31 December 2020.

The primary goal of the AML/CFT team is to carry out a mainly desk-based supervision, using any relevant information sources from specialised PFS (in particular reports drawn up by the internal control functions: internal audit function, risk control function and, where appropriate, compliance function), *réviseurs d’entreprises* (statutory auditors), national or international authorities as well as from any other private or public sources.

As in 2019, the CSSF requested in 2020 all specialised PFS to answer the AML/CFT questionnaire in order to collect quantitative and qualitative data of every entity. The quantitative data collected have been integrated in the off-site AML/CFT supervision which is performed by applying a risk-based approach. Consequently, each specialised PFS was subject to an AML/CFT risk assessment which aims at establishing the CSSF's off-site and on-site AML/CFT supervisory programme. Indeed, this risk score is used as allocation key of the available (on-site and off-site) resources for the AML/CFT supervision.

A total of 37 deficiency letters were sent to specialised PFS with respect to shortcomings identified in the reports provided as part of the 2018 and 2019 closing documents, as well as the AML/CFT questionnaires.

Four AML/CFT investigations were initiated following articles including negative information published in the press, in particular in the context of the Cyprus Leaks case.

In 2020, three interviews with specialised PFS were organised to discuss specific AML/CFT focus points, resulting, in particular, from the analysis of the answers provided in the AML/CFT questionnaires.

In July 2020, the first sub-sector analysis of ML/TF risks of specialised PFS providing services to companies and trusts was published. This "Sub-Sector Risk Assessment for Specialised Professionals of the Financial Sector providing corporate services" (Trust and Company Service Provider activities) (SSRA TCSP) follows on from the "National Risk Assessment" (NRA) of Luxembourg, published in December 2018 and updated in September 2020. The NRA concluded that the sub-sector of the TCSPs, to which specialised PFS providing services to companies and trusts belong, posed a high inherent ML/TF risk. The SSRA, which affects a large proportion of the specialised PFS, analyses the TCSP services provided by the specialised PFS providing services to companies and trusts from the perspective of the main ML/TF threats and weaknesses of these specialised PFS.

1.1.4. Payment institutions and electronic money institutions

ML/TF-risk supervision within Luxembourg payment institutions and electronic money institutions is an integral part of the prudential supervisory framework of these institutions. Thus, the supervision of ML/TF risks is subject to a multiannual control programme which combines off-site and on-site supervision.

A specialised team in charge of the off-site supervision of ML/TF risks of payment institutions and electronic money institutions has been set up within the "Innovation, payments, market infrastructures and governance" department. This team centrally manages the aspects of the AML/CFT supervision of payment institutions and electronic money institutions as well as of branches and agents of payment institutions or electronic money institutions authorised in other EU Member States.

The AML/CFT strategy of the CSSF, which allows a more efficient AML/CFT control of the professionals of the financial sector, requires the adoption of a risk-based approach for the AML/CFT supervision. Thus, as with the other professionals of the financial sector, an annual AML/CFT questionnaire is sent to payment institutions and electronic money institutions as well as to branches and agents of payment institutions or electronic money institutions authorised in other EU Member States. In addition to the data collected via these questionnaires, information is collected within the framework of the on-site and off-site supervision of these institutions. These data and information allow a risk assessment and a harmonised evaluation of these institutions and agents in Luxembourg, having regard in particular to the risk level of their activities. They are also used to allocate the available (on-site and off-site) resources to AML/CFT controls, in accordance with the basic principle governing the risk-based supervision.

The key elements of the off-site supervision of ML/TF risks include the analysis of the reports of the management body, the compliance function and the internal audit function, the work carried out by the *réviseur d'entreprises agréé* (approved statutory auditor) as part of the long form report and, where relevant, a critical review of the AML/CFT procedures established by these institutions, in particular, in the event of any material change having an impact on the provision of payment and/or electronic money services, the structural organisation of the institution (for example the use of agents) and/or the AML/CFT internal control arrangements in a broad sense.

Meetings are also held and contacts are maintained, on a regular basis, with the Compliance Officers and the members of the management bodies and administrative bodies of these institutions in order to further examine certain aspects of their reports, to follow the regular developments of their activities (in conjunction with the significant technological progress in this area) and of their organisation as well as of their internal control arrangements and to raise appropriate awareness to ML/TF risks.

The team set up within the “Innovation, payments, market infrastructures and governance” department also takes part in the ML/TF risk assessment of the application files of new payment institutions or electronic money institutions and in the monitoring of the AML/CFT remediation plans to be put in place by payment institutions and electronic money institutions.

1.1.5. Virtual asset service providers

With reference to the Law of 25 March 2020 amending the Law of 12 November 2004 on the fight against money laundering and terrorist financing, any virtual asset service provider (VASP) established or providing services in Luxembourg, on behalf of or for its customer, is subject to compliance with all the professional AML/CFT obligations and must be registered with the VASP register established by the CSSF.

A virtual asset service provider means any person that provides, on behalf of or for its customer, one or more of the following services:

- the exchange between virtual assets and fiat currencies, including the service of exchange between virtual currencies and fiat currencies;

- the exchange between one or more forms of virtual assets;
- the transfer of virtual assets;
- the safekeeping or administration of virtual assets or instruments enabling control over virtual assets, including the custodian wallet service;
- the participation in and provision of financial services related to an issuer's offer or sale of virtual assets.

In accordance with the legal provisions in force, the CSSF's role vis-à-vis these providers is limited to registration, supervision and enforcement only for AML/CFT purposes.

Having regard to its new responsibilities vis-à-vis VASPs, the CSSF carried out, as a priority, the following actions in 2020:

- strengthening of its specialised teams in order to take over the registration and supervision of VASPs within the “Innovation, payments, market infrastructures and governance” department;
- participation in the development of the understanding and assessment of ML/TF risks related to virtual assets and VASPs; the risk analysis was published by the Ministry of Justice on 25 January 2021;
- drawing-up of procedures and forms to register VASPs. In this context, the CSSF had multiple communications and interviews with the private sector in order to raise its awareness to the new professional obligations and to answer the questions from the sector. Although on 31 December 2020, no VASP had yet been registered, various providers nevertheless submitted a registration file. These files are being examined at the CSSF in order to ensure that the providers meet the legal requirements incumbent upon them.
- the development of exchanges with the industry and other national and European authorities within the framework of questions regarding virtual assets and VASPs.

1.1.6. UCI departments

Within the UCI departments, the “UCI AML” division conducts remote (desk-based) controls and specific face-to-face meetings covering AML/CFT together with the other divisions of the UCI departments. The team also manages the administration of the annual AML/CFT questionnaire and the analysis of the answers provided by the IFMs and the products which have not designated a management company.

On 19 November 2020, an AML/CFT conference – held virtually due to the health context – was organised by the UCI departments to exchange views with the supervised entities and to share feedback on the results of the supervisory measures. It gathered 850 participants from the private sector. To share feedback with a broader public, the “UCI AML” division recorded and made available podcasts on the results of the AML/CFT supervision in the collective management sector. Special emphasis was placed on the importance of taking into account tax fraud indicators as provided for in Circular CSSF 20/744 dedicated to supervised entities in the collective management sector.

As part of the off-site supervision, the “UCI AML” division held 49 interviews (+70% compared to 2019) focussing on AML/CFT based on an annual inspection plan drawn up following a risk-based approach. Two named reprimands were issued for late submission of the answers to the annual AML/CFT questionnaire.

Moreover, the UCI departments consulted various foreign supervisory authorities as part of their AML/CFT supervisory mission of the entities of the collective management sector. Thus, the UCI departments sent 21 international cooperation requests to foreign authorities and received 11 cooperation requests.

Still in the context of the international cooperation and AML/CFT supervision of entities of the collective management sector, the “UCI AML” division participated, in 2020, in four AML/CFT colleges set up by European competent authorities in the context of the application of the AML/CFT rules of conduct issued by the European supervisory authorities.

Finally, the “UCI AML” division continued the activities of the Expert Working Group AML UCI set up in 2018. This working group met six times in 2020 to deal with, inter alia, the impact of the COVID-19 pandemic and to work on an AML/CFT draft report for external auditors as part of the recast of Article 49 of CSSF Regulation No 12-02.

1.2. On-site supervision

The AML/CFT on-site inspections are carried out at all the professionals supervised by the CSSF in order to assess whether the quality of their AML/CFT framework is in line with the legal and regulatory requirements.

The impact of the COVID-19 pandemic on the CSSF’s on-site inspections, including the AML/CFT on-site inspections, is described in Chapter XVII. However, it should be noted that the AML/CFT on-site inspections provided an opportunity to assess the impact of the health crisis on the organisation of professionals as regards AML/CFT and on new emerging ML/TF risks.

In 2020, the “On-site Inspection” department of the CSSF carried out 25 AML/CFT inspections with a particular focus on professionals whose sector of activities is exposed to a high inherent ML/TF risk according to the national ML/TF risk assessment, i.e. credit institutions with a particular attention to private banks, specialised PFS providing domiciliation services, but also investment firms and payment institutions providing a virtual asset trading platform.

Fourteen out of 25 inspections focused on the assessment of one or several high-risk processes according to the risk assessment performed by off-site supervision departments. They covered, in particular, the processes of entering into a business relationship, transaction monitoring, name matching and cooperation with the authorities.

The most significant shortcomings, in terms of frequency or seriousness, identified in 2020, concern the following issues:

- unsuited assessment of the ML/TF risks, to which the professional is exposed, with regard to the activities or their development;
- absence of application of enhanced due diligence measures to customers presenting higher risk factors;
- transaction monitoring issues related, in some cases, to scenarios that did not appropriately cover risky situations or technical deficiencies resulting in an absence of alerts;
- shortcomings in the review of customer files entailing the non-identification of business relationships that are especially at risk or showing signs of tax non-compliance;
- incomplete customer data encoded in the system used to carry out name matching controls or name matching controls not carried out at the publication of the international financial sanction lists;
- failures to meet the obligation to report, or to report without delay, any ML/TF suspicion to the Financial Intelligence Unit (FIU).

In 2020, the involvement of the “Supervision of information systems and support PFS” department in AML/CFT inspections increased, thereby enabling the further assessment of the effectiveness of the different monitoring systems of the professionals (e.g. transactional ones and name matching).

Also notable in 2020 were the entry into force of the Law of 25 March 2020 amending the Law of 12 November 2004 on the fight against money laundering and terrorist financing and the publication of Circular CSSF 19/732 on 20 December 2019 providing clarifications on the identification and verification of the beneficial owner(s)’s identity. These regulatory developments indeed entailed the implementation of additional controls regarding the due diligence measures applied by the professionals to identify and verify the identity of the beneficial owners, including notably monitoring the professionals’ compliance with their obligations to collect proof of registration or an excerpt from the register of beneficial owners. Particular attention was also paid to the

reputational controls put in place by professionals as well as to the accuracy of their risk appetite and the adequacy of their AML/CFT internal control framework compared to the risk profile of their customers. Indeed, a high-risk appetite involves high expectations in terms of controls to be put in place by professionals.

As in 2018 and 2019, particular emphasis was also given to the fulfilment by the professionals of their AML/CFT obligations in relation to predicate offences of aggravated tax fraud or tax evasion.

In 2020, the “UCI on-site inspections” department carried out 13 inspections at authorised IFMs, registered AIFMs and a SICAV-FIS which gave rise to the following main observations at some of those entities:

- shortcomings in terms of the frequency and documentation of controls in respect of the identification of the persons, entities and groups subject to prohibitions or restrictive measures in financial matters, as provided for in Article 33 of CSSF Regulation No 12-02; nevertheless, a particular positive development was noted in terms of review frequency;
- weaknesses in customer due diligence measures, as required by Article 3 of the 2004 Law, and insufficient application of enhanced due diligence on intermediaries, as required by Article 3 of CSSF Regulation No 12-02 (including failures to meet the obligation to systematically keep up-to-date information and documents in order to carry out a periodic review of the business relationship);
- weaknesses in internal organisation, notably in terms of AML/CFT and ongoing training programmes not always adapted to the specificities of the investment funds under management, or not sufficiently taking into account the regulatory provisions applicable in Luxembourg;
- weaknesses with respect to the risk-based approach with either missing or inadequate risk classification of certain business relationships and weaknesses at risk-assessment level, as provided for in Article 2-2 of the 2004 Law and Circular CSSF 11/529;

- failures regarding key performance indicators enabling the ongoing monitoring by IFMs of the activities delegated to registrar and transfer agents in accordance with the requirements of point 466 of Circular CSSF 18/698;
- absence of due diligence measures on the assets held by the funds, as required by Article 34 of CSSF Regulation No 12-02 and point 309 of Circular CSSF 18/698.

In 2020, the “UCI on-site inspections” department also carried out five thematic missions relating to due diligence measures for unregulated alternative investment funds managed by authorised IFMs. These inspections showed that the inspected IFMs applied the same due diligence measures and procedures to both unregulated and regulated structures.

During the AML/CFT conference organised by the UCI departments, the “UCI on-site inspections” department presented the broad outlines of its programme and its working methodology, the main weaknesses encountered during its inspections, and guidance on how to prepare for an on-site inspection.

Finally, in April 2020, a warning was issued in accordance with the provisions of Article 2-1(1) and Article 8-4(1) and (2) of the 2004 Law, following an on-site inspection carried out at an IFM which revealed occasional breaches of the legal provisions relating to customer due diligence obligations and ongoing due diligence, in particular regarding customers with portfolios managed on a discretionary basis.

2. Amendments to the regulatory framework regarding the fight against money laundering and terrorist financing

2.1. Amendments to the AML/CFT European framework

2.1.1. Action plan of the European Commission

In this pandemic year, the European Commission presented, back in May, an ambitious action plan¹ which defines a set of concrete measures aiming to further improve compliance by all with AML/CFT rules within the EU.

This twelve-month action plan will mainly enable to better monitor and coordinate the application of the AML/CFT rules by the Member States. Through this new and global approach, the European Commission aims at addressing the potential shortcomings and flaws that might be included in EU regulations in this respect.

The target of this plan, which consists of six pillars, is to strengthen the EU’s AML/CFT role at global level. These six pillars may be summarised as follows:

- effective implementation of the EU rules that will go hand in hand with the enhanced powers already granted by the EBA as regards AML/CFT;
- an EU single rule book in order to avoid diverging interpretations of European law in this respect;
- EU level AML/CFT supervision of the application of EU rules in this area through the creation of a European supervisory authority;
- a support and cooperation mechanism for FIUs of Member States;
- strengthening of information exchange and judicial and law enforcement cooperation;
- assertion of the EU’s role as a single global player within the FATF and, on the world stage, for the drawing-up of international AML/CFT standards.

¹ The action plan of the European Commission is available under [https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=PI_COM:C\(2020\)2800&from=EN](https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=PI_COM:C(2020)2800&from=EN).

2.1.2. Commission Delegated Regulation (EU) 2020/855 of 7 May 2020 of third countries which present strategic deficiencies in their AML/CFT regimes

For the purposes of being a relevant player on the international stage, the European Commission reviewed and presented a clearer and more transparent methodology² for identifying high-risk third countries which present strategic deficiencies in their AML/CFT regimes. The methodology applied to the listing of the countries thus identified will include: (i) interaction between the procedures for registration of the EU and the FATF on the list of the countries concerned, (ii) a reinforced dialogue with third countries, and (iii) increased consultation of the Member States' experts.

Pending the application of this new methodology, the EU reviewed its list of third countries which present strategic deficiencies in their AML/CFT regimes which jeopardise the single market. This new list already ensures greater consistency with the FATF's list.

The regulation, which is applicable from 1 October 2020, amended Delegated Regulation (EU) 2016/1675 supplementing Directive (EU) 2015/849, as regards adding the Bahamas, Barbados, Botswana, Cambodia, Ghana, Jamaica, Mauritius, Mongolia, Myanmar/Burma, Nicaragua, Panama and Zimbabwe to the table in point I of the Annex and deleting Bosnia-Herzegovina, Ethiopia, Guyana, Lao People's Democratic Republic, Sri Lanka and Tunisia from this table³.

2.1.3. Non-cooperative jurisdictions for tax purposes

This EU list of non-cooperative countries and territories for tax purposes, to be updated twice a year, is a tool to tackle:

- tax fraud or evasion: illegal non-payment or under-payment of tax;
- tax avoidance: use of legal means to minimise tax liability;
- money laundering: concealment of origins of illegally obtained money.

It lists non-EU countries that encourage abusive tax practices and erode, through their legislation and conduct which do not comply with international tax standards, Member States' corporate tax revenues. The objective is not to point to one country more than another but to ensure together that the law in this field evolves.

The last amendment in 2020 was made on 7 October and resulted in the following list: American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands and Vanuatu.

² Internet link: Methodology for identifying high-risk third countries under Directive (EU) 2015/849 (europa.eu).

³ Internet link: EUR-Lex - 32020R0855 - EN - EUR-Lex (europa.eu).

2.1.4. Council Implementing Regulations (EU) 2020/1463 and 2020/1480 of 12 and 14 October 2020 implementing Regulation (EU) 2018/1542 concerning restrictive measures against the proliferation and use of chemical weapons

In a tense international political atmosphere and given the continuing threat posed by the proliferation and use of chemical weapons, the Council of the EU decided by means of regulations to register six people and one entity on the list of natural and legal persons, entities and bodies to which financial restrictive measures should apply included in Annexe I to Regulation (EU) 2018/1542.

The particulars of these regulations, such as the list of the persons concerned, are available on the CSSF website.

2.1.5. Council Regulation (EU) 2020/1998 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses

This is the first regulation adopted by the EU which allows targeting people, entities and bodies, including state and non-state actors, responsible for serious human rights violations or abuses worldwide.

The regulation provides for the freezing of funds and economic resources of, and the prohibition to make funds and economic resources available to, natural or legal persons, entities or bodies responsible for, providing support to or otherwise involved in serious human rights violations or abuses, as well as those associated with the natural and legal persons, entities and bodies covered.

2.1.6. EBA contributions

The year 2020 was marked by the enhanced role that has been granted, since 1 January 2020, to the EBA in charge of an AML/CFT supervisory system at European level. Thus, the EBA will be able to order AML/CFT supervisors of financial operators to launch investigations and recommend sanctions in case of indications of significant shortcomings by a financial sector operator. The EBA, whose role is to improve the functioning of the internal market by ensuring an appropriate, effective and harmonised supervision and regulation at European level, thus adopted in 2020 several binding technical standards in order to provide financial institutions with a set of harmonised AML/CFT rules throughout the EU, including in particular:

- its inquiry into dividend arbitrage trade schemes (“Cum-Ex/Cum-Cum”) and its ten-point action plan to improve the future regulatory framework;
- a methodology for carrying out risk assessments for competent authorities in this respect under Article 9a of the EBA’s amended regulation. This risk assessment is part of the EBA’s new role to lead, coordinate and monitor ML/TF in all EU Member States⁴. This methodology sets out how the EBA will identify emerging ML/TF risks, and how it will carry out the risk assessment. The methodology also explains the review and publication process of the outcome of each risk assessment;
- the EBA report on the functioning of AML/CFT colleges that meet the recommendations relating to the cooperation and information exchange between competent authorities with respect to the supervision of credit and financial institutions, as provided for in Directive (EU) 2015/849⁵. This report highlights the areas on which the competent authorities may focus more when setting up, in the future, AML/CFT colleges, as of January 2022. The aim of the colleges is, in particular, to enable regulators to agree on a common approach and to take coordinated actions as regards the risk assessment and prudential approach of the supervised entities. In its capacity as permanent

⁴ Internet link: Risk assessment under Article 9a of the EBA Regulation.pdf (europa.eu).

⁵ Internet link: EBA Report on the functioning of AML Colleges.docx (europa.eu).

member of the current and future colleges, the EBA will continue to follow the ongoing work in the colleges and will support the competent authorities in setting up new colleges.

The other documents adopted by the EBA in 2020 are:

- EBA Opinion on the interplay between the EU AMLD and the EU DGSD (14 December 2020);
- EBA Opinion on how to take into account ML/TF risks in the Supervisory Review and Evaluation Process (4 November 2020);
- EBA Opinion on European Commission's call for advice on the future EU legal framework on AML/CFT (10 September 2020);
- EBA Report on the functioning of AML Colleges (15 December 2020);
- EBA Report on European Commission's call for advice on the future EU legal framework on AML/CFT (10 September 2020);
- EBA Report on competent authorities' approaches to the anti-money laundering and countering the financing of terrorism supervision of banks (5 February 2020).

2.2. Amendments to the Luxembourg legal and regulatory framework

The Luxembourg legal and regulatory framework was considerably expanded in 2020 following the entry into force of the following laws and regulations aiming to strengthen AML/CFT.

2.2.1. Law of 25 March 2020 amending, inter alia, the Law of 12 November 2004 on AML/CFT

For further information, readers are referred to Circular CSSF 20/742 of 4 May 2020 published by the CSSF on its website.

2.2.2. Law of 25 March 2020 establishing a central electronic data retrieval system related to payment accounts and bank accounts identified by IBAN and safe-deposit boxes and amending, inter alia, the Law of 12 November 2004 on AML/CFT

For further information, readers are referred to Circular CSSF 20/742 of 4 May 2020 and relating FAQs published by the CSSF on its website.

2.2.3. Law of 3 March 2020 amending the Penal Code and the Code of Criminal Procedure

This law notably supplemented, in the chapter relating to terrorism offence, subparagraph 4 of Article 135-5 of the Penal Code with the addition under the name "funds" of "raw materials and other natural resources" which constitute means of financing terrorism used by certain terrorist groups. By way of this law, Luxembourg demonstrates, once again, its commitment to combating terrorist financing, while complying with the conduct instructions drawn up by the FATF in this respect.

The fourth subparagraph of Article 135-5 of the Penal Code henceforth reads as follows: "Are referred to under the term "funds" assets of every kind, whether tangible or intangible, movable or immovable, however acquired, and legal documents or instruments in any form, including electronic or digital, evidencing title to, or interest in, such assets, including, but not limited to, bank credits, travellers' cheques, bank cheques, money orders, shares, securities, bonds, drafts and letters of credit, economic resources, raw materials and other natural resources."

2.2.4. Law of 10 July 2020 establishing a Register of *Fiducies* and Trusts

This law transposes Article 31 of Directive (EU) 2015/849 into Luxembourg law. The Register of *Fiducies* and Trusts, which supplements the arsenal of the Register of Beneficial Owners applicable to companies and other Luxembourg entities including foundations, aims to keep and make available some information relating to *fiducies* and trusts, in the manner prescribed by Chapter 5 of the law, where these are administrated by *fiduciaires* and trustees residing or established in Luxembourg. However, even if these do not reside or are not established in Luxembourg, the obligation to register applies in any case where, on behalf of the *fiducie* or trust, they enter into a business relationship with a professional established in Luxembourg or acquire real estate which is situated in Luxembourg.

2.2.5. Law of 19 December 2020 on the implementation of restrictive measures in financial matters

The law, which entered into force on 27 December 2020, refines the 2010 legal framework as regards international financial sanctions.

While being an extremely significant objective of the implementation of restrictive financial measures, the fight against terrorist financing could not be the sole purpose of these measures. Other objectives, such as the fight against the financing of the proliferation of weapons of mass destruction, the maintenance of international peace and security, the fight against international law infringements, must also be pursued. It follows therefrom that the national legal and regulatory framework, aiming only at the fight against terrorist financing, should be adapted in order to meet the requirements for a holistic implementation of financial sanctions in compliance with the country's international obligations.

Consequently, the purpose of this law is the implementation by Luxembourg of the financial restrictive measures adopted against certain States, natural and legal persons, entities and groups. The financial restrictive measures are imposed on:

- natural persons of Luxembourg nationality, who reside or operate within or from the territory of the Grand Duchy of Luxembourg or abroad;
- legal persons having their registered office, a stable establishment or their centre of main interests within the territory of the Grand Duchy of Luxembourg territory and which operate in or from the Grand Duchy of Luxembourg or abroad;
- branches of Luxembourg legal persons established abroad as well as on branches, in the Grand Duchy of Luxembourg, of foreign legal persons;
- any other legal and natural persons operating within the territory of the Grand Duchy of Luxembourg.

The legal and natural persons, that are required to implement the restrictive measures provided for in the law, must inform the Minister of Finance of the implementation of each restrictive measure taken with respect to a State, a legal or natural person, an entity or a group designated in compliance with this law and the implementing regulatory texts.

The CSSF is in charge of the supervision of the professionals that fall within its sphere of competence, for the purposes of implementing this law. In this respect, it may apply all the measures and exercise all the powers, including sanctioning powers, conferred on it, in accordance with the legal and regulatory provisions applicable.

2.2.6. CSSF Regulation No 20-05 of 14 August 2020 amending CSSF Regulation No 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing

As a result of many AML/CFT legal and regulatory amendments, CSSF Regulation No 12-02 had to be updated. Among the significant amendments made to CSSF Regulation No 12-02, are notably:

- definitions of person responsible for compliance with the professional obligations and compliance officer in charge of the control of compliance with the professional obligations, as well as the respective obligations relating to these two statuses (Articles 40 and 43);
- significant additions to the risk-based approach both with respect to the intermediary acting on behalf of others (Article 3) and the relevant activity (Article 4) or the business relationship (Article 5) and the consistency with the ML/TF risk appetite to be defined (Article 4(4));
- requirements of professionals regarding ongoing due diligence (Article 32(2)) must take into account the guidance published by the CSSF on this matter (Article 32(1));
- details on the review and update of the documents, data and information collected while fulfilling the customer due diligence obligations (Article 35(3));
- enhanced obligations regarding outsourcing and agency relationships (Article 37);
- significant additions to the three lines of defence model which must comply with any adequate and effective supervisory system (Article 39(7)).

2.2.7. Grand-ducal Regulation of 14 August 2020 amending Grand-ducal Regulation of 1 February 2010 providing details on certain provisions of the Law of 12 November 2004 on AML/CFT

Similarly to CSSF Regulation No 12-02, the Grand-ducal Regulation of 1 February 2010 has also been significantly amended in order to be in line with the Law of 12 November 2004, as amended. The regulation and its coordinated version have been published on the CSSF website.

2.2.8. National ML/TF risk assessment of 14 December 2020

This second national risk assessment report updates the report adopted in 2018 while listing new risk and vulnerability areas. Contrary to the previous version, the full version of the new report is available to the public⁶.

2.2.9. Ministerial regulations

The Ministry of Finance issued several ministerial regulations amending Annex I C of the Grand-ducal Regulation of 29 October 2010 enforcing the Law of 27 October 2010 implementing United Nations Security Council resolutions as well as acts adopted by the EU comprising prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the fight against terrorist financing, the last of which dates 9 October 2020.

These regulations may be consulted on the CSSF website and on the website of the Ministry of Finance.

⁶ <https://mj.gouvernement.lu/fr/dossiers/2020/lutte-blanchiment.html>.

2.2.10. CSSF circulars and other information

• Circular CSSF 20/740

Similarly to the FIU which communicated on the COVID-19 typologies, the CSSF issued Circular CSSF 20/740 on financial crime and AML/CFT implications during the COVID-19 pandemic. The CSSF notably drew the attention of the professionals of the financial sector to the new threats to take into consideration in an exceptional pandemic context and made available an analysis of the main risks, as well as a set of the main measures to put in place to identify and mitigate these risks and challenges inherent in the health crisis (in particular as regards remote customer identification measures).

The pandemic situation may also entail an increase in certain types of financial crime which already existed before the health crisis. Such is the case of “financial mules” or “money couriers” whose phenomenon – albeit rather marginal in Luxembourg today – has grown significantly in other European countries over the last years. Economic hardship resulting from the pandemic are potentially conducive to a growing “financial mules” phenomenon.

The professionals of the financial sector are thus requested to continually enhance due diligence and adjust their AML/CFT arrangements, including their risk mapping, in order to take into account the threats and vulnerabilities specific to the pandemic which may continue to exist after the pandemic.

• Circular CSSF 20/747

This circular is concerned with the technical arrangements relating to the application of the Law of 25 March 2020 establishing a central electronic data retrieval system concerning payment accounts and bank accounts identified by IBAN and safe-deposit boxes held by credit institutions in Luxembourg.

• Circular CSSF 20/744

Circular CSSF 20/744 supplements Circular CSSF 17/650 implementing the Law of 12 November 2004 on the fight against money laundering and terrorist financing and the Grand-ducal Regulation of 1 February 2010 providing details on certain provisions of this law to predicate tax offences, with a list of indicators to be taken into account in the context of collective investment activities.

• Circular CSSF 20/742

The purpose of this circular is to draw the attention of the financial sector professionals to the major changes introduced by the two above-mentioned laws dated 25 March 2020 to the AML/CTF regime applicable to the Luxembourg financial sector, as provided for in the AML/CTF Law of 12 November 2004.

• Circular CSSF 20/754

In accordance with the FATF statements following its plenary meetings, the CSSF updated three times, by means of a circular, the list of high-risk jurisdictions on which enhanced due diligence measures and, where appropriate, counter-measures are imposed, as well as jurisdictions under increased monitoring of the FATF. The last of these circulars for 2020 is Circular CSSF 20/754.

3. CSSF participation in meetings regarding the fight against money laundering and terrorist financing and regarding international financial sanctions

3.1. International dimension

As happens every year, the CSSF participated in several international working groups relating to AML/CFT, including the Expert Group on Money Laundering and Terrorist Financing (EGMLTF) of the European Commission, the Anti-Money Laundering Expert Group (AMLEG) of the Basel Committee on Banking Supervision and the Joint Committee's Sub-Committee on Anti-Money Laundering (AMLC) under the Joint Committee of the three European Supervisory Authorities, as well as in the FATF's meetings, even if these participations were remote participations due to the pandemic.

The following key documents were adopted by the FATF in 2020:

- FATF COVID-19-Related Money Laundering and Terrorist Financing Risks;
- FATF/Egmont Trade-based Money Laundering: Trends and Developments (December 2020);
- FATF amendments to Recommendations 1 and 2 and their Interpretive Notes and to Recommendation 7 (October 2020);
- FATF statement following unauthorised disclosure of confidential FinCEN documents (September 2020);
- FATF Virtual Assets Red Flag Indicators of Money Laundering and Terrorist Financing (September 2020), the FATF Report to G20 on So-called Stablecoins (July 2020) and the 12 Month Review of Revised FATF Standards – Virtual Assets and VASPs (July 2020);
- FATF Report on Money laundering and the Illegal Wildlife Trade (June 2020);
- FATF Guidance on Digital ID (March 2020).

For the United Arab Emirates and Korea, the FATF adopted a mutual evaluation report in 2020.

The CSSF publishes the FATF's AML/CFT information bulletins on its website on a regular basis.

3.2. National dimension

In 2020, the CSSF held several meetings with representatives of the FIU. The discussions mainly focussed on the exchange of information within the context of certain suspicious transaction reports of major importance for the Luxembourg financial centre and the new AML/CFT typologies.

Several coordination and consultation meetings of all the national authorities competent in the sphere of AML/CFT were also held in 2020, under the chairmanship of the Ministry of Justice and the Ministry of Finance, respectively, depending on the topic addressed by the corresponding working groups. The meetings were aimed at working on the transposition of AML/CFT laws and regulations and on international financial sanctions entered into force during the year, the drawing-up of risk assessment reports, as well as the continuity of the preparation of the FATF's plenary meetings.

The CSSF also met with other national supervisory authorities (Commissariat aux Assurances and Administration de l'enregistrement, des domaines et de la TVA) and some self-regulatory bodies to exchange information on the implementation of the AML/CFT supervision.

Finally, as in the previous years, the CSSF organised several series of AML/CFT conferences.



XXI. Financial consumer protection

1. Financial consumer protection and financial education

1.1. Financial consumer protection and financial education at national level

As part of its public duty of financial education, the CSSF continued to develop its information portal www.letzfin.lu, which contains a broad range of information on issues regarding money and finance in general. For example, there are practical tools to simulate credit calculation, establish a personal budget or test one's financial knowledge.

The dynamic educational game Financial Game of Life (FinGoL), which allows young people to simulate the financial life of an adult in a fun way and which was launched in 2019, continued to be developed in 2020. Thus, a new application FinGoL Junior was designed, offering a simplified content for young people under 16. In the context of this game, young people can create a fictional profile, open a current account or savings account, manage their budget whilst ensuring that their expenses do not exceed their income. In addition, it is possible to purchase various insurance contracts against unforeseeable events.

As part of the "World Investor Week", the CSSF participated in a webinar on financial education organised by Bourse de Luxembourg.

1.2. Financial consumer protection and financial education at international level

1.2.1. Task Force on consumer protection of the OECD Committee on Financial Markets

The Task Force's work concerns the 10 High-Level Principles of the G20 relating to financial consumer protection. The Task Force, in charge of monitoring

their implementation, started to work on the review of the Principles in 2020. Indeed, almost 10 years after the adoption of the Principles, such review was deemed beneficial. The objectives of the review are the following: (i) assessing the level of implementation of the Principles and the possible barriers to a full implementation, (ii) assessing the importance and relevance of the Principles in terms of overall financial consumer protection, and (iii) identifying whether the new developments regarding financial consumer protection require amendments to the Principles or the adoption of new principles.

Moreover, the Task Force participated in the publication of the reports "Financial Consumer Protection Policy Approaches in the Digital Age – Protecting consumers' assets, data and privacy" and "Financial Consumer Protection and Ageing Populations", in the "Business & Finance Outlook 2020 on Sustainable and Resilient Finance", as well as in research into the use of personal data in financial services and the role of financial education in this matter. It also carried out research on the protection of personal data and privacy.

A special session of the Task Force was organised remotely in order to assess the measures taken by the authorities following the COVID-19 health crisis and two documents were published on the OECD's website to accompany financial consumers throughout the crisis.

1.2.2. International Financial Consumer Protection Network (FinCoNet)

FinCoNet is an international organisation gathering supervisory authorities from 27 countries that are responsible for financial consumer protection. It aims at fostering information exchange and cooperation between supervisory authorities in

order to encourage proper conduct of the market and strong consumer protection in banking and credit.

In 2020, FinCoNet published, among others, the following documents in relation to financial consumer protection:

- the report “Financial Consumer Protection Policy Approaches in the Digital Age – Protecting consumers’ assets, data and privacy” in cooperation with the OECD;
- a report following the international conference on “Behavioural insights for conduct supervision” held in cooperation with Banca d’Italia;
- the report “Financial Consumer Protection and Ageing Populations” which sets out policy considerations to protect ageing consumers receiving financial products and services, written in cooperation with the OECD;
- a report concerning “SupTech Tools for Market Conduct Supervisors”.

1.2.3. OECD’s International Network on Financial Education (INFE)

This international network created by the OECD seeks to promote and facilitate international cooperation between the different participants (politicians, regulators, associations, etc.) involved in financial education. In 2020, 119 countries were represented in the INFE. A total of 91 authorities, including the CSSF, have the status of full members.

In 2020, the INFE published, in particular, the following documents:

- a report setting out the main findings, conclusions and policy considerations regarding approaches to protection of consumers of financial products in response to the issues associated with ageing populations;
- a document on the policy response to protect the ageing population against the effects of the crisis related to the COVID-19 pandemic;
- the report “Advancing the Digital Financial Inclusion of Youth” which examines the factors contributing to youth financial inclusion and the role of digital financial services in meeting their needs as well as the opportunities and

challenges relating to advancing youth digital financial inclusion.

Moreover, the INFE published a recommendation on financial education in order to assist governments, public authorities and other relevant stakeholders in their efforts to design, implement and evaluate financial literacy policies.

At the request of the INFE, the CSSF presented the digital tools it developed in the context of the Lëtzfîn programme during the conference on “Financial education for children and young people in South East Europe”.

Further information about projects and events on the activities carried out by the OECD and the INFE in relation to financial education is available on the website www.financial-education.org.

1.2.4. IOSCO’s Committee 8 on Retail Investors

The primary mandate of Committee 8 is to conduct IOSCO’s policy work on financial education. Its secondary mandate is to advise the IOSCO Board on issues relating to investor protection and to work on the policy to be adopted in this field.

In 2020, IOSCO published the final report about investor education on crypto-assets. Technological innovation related to crypto-assets may offer many promising possibilities such as the potential to facilitate capital formation and improve access to financial services. However, the immaturity of the ecosystem and the assets themselves may expose the users to certain risks, hence the importance of financial education in this field.

Furthermore, the committee is interested in other topics, such as remote working, fraud, scams or operational resilience in the context of the COVID-19 pandemic.

2. Alternative dispute resolution

In 2020, the CSSF continued to fulfil its functions as entity competent for the alternative resolution of consumer disputes, which it takes on, in particular, pursuant to the provisions of the Consumer Code. In this respect, the CSSF does not only handle requests for the alternative resolution of disputes made by consumers as such, but it also handles disputes between professionals of the financial sector in order to provide an amicable resolution.

Article L. 432-4 of the Consumer Code provides that the entities qualified for alternative consumer dispute resolution must publish their annual reports. It also determines the information to be included in these reports.

In this chapter, the CSSF informs the public of its activities as qualified entity for alternative consumer dispute resolution, by providing, inter alia, the information required under the aforementioned Article L. 432-4¹.

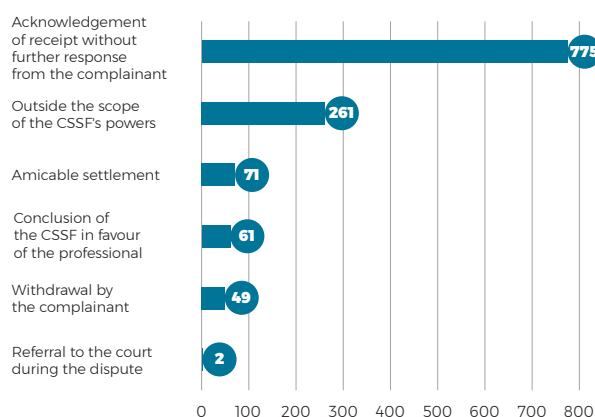
2.1. Statistics regarding CSSF complaint handling in 2020

In 2020, the CSSF received 1,350 and closed 1,219 complaint files (including files received before 1 January 2020).

The year 2020 recorded a substantial 50% increase in the number of complaints compared to the previous year. This increase could be the result of the COVID-19 pandemic, which began in March 2020, given that many payment transactions by debit or credit card or online payment transactions (reservations of hotels, flights, any type of events, etc.) were subject to complaints as a large number of payments were blocked, suspended or cancelled without always being reimbursed. However, a correlation between the record number of complaints registered in 2020 and the exceptional health situation associated with the pandemic cannot be established with certainty.

The expansion of digitisation in firms and households is undoubtedly another explanatory factor. Indeed, after preparing a complaint, it can be sent to the CSSF in just a few clicks. In addition, the online financial consumers discuss with each other on internet fora or on social media particularly about their rights. This new consumer behaviour may thus explain, at least in part, the 50% rise in the number of complaints received by the CSSF in 2020.

Outcome of the CSSF's intervention/reasons for closing the files



Upon reception of a financial consumer complaint, the CSSF generally responds with an acknowledgement of receipt which provides useful instructions for the complainant on how to resolve the dispute with the professional without additional intervention of the CSSF. This acknowledgement of receipt indicates, among others, the full name of the manager in charge of complaints whom the complainant should contact at the entity concerned in order to reach an amicable settlement and the link to the webpage where useful information on the alternative handling of complaints by the CSSF is available to the complainant.

Judging by the high number of disputes that have been settled following these first instructions by the CSSF, the CSSF's approach consisting in favouring the dialogue between the parties to the disputes and not intervening immediately with the supervised entity concerned by a complaint, is bearing fruit.

It should be noted that the CSSF took on average 66 days to close complaint files submitted and closed in 2020. By taking also into account the files already opened before 2020, the average reaches 149 days.

A total of 261 requests for the alternative resolution of complaints were inadmissible for the following reasons:

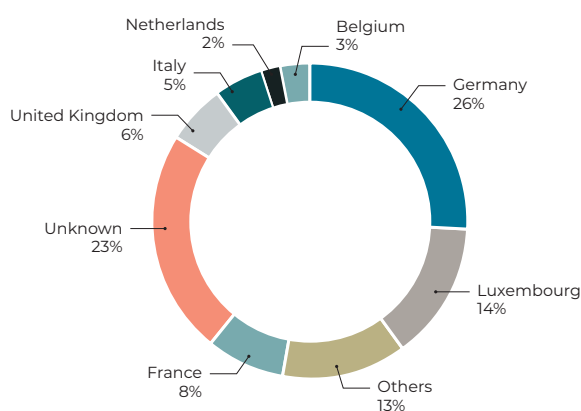
- complaints involving entities that are not subject to the CSSF's supervision (72%)²;
- failure of the complainant to act (14%);

¹ The statistics mirror the CSSF's activities relating to the alternative dispute resolution: they concern not only consumer disputes as the CSSF also handles complaints from professionals, including professionals of the financial sector, against professionals supervised by the CSSF.

² Including complaints concerning entities of the insurance sector.

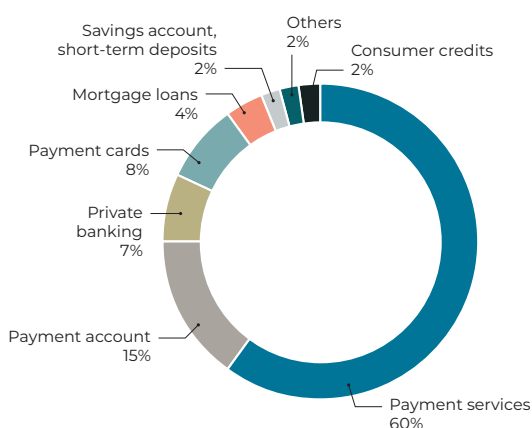
- complaints falling within the scope of the insurance sector (6%);
- complaints concerning a non-financial product (6%);
- complaints already heard by a court (1%);
- frivolous or vexatious requests (1%).

Breakdown of the disputes according to the complainants' country of residence



There is a large part of complaints from Germany with 26% of the total, which is similar to 2019 (25%). The country of residence of the complainants has not been identified in 23% of the cases, which is, in general, due to the fact that these complainants contacted the CSSF, for the first time, by way of emails without indicating their country of residence and they did not manifest themselves any more after the CSSF invited them to seek dialogue with the supervised entity concerned. Finally, the category "Others" covers 53 different countries.

Breakdown of complaints according to their object



The breakdown of complaints according to their object remained stable compared to the previous years. The major share of complaints (60%) concerned problems linked to the use of electronic payment services. The share of complaints relating to payment accounts (15%) decreased as compared to the previous year (20% in 2019). The same applies to complaints relating to mortgage loans (4% in 2020 against 7% in 2019).

2.2. Complaints handled in 2020

The CSSF recounts here some disputes resolved during 2020 which may be rich in lessons for financial consumers and professionals.

2.2.1. Execution of a customer's order

In one case, the customer requested compensation from his bank for the damage he allegedly suffered following the late execution of his order to sell securities listed on the stock exchange. Thus, the complainant indicated that he had made a market order on the bank's secure website to sell securities listed on a foreign stock exchange "at market price". The complainant verified several times the status of his execution order and, each time, his order indicated "pending".

The complainant contacted the bank to ask for the reasons behind this non-execution. The bank then realised that the sell order had not yet been executed and finally remedied the non-execution of the order with a certain delay. The complainant requested the bank to compensate him for the damage incurred due to the delay but the bank refused.

The bank explained to the CSSF that it had outsourced the processing of market orders to third-party service providers and that the complainant's market order was not executed due to a technical problem which occurred at one of the third-party service providers. The bank argued that it could not be held liable for the damage incurred by the complainant because the delay was attributable to the third-party service provider.

The CSSF reminded the bank of the provisions of Article 37-1(5) of the Law of 5 April 1993 on the financial sector which states: "Outsourcing shall not prejudice the level and quality of the service provided to clients. It is carried out based on a service contract. Credit institutions and investment firms shall remain entirely liable for the compliance with all their obligations pursuant to the prudential



regulations when they outsource functions or activities (...).”

Moreover, the complainant blamed his bank for not having noticed itself the delay in the execution of his sell order. Indeed, the bank only contacted the third-party service provider to enquire about the non-execution of the sell order after it had been approached by the complainant. The bank admitted, in this context, that it did not receive an updated message from the service provider on the status of execution of the disputed order.

Thus, the bank was not aware of the status of execution of the complainant’s sell order when the complainant asked the bank whether his order had been executed and only when the complainant made the request did the bank notice that the sell order had not (yet) been executed. Only at that moment did the bank become aware of the technical problem which occurred at the third-party service provider.

The CSSF closed this file concluding that the bank was responsible for the damage incurred by the complainant because, even if the damage was due to a technical problem which occurred at the service provider to which the bank outsourced some services, the bank remained liable for the late execution of its customer’s order. The CSSF

also concluded that the bank should have ensured to receive in due course the information on the status of execution of the sell order. Finally, the bank offered the complainant compensation proportionate to the damage.

2.2.2. Fraudulent transfer

In the context of its responsibility for alternative dispute resolution, the CSSF regularly receives complaints from complainants who claim to have been the victims of financial transactions performed on their bank account without their knowledge.

In one of these cases, the complainant contacted the CSSF to challenge a transfer, carried out without his approval, from his bank account to another bank account opened with a foreign bank.

One of the specificities of this file was the fact that the disputed transfer had been carried out six years prior to the complainant’s challenge. The complainant claimed that he only discovered the disputed transfer six years after the execution, when the bank informed him of this order during a phone conversation.

The bank explained to the CSSF that the disputed transfer was executed after the bank had received a fax containing the written instruction to carry out the disputed transfer. This transfer instruction was followed, a few days later, by the dispatch of a copy of the complainant’s ID.

However, during the examination of the complaint file by the CSSF, it was found that the email address indicated on the aforementioned transfer instruction was different from the complainant’s email address registered in the account opening documents. The examination of the file also revealed that the complainant’s postal address indicated on the disputed transfer order corresponded to his former postal address.

It so happened that, several months before the disputed event, the complainant had informed the bank of his new postal address and that the bank noted in an internal register that the postal address of the complainant was problematic a few days before receiving the disputed transfer order.

In the light of these elements, the CSSF requested the bank to explain in which manner it had authenticated the disputed order. The CSSF based its request, in particular, on the provisions of

Article 86(1) of the Law on payment services which lays down that where a payment service user (in this case, the complainant) claims not to have authorised a payment transaction or asserts that the payment transaction was not correctly executed, it is for the payment service provider (in this case, the bank) to prove that the payment transaction had been (duly) authenticated.

In that respect, the bank replied that the disputed transfer order was executed following the reception of an “apparently certified copy” of the account holder’s ID.

However, the CSSF was of the opinion that the bank did not correctly authenticate the payment transaction before executing it. The bank should have been more careful during the processing of the disputed payment transaction and should have verified that the complainant’s details and the signature on the disputed transfer order corresponded to the information the bank had in its books.

However, even if the CSSF could consider that the bank had not been sufficiently diligent, the question arose as to whether the complainant could still avail himself of the provisions of the Law of 10 November 2009 on payment services.

Indeed, Article 85 of this law requires that the payment service user, who notes an unauthorised payment transaction, reports this to the payment service provider within 13 months unless the payment service provider fails to make available the information on the disputed payment transaction to the payment service user, so that the payment service user is not able to report the irregularity of which he is a victim to his payment service provider within 13 months. In this case, the complainant only found out about the transaction executed without his knowledge six years after it had taken place, when the bank informed him thereof during a phone conversation. Since the bank was not able to prove that it had duly informed the complainant of the disputed order execution before the phone conversation, the CSSF concluded that the time limit of 13 months laid down in the aforementioned Article 85 could not be invoked against the complainant.

It should also be pointed out in this context that the complainant informed the bank that he had not authorised the disputed transfer as soon as he found out about it.

The CSSF concluded that the bank had not been sufficiently diligent when it executed the disputed transfer order and that the complainant should be compensated for the damage he suffered as a result of this lack of diligence. The bank finally accepted to return the amount of the unauthorised transfer order to the complainant.

2.2.3. Early repayment of a mortgage credit

The CSSF handled a dispute where the complainant challenged the amount of compensation claimed by the bank for the early repayment of his mortgage credit agreement.

The complainant concluded a first mortgage credit agreement with Bank A. This credit agreement was bought by a second bank, Bank B. Later, the complainant wished to reimburse his mortgage credit with Bank B so that a third bank, Bank C, could take over the credit.

The dispute concerns a disagreement between the complainant and Bank B. Indeed, Bank B requested the complainant to pay compensation for early repayment in relation to the repurchase by Bank C. The complainant deemed that this compensation was too high. He requested the application of the provisions of Article L. 226-20(3) of the Consumer Code which states notably that “(...) where a mortgage credit agreement was signed in order to acquire a home used as actual and main residence by the consumer for at least two consecutive years, the compensation referred to in the first subparagraph may not exceed the value corresponding to six months of interests on the capital repaid during each early repayment, calculated at the borrowing rate applicable to the mortgage credit agreement on the day of the early repayment”.

In this case, the question was to know whether the threshold of the compensation for early repayment laid down in Article L. 226-20(3) applied to the mortgage credit agreement concluded between the complainant and Bank B in order to repay the first mortgage credit agreement concluded with Bank A for the purchase of his main residence. Indeed, Bank B argued that the compensation for early repayment provided for in Article L. 226-20(3) did not apply to the repurchase of a mortgage credit such as in this case.

During the analysis of the supporting documents provided by the parties to the dispute, the CSSF first noted that the mortgage loan concluded between the complainant and Bank B was titled “mortgage credit agreement”. The CSSF also noted that this credit agreement provided for the contract to be subject to Articles L. 226-1 et seq. of the Consumer Code regarding mortgage credit agreements.

Moreover, the credit agreement explicitly referred to the aforementioned Article L. 226-20(3) which sets a threshold for the calculation of the amount of compensation for early repayment under certain conditions. The CSSF thus deduced that it was explicitly agreed between the parties that the provisions of Article L. 226-20(3) applied, where appropriate, to this mortgage credit agreement.

The CSSF was of the opinion that, by referring to the provisions of Article L. 226-20(3) of the Consumer Code in the credit agreement and excluding its application afterwards in practice, the bank could mislead the consumers.

The CSSF did not follow the bank’s line of argument that Article L. 226-20(3) does not apply to the credit agreement. The bank then raised the question about the interpretation of the condition of actual and main residence during two years provided for in Article L. 226-20(3) in the context of a mortgage credit agreement intended for the repurchase of an existing mortgage credit.

The bank considered that in the case of a repurchase of a mortgage credit, this two-year time frame (re)started as from the conclusion of the agreement for the repurchase of a mortgage credit.

The CSSF was not of the same opinion as the bank and considered that for the purpose of verifying whether the condition of actual and main residence during at least two years was met, the entire period during which the consumer actually lived in the home referred to in the mortgage credit agreement should be taken into account and one should not fictitiously run a new two-year period as from the credit repurchase.

In this case, the CSSF noted that the legal condition of actual and main residence during an uninterrupted period of two years was complied with and it was established that the home referred to in the mortgage credit agreement was used as actual and main residence of the complainant during an uninterrupted period of two years at

least as from the date of the conclusion of the first mortgage credit agreement.

The CSSF concluded that the provisions of Article L. 226-20(3) of the Consumer Code were indeed applicable to the disputed mortgage credit agreement. Consequently, the amount of the compensation for early repayment that the bank requested from the complainant should be reduced to take into account the threshold of the compensation for early repayment provided for in Article L. 226-20(3). The bank ultimately made a gesture in favour of the complainant.

2.2.4. Request for a mortgage credit

Often asked to intervene in disputes concerning the application of mortgage credit agreements, the CSSF was confronted with a dispute where the complainant claimed that his bank refused to release the funds that it had committed to give him pursuant to the mortgage credit agreement.

The bank explained to the CSSF that the disputed credit was granted by its credit committee under the express condition that the complainant provides the quotes regarding the works to be carried out in the context of a real estate project to be financed by the borrowed funds. The provision of quotes was deemed necessary by the credit committee in order to ensure, in the light of the financial size of the real estate project, that the budget set for the envisaged works was sufficient. The credit committee also granted the loan to the complainant on condition that he receive all the administrative authorisations necessary for the completion of the real estate project. The bank mentioned in this matter a clause of the credit contract which indeed stated that the provision of funds depended on the prior submission of quotes concerning the works to be carried out as well as the necessary authorisations.

As the complainant did not challenge the applicability of this clause, the CSSF could consider that it was established that the complainant had indeed been informed that the provision of the funds was subject to the prior submission of quotes concerning the works to be carried out as well as the necessary authorisations.

During the examination of the file, the complainant presented a quote established by his architect, which was labelled as “approximate summary” by the architect himself. However, the bank was of the opinion that this quote did not meet the

contractual provisions agreed with the complainant and, consequently, requested the complainant to provide quotes from the building trades. Since the complainant had not responded to this request, the bank did not provide the funds and refused to pay the bills for the real estate project. The bank was also not satisfied by the administrative authorisations that the complainant submitted to it, because these authorisations contained some reserves expressed by the administrative authorities which delivered them.

In conclusion, the CSSF decided that the bank could rightly refuse to release the funds needed by the complainant because the latter was unable to fulfil the conditions of the mortgage credit agreement.

2.2.5. Failure by the customer to inform his bank of the change of address

In the framework of the alternative dispute resolution, the CSSF is regularly sought in relation to disputes where the complainants blamed their bank for not complying with the applicable rules, whereas the examination of the file often revealed that negligence attributable to the complainants was the source of the dispute.

In one of these cases, the complainant blamed his bank for not informing him about the situation of his bank account. In particular, he claimed that the bank no longer sent him account statements.

The CSSF noted that the complainant and the bank only communicated with each other by email and that the bank used the email address of the complainant recorded in the account opening documents.

The complainant informed the CSSF that he had changed his email address and no longer used the email address recorded in the account opening documents.

However, the bank explained to the CSSF that it had never been informed by the complainant of this change of email address and, consequently, it continued to send the complainant's account statements to the email address recorded in the account opening documents and it presented copies of emails as supporting evidence. The bank also pointed out that it never received an error message following the dispatch of the emails to this address. Finally, the bank invoked its terms and conditions which specify that it cannot be held liable for

damages that the customer might suffer as the result of the customer's failure to inform the bank of the change of his email address.

Faced with the bank's explanations, the complainant admitted that he did not inform the bank of the change of his email address. He tried to justify this omission by arguing that during the creation of his new email address, he configured the email account so that emails sent to his old email address are automatically redirected to his new email address, but the CSSF was not satisfied with this explanation.

The CSSF finally concluded that the complainant should bear the consequences for his failure to inform the bank of the change of the email address.

2.3. FIN-NET

FIN-NET was launched in 2001 by the European Commission with the purposes of enhancing cooperation between national ombudsmen in financial services and offering consumers easy access to extra-judicial mechanisms for alternative dispute resolution in the area of financial services.

The CSSF took part in the only FIN-NET plenary meeting of 2020. FIN-NET members exchanged their views on topical issues, including the impact of the COVID-19 crisis on alternative dispute resolution. It seems that the work flow of the alternative dispute resolution entities reflects the economic shocks caused by the health crisis with a delay of about three months and that the most obvious effect was an increase in frauds mainly committed through digital means. The health crisis also affected the organisational arrangements of FIN-NET members, with more remote working and digital interaction with users.

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
ABBL	Association des Banques et Banquiers, Luxembourg - Luxembourg Bankers' Association
AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers
ALFI	Association Luxembourgeoise des Fonds d'Investissement - Association of the Luxembourg Fund Industry
AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
ASSEP	Pension savings association
Audit Law	Law of 23 July 2016 concerning the audit profession
BCL	Banque centrale du Luxembourg - Luxembourg Central Bank
BMR	Benchmark Regulation - 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
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
BRRD Law	Law of 18 December 2015 on the failure of credit institutions and certain investment firms
CdRS	Comité du risque systémique - Luxembourg Systemic Risk Committee
CPDI	Conseil de protection des déposants et des investisseurs - Council for the Protection of Depositors and Investors
CRD IV	Capital Requirements Directive IV - 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 V	Capital Requirements Directive V - Directive (EU) 2019/878 of 20 May 2019 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
CRR	Capital Requirements Regulation - Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms
CRR2	Capital Requirements Regulation 2 - Regulation (EU) 2019/876 of 20 May 2019 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
CSD	Central securities depositories
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 - Luxembourg supervisory authority of the financial sector
DQEF	Data Quality Engagement Framework
EBA	European Banking Authority
EC	European Community
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation – Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
ESEF	European Single Electronic Format
ESG	Environmental, Social, and Corporate Governance
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 - Luxembourg Deposit Guarantee Fund
FIU	Financial Intelligence Unit
FSB	Financial Stability Board
IFD/IFR	Investment Firm Directive and Investment Firm Regulation
IFM	Investment Fund Manager
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISA	International Standard on Auditing
ITS	Implementing Technical Standards
JST	Joint Supervisory Team
LSI	Less significant institution
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
ML/TF	Money Laundering and Terrorist Financing
NAV	Net Asset Value
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
REIF	Real-Estate Investment Fund
RTS	Regulatory Technical Standards
SEPCAV	Pension savings company with variable capital
SFTR	Securities Financing Transactions Regulation - Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse
SI	Significant institution
SICAR	Investment company in risk capital
SIF	Specialised Investment Fund
SIIL	Système d'indemnisation des investisseurs Luxembourg - Investor Compensation Scheme Luxembourg
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
STOR	Suspicious Transaction and Order Report
UCI	Undertaking for Collective Investment
UCITS	Undertaking for Collective Investment in Transferable Securities
UCITS Directive	Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
VASP	Virtual Asset Service Provider

Notes

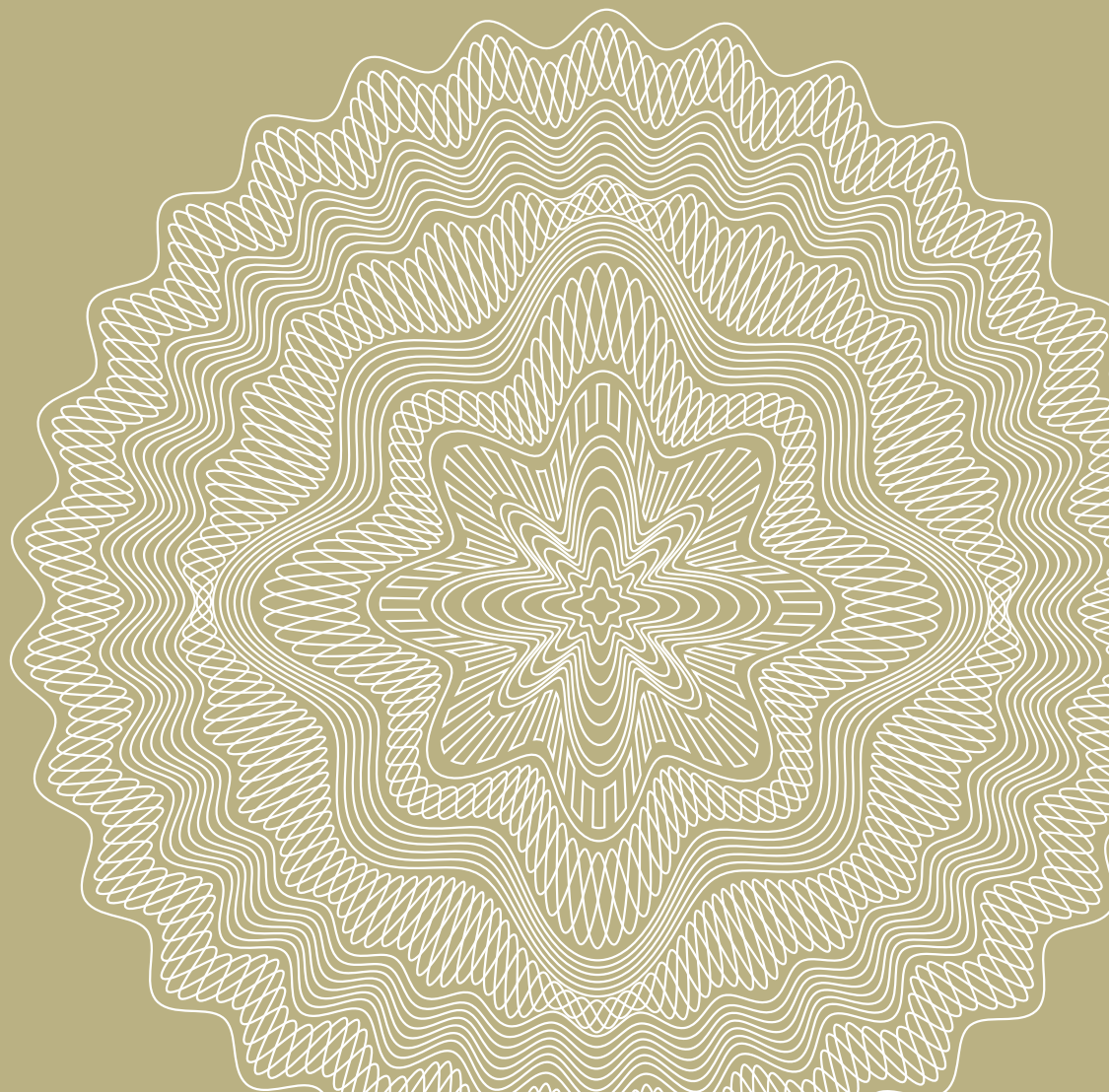


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