



COMMISSION  
DE SURVEILLANCE  
DU SECTEUR  
FINANCIER

ANNUAL REPORT 2016





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### REVIEW OF 2016

#### 1. The geopolitical and economic environment

From an economic point of view, the start of 2016 was difficult but the situation improved during the year, notably due to some measures taken by the European Central Bank to enhance monetary stimulus as, for example, a new decrease of the key interest rate and an intensification of quantitative easing. This led to a lower deflation risk and a strengthened confidence in the economy in most of the euro area countries. At the same time, the historically low interest rates have adversely impacted the profitability of some players like banks, insurance companies and pension funds. This factor, combined with increasing regulatory costs and essential technological investments, significantly affected the profitability of European and Luxembourg financial institutions. However, the improvement of the economic situation has not been felt all over Europe; some countries continued to suffer from the volume of bad debts, jeopardising not only their own financial stability but that of the EU. Public debt and the high unemployment rate (exceeding 10% in six countries) also remain concerns in parts of the Old Continent.

At the political level, on 23 June 2016, the United Kingdom decided to leave the EU. The single market will inevitably be impaired: the United Kingdom represents 13% of the European population, contributes up to 10% to the European budget and represents 14% of its GDP. The governments of the other Member States focussed with some, albeit fragile, success on preserving what is now called the "Union of 27".



#### 2. The Luxembourg financial centre

The income generated by the Luxembourg financial sector remained high in 2016. The same applies to assets under management. The balance sheet total of banks increased by EUR 27 billion to EUR 770 billion in 2016 and profit before provisions increased by EUR 826 million to EUR 6.3 billion. Assets under management of Luxembourg UCIs went up by EUR 198 billion and reached EUR 3,741 billion at the end of 2016.

However, these figures hide the existing and future pressure on the profitability of these players. As regards expenditures, the regulatory cost, the staff cost, the investments in IT and new technologies as well as the real estate cost continuously rise. As for revenues, income is impacted by the ongoing historically low interest rates, the payment of commissions affected by transparency requirements and retrocession limits. Income is also impacted by the fact that some services usually provided by conventional players will be provided in the near future by new competitors, like crowdfunding, other peer-to-peer services or services provided by some FinTech companies.

The government undertook to modernise the legal and regulatory framework. Thus, in 2016, it launched consultations in order to amend Article 41 on professional secrecy of the law on the financial sector. The aim is to allow the entities falling within the scope of this law to outsource part of their operations inside or outside their group under certain conditions. The CSSF published FAQs in relation to the identification through video chat and launched consultations regarding IT outsourcing relying on cloud solutions which resulted in the publication of Circular CSSF 17/654 in May 2017. The CSSF also created a working group whose purpose is to analyse the adequacy of the current regulatory framework with respect to new technologies, such as the distributed ledger technology. This working group will propose, where appropriate, amendments to the regulatory framework or even a new regulation whilst keeping in mind consumer protection, protection against cybercrime and prevention of the use of new technologies for money laundering.

Furthermore, 2016 was also the year of the entry into force of the large-scale automatic exchange of information, covering all types of income and account balances. The first exchanges of data, which were collected in 2016, are taking place in 2017. With the law of December 2016, the Luxembourg parliament created the offence of aggravated tax fraud and, as from January 2017, this offence and tax evasion have become money laundering primary offences. The entry into force of the law of December 2016 entails that the supervised entities must notify any suspicion of tax fraud to the Financial Intelligence Unit, thus participating in the fight against national and international tax fraud.



As the Grand Duchy introduced new transparency requirements, particularly in the tax area, the CSSF launched, in 2016, several important investigations regarding money laundering and governance in order to ensure that the internal control mechanisms are efficient. These investigations, which continue in 2017, show that the CSSF keeps a watchful eye in order to prevent that the tax risk is replaced by a risk of using the financial centre for criminal purposes, and ensures that the supervised entities do not increase their risk appetite to maintain their income level in a difficult context. The CSSF will be inflexible in this area and will not hesitate to severely sanction the offenders. The reputation of the whole financial centre and of the country is at stake.

In the context of the Brexit, a certain number of British and international operators, having their European registered office or a significant presence in the United Kingdom, showed interest in relocating part of their operations to the Grand Duchy. The CSSF welcomes these requests, provided that the entities have sufficient substance in Luxembourg, thus complying with EU requirements, and that they do not delegate or outsource the majority of their activities in the United Kingdom, which would mean granting the EU passport to legal entities without economic substance. The above has always been the CSSF's policy in a market dominated by cross-border provision of services and distribution of financial products based on the core principles of the EU and the single market.

### 3. The CSSF

Given the increasing volume and complexity of the European and international regulation, the CSSF recruited 72 new agents in 2016, notably in the areas of authorisation and supervision of management companies and of on-site inspections. The total staff number of the CSSF amounted to 717 agents as at 1 June 2017 and the recruitment will continue throughout 2017. At the same time, the CSSF rented additional office space and is currently searching for a long-term real estate solution. It also continued to invest in new IT systems and, in particular, in a new electronic document management system. Other investments were made in IT security and in mobile tools allowing the agents to work from remote locations. Indeed, a great number of agents actively participate in the work of European and international bodies and authorities, such as the ECB, ESMA, the EBA or the Basel Committee.

There were many external priorities in 2016, including, in particular, the review of the supervised entities' risk management, governance, efficiency of the internal control mechanisms, procedures for the fight against money laundering as well as business models. The CSSF reviewed the remuneration policies of a certain number of entities, monitored the implementation of the UCITS V Directive and the independence of the depositary bank functions from the management companies, as well as the implementation of new transparency rules for issuers and the prevention of market abuse.

Internally, the CSSF will refine the risk analysis of the different supervised entities and adjust the frequency and intensity of the controls carried out according to this analysis (risk-based approach). The CSSF will perform itself further controls and it will continue its policy of carrying out more on-site inspections.

\* \* \*

I would like to thank all the CSSF agents and my director colleagues for the remarkable work carried out in the public interest throughout 2016. The quality of their work contributed to ensure the efficiency and maintain the reputation of the financial centre.

Claude Marx  
Director General



## TABLE OF CONTENTS

<b>Chapter I</b>	<b>GOVERNANCE AND FUNCTIONING OF THE CSSF</b>	<b>7</b>
	1. Principles	
	2. Governing bodies	
	3. Committees	
	4. Human resources	
	5. CSSF library	
	6. Budget and annual accounts of the CSSF – 2016	
<b>Chapter II</b>	<b>THE EUROPEAN DIMENSION OF THE SUPERVISION OF THE FINANCIAL SECTOR</b>	<b>19</b>
	1. Supervision of banks	
	2. Supervision of financial markets	
	3. Cooperation within other European bodies	
<b>Chapter III</b>	<b>MACROPRUDENTIAL SUPERVISION WITHIN THE FINANCIAL SECTOR SUPERVISION</b>	<b>31</b>
	1. The framework of macroprudential supervision	
	2. Implementation of the macroprudential policy	
<b>Chapter IV</b>	<b>THE INTERNATIONAL DIMENSION OF THE CSSF'S MISSION</b>	<b>37</b>
	1. Basel Committee on Banking Supervision	
	2. International Organization of Securities Commissions	
<b>Chapter V</b>	<b>FINANCIAL INNOVATION</b>	<b>41</b>
<b>Chapter VI</b>	<b>SUPERVISION OF BANKS</b>	<b>45</b>
	1. Developments in the banking sector in 2016	
	2. Prudential supervisory practice	
<b>Chapter VII</b>	<b>SUPERVISION OF PFS</b>	<b>67</b>
	1. Investment firms	
	2. Specialised PFS	
	3. Support PFS	
<b>CHAPTER VIII</b>	<b>SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS</b>	<b>77</b>
	1. Payment institutions	
	2. Electronic money institutions	
<b>CHAPTER IX</b>	<b>SUPERVISION OF INVESTMENT FUND MANAGERS AND UCIS</b>	<b>79</b>
	1. Authorised investment fund managers	
	2. Other investment fund managers	
	3. Cross-border activities	
	4. Evolution of the UCI sector in 2016	
	5. Prudential supervisory practice	
	6. Developments in the regulatory framework	
<b>CHAPTER X</b>	<b>SUPERVISION OF SECURITISATION UNDERTAKINGS</b>	<b>97</b>
<b>CHAPTER XI</b>	<b>SUPERVISION OF PENSION FUNDS</b>	<b>99</b>
	1. Development of pension funds in 2016	
	2. Development of liability managers in 2016	

<b>CHAPTER XII</b>		
	<b>SUPERVISION OF SECURITIES MARKETS</b>	<b>103</b>
	1. Approval of prospectuses for securities relating to offers to the public or admissions to trading on a regulated market	
	2. Takeover bids	
	3. Mandatory squeeze-out and sell-out of securities	
	4. Supervision of issuers of securities of which the CSSF is the competent authority	
	5. Enforcement of financial information	
	6. Supervision of markets and market operators	
	7. Investigations and cooperation	
	8. Indices used as benchmarks	
<b>CHAPTER XIII</b>		
	<b>SUPERVISION OF INFORMATION SYSTEMS</b>	<b>119</b>
	1. Activities in 2016	
	2. Supervision of information systems in practice	
<b>CHAPTER XIV</b>		
	<b>SUPERVISION OF THE REMUNERATION POLICIES</b>	<b>125</b>
<b>CHAPTER XV</b>		
	<b>PUBLIC OVERSIGHT OF THE AUDIT PROFESSION</b>	<b>127</b>
	1. Legal, regulatory and normative framework of the audit profession	
	2. Quality assurance review	
	3. Overview of the population of <i>réviseurs d'entreprises</i> in Luxembourg	
	4. Cooperation agreements	
<b>CHAPTER XVI</b>		
	<b>INSTRUMENTS OF SUPERVISION</b>	<b>137</b>
	1. On-site inspections	
	2. Decisions as regards sanctions and administrative police taken in 2016	
<b>CHAPTER XVII</b>		
	<b>RESOLUTION</b>	<b>149</b>
<b>CHAPTER XVIII</b>		
	<b>PROTECTION OF DEPOSITORS AND INVESTORS</b>	<b>151</b>
<b>CHAPTER XIX</b>		
	<b>FINANCIAL CRIME</b>	<b>153</b>
	1. Amendments to the regulatory framework regarding the fight against money laundering and terrorist financing	
	2. CSSF participation in meetings regarding the fight against money laundering and terrorist financing and regarding international financial sanctions	
<b>CHAPTER XX</b>		
	<b>FINANCIAL CONSUMER PROTECTION</b>	<b>157</b>
	1. Financial consumer protection and financial education	
	2. Out-of-court resolution of complaints	
<b>CHAPTER XXI</b>		
	<b>BANKING AND FINANCIAL LAWS AND REGULATIONS</b>	<b>165</b>
	1. Directives and regulations under negotiation at EU level	
	2. Directives to be transposed into national law	
	3. Laws and regulations adopted in 2016	
<b>ANNEX</b>		
	List of abbreviations	<b>174</b>





# CHAPTER I

## GOVERNANCE AND FUNCTIONING OF THE CSSF

### 1. PRINCIPLES

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

#### 1.1. CSSF bodies

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

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

The Council for the Protection of Depositors and Investors (CPDI) is the internal executive body of the CSSF in charge of managing and administering the Fonds de Garantie des Dépôts Luxembourg (FGDL) and the Système d'Indemnisation des Investisseurs Luxembourg (SIIL). Its missions and powers are assigned to it by Part Three of the BRRD Law. Its functioning is governed by the provisions of Section 4-2 of the Law of 23 December 1998 establishing the CSSF. The CPDI is the designated authority referred to in point (18) of Article 2(1) of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes. It cooperates, within the limits of its duties, to the drawing-up of reports and other documents to be submitted to the CSSF's Board.



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

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

### 1.2. Decision-making process

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

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

### 1.3. Drawing-up of regulations

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

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

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

### 1.4. Financing of the CSSF and account auditing

The CSSF is authorised to levy taxes on supervised persons and undertakings to cover its staff, financial and operating costs. The Grand-ducal Regulation of 28 October 2013 lays down the amounts applicable and guarantees full financing of the operating costs.

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

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

## 2. GOVERNING BODIES

### Board

Chairwoman	Isabelle Goubin	Director of the Treasury, Ministry of Finance
Members	Rima Adas	Institut des Réviseurs d'Entreprises
	Serge de Cillia	Chief Executive Officer of the Luxembourg Bankers' Association
	Marny Schmitz	Attaché, Ministry of Finance
	Camille Thommes	Director General of the Association of the Luxembourg Fund Industry
	Pascale Toussing	Director of the Administration des Contributions Directes
	Claude Wirion	Chairman of the Executive Committee of the Commissariat aux Assurances
Secretary	Danielle Mander	Conseiller, CSSF

### Resolution Board

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

### Council for the Protection of Depositors and Investors

Chairman	Claude Simon	Director, CSSF
Members	Isabelle Goubin	Director of the Treasury, Ministry of Finance
	Gaston Reinesch	Director General, Banque centrale du Luxembourg
	Serge de Cillia	Chief Executive Officer of the Luxembourg Bankers' Association
	Karin Guillaume	Premier conseiller to the <i>Cour d'appel</i> (Court of Appeal)
Secretary	Laurent Goergen	Attaché, CSSF

### Executive Board

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



*Executive Board of the CSSF*

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

### 3. COMMITTEES

#### 3.1. Consultative committees

##### 3.1.1. Consultative Committee for Prudential Regulation

The Government may seek advice from the committee, constituted by the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de Surveillance du Secteur Financier), on any draft law or grand-ducal regulation in the field of the financial sector falling within the competence of the CSSF. The CSSF's Executive Board seeks the opinion of the committee on any draft CSSF regulation other than those related to statutory audits and the audit profession. Members of the committee may also seek its advice concerning the implementation or application of prudential regulations overall or for specific issues. The external members of the committee are appointed by the Minister of Finance.

Committee composition:

Executive Board of the CSSF: Claude Marx (Chairman), Simone Delcourt, Claude Simon, Françoise Kauthen, Jean-Pierre Faber

Members: Anouk Agnes, Serge de Cillia, Alain Feis, Isabelle Goubin, Robert Scharfe, Carlo Thill, Camille Thommes

Secretary: Danielle Mander

##### 3.1.2. Consultative Committee for the Audit Profession

The Government may seek advice from the committee, established by the Law of 18 December 2009 concerning the audit profession, on any draft law or grand-ducal regulation related to statutory audits and the audit profession subject to the oversight of the CSSF. The CSSF's Executive Board seeks the opinion of

the committee on any draft CSSF regulation related to statutory audits and the audit profession. Members of the committee may also seek its advice concerning the implementation or application of the regulation of public oversight of the audit profession overall or for specific issues. The external members of the committee are appointed in accordance with Article 15-1 of the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de Surveillance du Secteur Financier).

Committee composition:

Executive Board of the CSSF:	Claude Marx (Chairman), Simone Delcourt, Claude Simon, Françoise Kauthen, Jean-Pierre Faber
Members:	Anouk Agnes, Daniel Croisé, Serge de Cillia, Yasmin Gabriel, Jean-Michel Pacaud, Daniel Ruppert, Philippe Sergiel, Anne-Sophie Theissen, Claude Wirion
Secretary:	Danielle Mander

### 3.1.3. Consultative Committee for Resolution

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

Committee composition:

Resolution Board:	Romain Strock (Chairman), Isabelle Goubin, Karin Guillaume, Gaston Reinesch, Claude Simon
Members:	Jean-Louis Barbier, Claude Eyschen, Thierry Lopez, Gilles Pierre, Philippe Sergiel, Vincent Thurmes
Secretary:	Nicole Lahire

## 3.2. Permanent and ad hoc expert committees

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

The permanent expert committees are the following:

- Anti-Money Laundering Committee;
- Banks Issuing Covered Bonds Committee;
- Banks and Investment Firms Committee;
- Bank and Investment Firm Accounting Committee;
- Depositaries Committee;
- Pension Funds Committee;
- Investment Fund Managers Committee;

- Corporate Governance Committee;
- Financial Consumer Protection Committee;
- SICAR Committee;
- Audit Technical Committee;
- Securitisation Committee.

## 4. HUMAN RESOURCES

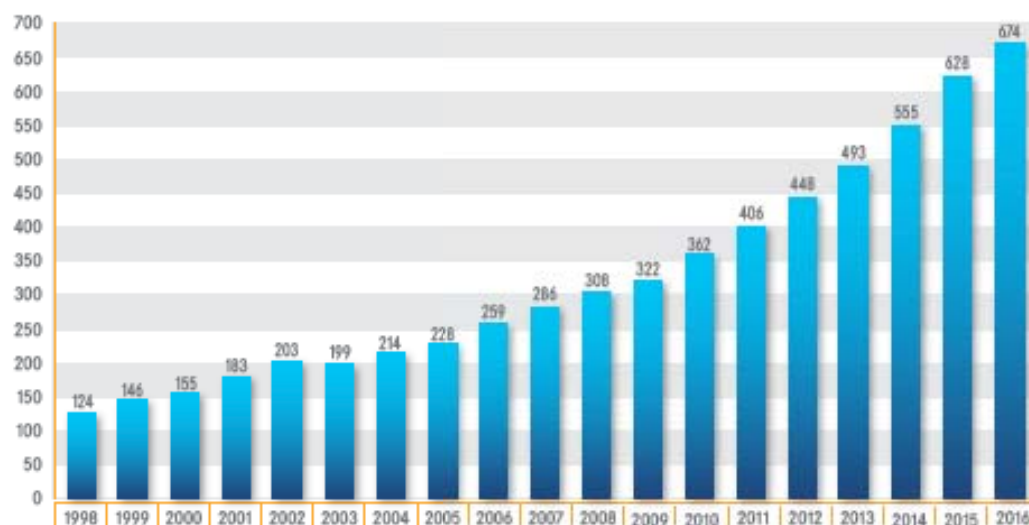
### 4.1. CSSF staff

In constant growth since 2010, the CSSF staff continued to increase in 2016 with the recruitment of 72 new agents. Following the resignation of 26 agents over that period, total employment reached 674 units as at 31 December 2016, representing a 7.32% increase compared to 2015. This is the equivalent of 601.50 full-time jobs, i.e. an 8.86% growth compared to 2015.

Following the reform within the Luxembourg Civil Service which brings about, among others, greater ease in working part-time and taking leave without pay, the number of agents benefitting from part-time employment, partial leave, parental leave or unpaid leave as at 31 December 2016 rose to 154, i.e. 23.05% of total staff.

In 2016, the CSSF received 2,475 job applications, including 228 spontaneous applications, 63 internal applications, 68 applications for internships/students' jobs and 71 applications via the recruitment fair UniCareers. As in the previous years, recruitment mainly focused on University degrees and candidates' competence.

#### Movements in staff numbers



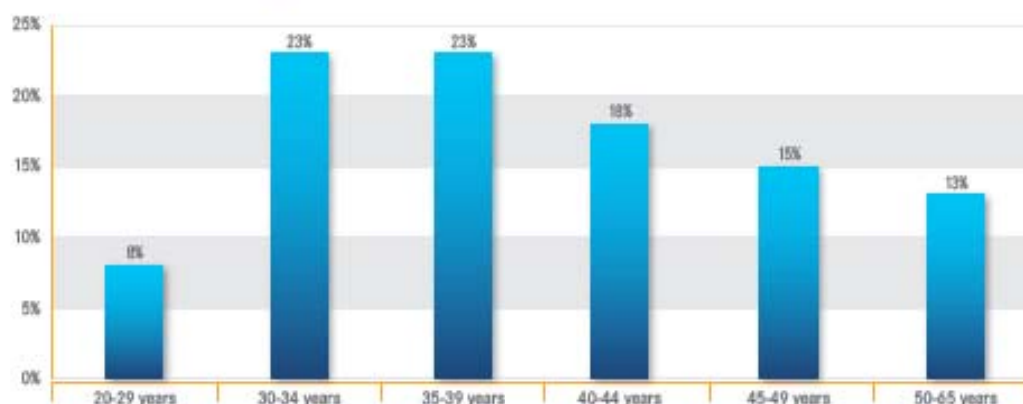
CSSF agents represent 15 nationalities, the Luxembourg nationality being the most represented with 61.13% of total staff. However, the percentage of Luxembourg agents is falling continuously.



**Breakdown of staff by nationality**

Nationality	Number of agents
Luxembourgish	412
French	135
Belgian	67
German	30
Italian	11
Spanish	3
Dutch	3
Portuguese	3
Austrian	2
Bulgarian	2
Polish	2
English	1
Greek	1
Irish	1
Romanian	1
<b>Total</b>	<b>674</b>

The average age of CSSF staff members increased slightly from 38.82 years as at 31 December 2015 to 39.31 years at the end of 2016. Women make up 47.03% of total staff and men 52.97%.

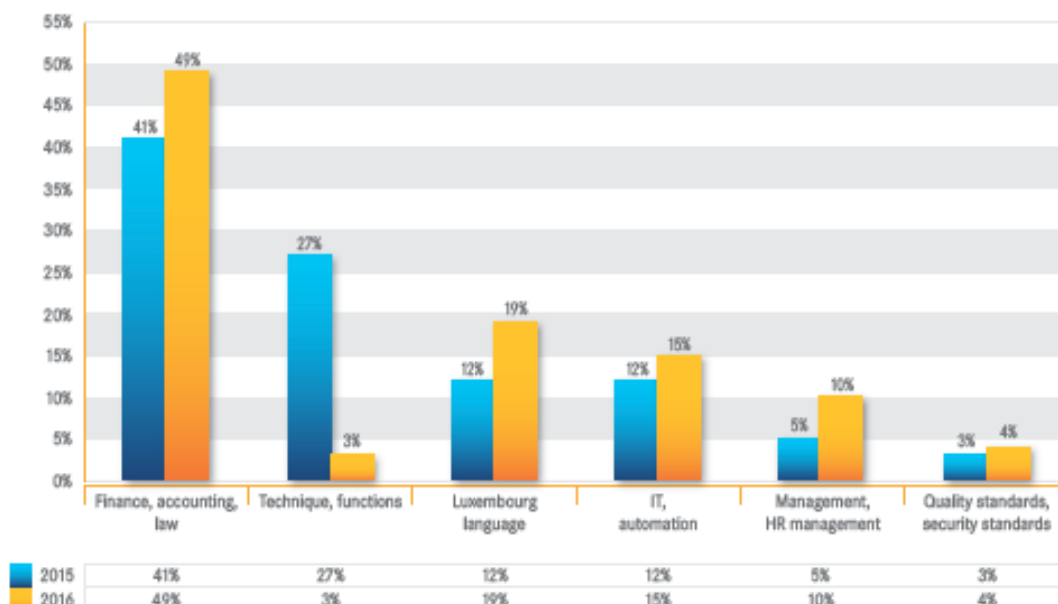
**Breakdown of staff by age****4.2. Staff training**

In 2016, CSSF staff attended a total of 431 training sessions, i.e. 3,178 training days or 19,070 training hours. This figure represents an average of 4.9 training days per agent. As it is capital that the CSSF agents' expertise is at any time in adequacy with the speed of evolution of markets and financial products, as well as with the work methods and techniques of the supervised entities, training is highly encouraged.

These training courses consist of both continuing education, offered to CSSF staff throughout their professional career, and training undertaken during the internship to become a *fonctionnaire* (civil servant). However, given the entry into force, on 1 October 2015, of the reform of the *fonctionnaire* status and the alignment, on 16 December 2016, of the CSSF's organic law with the measures of the reform, the training courses organised

for the internship to become a *fonctionnaire* were postponed to 2017. As the courses undertaken for the internship generally concern the category "Technique/functions", the number of training courses taken in this category in 2016 decreased compared to 2015.

**Breakdown of training according to topic**



### 4.3. Organisation chart

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

## 5. CSSF LIBRARY

The CSSF library is a reference library which is part of the Luxembourg libraries' network [bibnet.lu](http://bibnet.lu) since 2009. It is specialised in banking and financial law as well as financial economy. It contains around 3,000 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](http://bibnet.lu) network. The unified search engine of the collections of the network ([www.a-z.lu](http://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 by appointment, Monday through Friday from 9 a.m. to 11 a.m. and from 2 p.m. to 4 p.m.

## 6. BUDGET AND ANNUAL ACCOUNTS OF THE CSSF - 2016

### 6.1. CSSF budget

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

The 2016 budget was drawn up in accordance with the principles which have proved their worth in the previous years. It was approved by the Board of the CSSF on 16 November 2015. New needs have emerged during the first quarter of 2016 which led to a proposal for a budget extension submitted to the Board in the framework of a reviewed budget approved on 13 April 2016.

The key factors that have affected the 2016 budget are the following:

- In the context of the consolidation of the new architecture for banking supervision in Europe and the development related to on-site supervision, the budget included an increase in CSSF staff, in terms of operational and support departments.
- Notwithstanding the end of the construction of the CSSF's new headquarters in 2015, the surface capacity has become insufficient to welcome all the staff until the end of 2016. Taking into account the recruitment calendar of 2016, the budget included the renting of additional office surface.
- In accordance with the recommendations of the Board of the CSSF, efforts for the consolidation of the quality of the IT infrastructure and operation continued and impacted on the 2016 budget.

The CSSF's finance division closely monitors the budget and draws up monthly reports for the Executive Board. An analysis detailing the gaps between the budgeted figures and the real figures is made at the end of every financial year. It should be noted that, as at 31 December 2016, the amount of operating costs and investment costs remained below the budgeted amounts set for 2016.

## 6.2. Annual accounts of the CSSF - 2016

### BALANCE SHEET AS AT 31 DECEMBER 2016

<i>Assets</i>	<i>EUR</i>
Fixed assets	62,100,839.96
- Intangible fixed assets	4,630,640.10
Development costs	2,729,746.87
Payments on account and intangible assets in progress	1,900,893.23
- Tangible fixed assets	57,470,199.86
Land and constructions	56,644,197.46
Other fixtures, fittings, tools and equipment	826,002.40
Current assets	56,580,617.29
- Debtors	3,084,122.51
Trade debtors with a residual term of up to one year	3,051,618.44
Other debtors with a residual term of up to one year	32,504.07
- Cash at banks, in postal cheque accounts, cheques in hand	53,496,494.78
Prepayment and accrued income	3,854,124.22
<b>Balance sheet total (assets)</b>	<b>122,535,581.47</b>
<i>Liabilities</i>	
Own capital	56,086,117.35
- Profit brought forward	52,994,363.26
- Result for the financial year	3,091,754.09
Provisions	4,300,777.63
- Other provisions	4,300,777.63
Liabilities	62,105,763.29
- Amounts owed to credit institutions	58,383,233.78
with a residual term of up to one year	4,616,567.08
with a residual term of over one year	53,766,666.70
- Debts on purchases and provision of services	2,375,910.72
with a residual term of up to one year	2,375,910.72
- Other debts	1,346,618.79
Tax debts	120,257.87
Social security debts	1,062,932.30
Other debts with a residual term of up to one year	163,428.62
Prepayment and accrued income	42,923.20
<b>Balance sheet total (liabilities)</b>	<b>122,535,581.47</b>

## PROFIT AND LOSS ACCOUNT AS AT 31 DECEMBER 2016

	<i>EUR</i>
<b>Net turnover</b>	<b>81,476,244.94</b>
<b>Other operating income</b>	<b>239,691.44</b>
<b>Raw materials and consumables and other external charges</b>	<b>-6,770,055.99</b>
- Raw materials and consumables	-261,599.24
- Other external charges	-6,508,456.75
<b>Staff costs</b>	<b>-66,088,779.28</b>
- Wages and salaries	-61,438,480.43
- Social security costs	-3,630,640.23
relating to pensions	-536,036.15
other social security costs	-3,094,604.08
- Other staff costs	-1,019,658.62
<b>Value adjustments</b>	<b>-2,922,651.87</b>
- on formation expenses and tangible and intangible fixed assets	-2,922,651.87
<b>Other operating charges</b>	<b>-1,352,317.20</b>
<b>Other interests and financial revenues</b>	<b>65,955.84</b>
- Other interests and financial revenues	65,955.84
<b>Interests and other financial charges</b>	<b>-1,556,333.79</b>
- Other interests and financial charges	-1,556,333.79
<b>Result for the financial year</b>	<b>3,091,754.09</b>

Financial controller Deloitte Audit







## CHAPTER II

### THE EUROPEAN DIMENSION OF THE SUPERVISION OF THE FINANCIAL SECTOR

#### 1. SUPERVISION OF BANKS

##### 1.1. Single Supervisory Mechanism (SSM)

In 2016, the CSSF continued to fully assume its role as a member of the SSM. In this context, it participated, within the Supervisory Board of the SSM, in 1,800 decisions concerning individual banks that are under the direct supervision of the European Central Bank (ECB). At the same time, the CSSF contributed, within the Joint Supervisory Teams (JSTs) to the prudential supervision of Luxembourg significant banks and cooperated with the ECB in the direct supervision of less significant Luxembourg banks for which the CSSF remains responsible. Finally, CSSF experts contributed to the work of about 70 committees and working groups established by the ECB.

##### 1.1.1. Harmonisation of banking supervision within the euro area

In its second year of existence, the SSM continued working on the harmonisation of banking supervision within the euro area by adopting a certain number of political guidelines and regulatory texts.

In 2016, the SSM finalised, among other things, the political guidelines concerning the assessment of qualifications, skills and proper standing of candidates for a position in a bank as a board member, as CEO or as a supervisory board member. In this context, it launched a public consultation on a draft guide gathering all the positions of the SSM on the fit and proper assessment. The rules in the final guide will apply to all significant banks in Luxembourg. They will also apply to less significant banks as far as fit and proper assessment made for authorisation files of new banks and authorisation files for qualifying holdings is concerned.

With the same goal in mind, namely harmonising banking supervision, the ECB published, in 2016, a regulation and a guide setting down the exercise by the ECB of certain options and discretions available in EU banking law. While the scope of application of these texts is limited to significant banks under the direct supervision of the ECB, a public consultation has also been launched on a draft guide and a draft recommendation aiming at harmonising the exercise of options and discretions for the supervision of less significant banks. The proposal provides that the options and discretions for these banks be exercised by the national competent authorities according to the same approach as that applied to significant banks, except for some options and discretions

for which the principle of proportionality justifies a different approach. Similarly to significant banks, the CSSF does not expect a significant global impact of the exercise of options and discretions on regulatory capital requirements for less significant Luxembourg banks. It should be noted that the approach adopted by the ECB for significant banks as regards the liquidity waiver will, in principle, not apply to less significant banks.

### 1.1.2. Implementation of the SSM supervisory review process

In 2016, several measures were taken to implement the SSM's supervisory model, including, in particular, finalising the methodology for the supervisory review and evaluation process (SREP), continuing the work on the overall analysis process for credit institutions' internal models, as well as continuing work on the treatment of bad debt.

At the same time, the SSM continued working on the thematic examinations that had been started in 2015 and launched three new thematic examinations in 2016 relating to business models and banks' profitability drivers, the possible effect on banks of the implementation of IFRS 9 - Financial Instruments (cf. point 1.1.4. below) and banks' compliance with the principles for risk data aggregation and efficient risk reporting.

Moreover, the SSM developed several common methodologies that the national competent authorities must apply to the direct supervision of less significant banks. These methodologies concern areas such as the analysis of recovery plans, on-site inspections or crisis management. Moreover, the SSM started working on the implementation of a common methodology within the SSM for the SREP of less significant banks.

### 1.1.3. Priorities of the prudential supervision of the SSM

The main risk factors identified by the SSM for 2017 are the weak, even negative, level of interest rates, the substantial amount of outstanding bad debt and the sluggish economic growth in the different euro-area countries. Based on these considerations, the SSM defined three priorities for the prudential supervision of banks in 2017: business models and profitability drivers, credit risk (bad debt and concentrations requiring particular attention) and risk management. Each priority will be addressed through prudential initiatives in 2017.

### 1.1.4. Implementation of the accounting standard IFRS 9

Monitoring the implementation of IFRS 9 by euro-area banks is considered a priority by the ECB. Thus, in 2016, the ECB led several initiatives in this area.

A new working group, the Accounting Expert Work Stream (AEWS), has been created. This group is composed of representatives of the euro-area Member States as well as ECB experts. Its purpose is to allow the ECB to benefit from the existing experience within national competent authorities in the accounting and prudential areas and to promote efficient cooperation/coordination between the ECB and those authorities for any accounting-related questions.

The first assignment of the AEWS was to draw up "IFRS 9 operational tools" which were transmitted to the JSTs to allow them to assess the level and quality of implementation of the new standard within supervised entities (project "IFRS 9 Thematic Review" of the ECB). This project only concerned institutions considered as significant by the ECB. The review, which is led at the highest level of consolidation at the level of the ECB, started at the end of 2016 and continued throughout the first quarter of 2017.

For less significant institutions, the ECB opted for an approach similar to that of the EBA, i.e. a survey addressed to a limited number of entities. To this end, every national supervisory authority had to communicate to the ECB at least one banking entity active in the lending business. The survey, which was launched on 2 June 2016, confirmed the conclusions drawn from the EBA survey. A second survey, on a larger scale, is planned for 2017.

#### • Strategic approach of the CSSF concerning the implementation of IFRS 9

The surveys being led at the highest level of consolidation by both the ECB and the EBA (cf. point 1.2.3. below) implies that the results are difficult to use by the CSSF as far as the progress of Luxembourg banks in implementing this new standard is concerned.

As such, although many Luxembourg banks are indirectly covered by these surveys (via their inclusion in the consolidated accounts of their parent undertakings), the analysis of the estimations at group level does not allow to identify their marginal impact.

To address this shortcoming, the CSSF launched a major impact study of Luxembourg banks at the end of 2016. This study was composed of two complementary but distinct components:

- Part 1: Qualitative disclosures

This part, to be submitted to the CSSF by 15 December 2016, mainly addressed the project status and timeline, governance matters and the impact on internal systems.

- Part 2: Quantitative disclosures

This part, to be submitted to the CSSF by 30 April 2017, addressed the impact on the classification of financial assets, provisions and prudential own funds. The information had to be presented on an individual basis (including any branches) as at 31 December 2016.

The CSSF intends to publish a report on the key findings of these surveys in 2017.

Moreover, as announced in its press release of 13 May 2016, the CSSF informed credit institutions that an IAS 39/IFRS 9 reconciliation will be requested from all the banks, as at 31 December 2017, for FINREP and COREP reporting tables, on an individual, and, where applicable, consolidated basis. This reconciliation must be certified by the *réviseur d'entreprises agréé* (approved statutory auditor).

### 1.2. European Banking Authority - EBA

All EBA publications are available on the website [www.eba.europa.eu](http://www.eba.europa.eu). For 2016, the following topics in relation to the activities of the EBA, its working groups and sub-working groups should be pointed out.

In 2016, the EBA's work continued to focus on issues relating to the practical application of the regulatory requirements under CRD IV/CRR<sup>1</sup>, Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) and Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes (DGSD). A growing number of subjects relating to the practical application of the provisions of Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market (PSD2), which will enter into force in 2018, as well as topics that have been raised in the context of FinTech and consumer protection were also discussed.

#### 1.2.1. Proposals to recast Basel III

From the point of view of prudential regulation on own funds, the EBA actively followed the proposals for a recast of Basel III, which is being discussed in the Basel Committee on Banking Supervision. To this end, proposals for a harmonised European position were prepared and discussed within the Board of Supervisors.

#### 1.2.2. Supervisory stress testing

As regards supervisory stress tests, the EBA published a note explaining how the results of the stress test are taken into account by the competent authorities within the scope of the 2016 supervisory review and evaluation process (SREP). Moreover, the EBA decided not to carry out a prudential stress test in 2017, although there will be a transparency exercise. The 2018 supervisory stress test will take into account the impact of the entry into force of the new financial instruments valuation accounting standard IFRS 9 on 1 January 2018.

<sup>1</sup> Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) and Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR).



### 1.2.3. Prudential regime for the supervision of investment firms

In response to the European Commission's call for advice, the EBA published, on 4 November 2016, a discussion paper on the design of a new prudential regime for investment firms. Based on a new categorisation which distinguishes between investment firms that are systemic and/or carrying out bank-like activities and the other investment firms, the EBA is proposing to introduce a distinct regulatory framework which is more adapted to the risks incurred by the "other investment firms".

### 1.2.4. Covered bonds

On 20 December 2016, the EBA issued a report on covered bonds<sup>2</sup> to the European Systemic Risk Board (ESRB) and the European Commission. This report provides certain recommendations on how to design a cross-sectoral European regulatory framework. These recommendations rely on an analysis of regulatory frameworks existing in Member States as well as on an assessment of the latest market trends, while taking into account recent regulatory developments at European level.

### 1.2.5. Large exposures regime

In response to the European Commission's call for advice on the review of the large exposures framework defined in the CRR, the EBA drew up a report on the possible alignment of the rules with the Basel Committee on Banking Supervision international standards on large exposures, as well as on the assessment of the relevance of maintaining certain exemptions and transitional provisions from the large exposures regime of the CRR<sup>3</sup>. According to the EBA, a better harmonisation of both regulatory frameworks (European and international) would have, overall, a limited impact on the institutions' own funds. As regards the five exemptions analysed, the EBA recommended to abolish most of them. Regarding the only exemption deemed important for Luxembourg<sup>4</sup>, the EBA recommended its removal given the low overall impact that its removal would have on all the countries in which it is applied.

Moreover, in order to take into account developments in large exposures since the publication of the guidelines of the former Committee of European Banking Supervisors (CEBS) in 2009, the EBA launched a public consultation in 2016, aiming to guide its thoughts on the identification and management of groups of connected clients, i.e. groups of clients that must be considered by an institution as representing a single risk as their control or economic dependency are interlinked. Feedback to the consultation allowed the EBA to specify certain aspects relating to the treatment of these groups and to prepare guidelines that supplement the current provisions governing treatment of connected clients. The new guidelines should be published by the end of 2017.

### 1.2.6. Calibration of the minimum requirement for own funds and eligible liabilities (MREL)

On 14 December 2016, the EBA published its report on the calibration of the minimum requirement for own funds and eligible liabilities (MREL). The report includes a quantitative impact study and develops various subjects such as the basis for determining the MREL, the relation between the MREL and the other regulatory requirements (in particular, the capital adequacy ratio, liquidity and restrictions on distribution), eligibility criteria, as well as the calibration of the MREL. As regards intragroup issues, the EBA promotes the concept of single jurisdiction under which banking groups are required to comply with the MREL only on a consolidated level. On a practical level, this means that eligible instruments are only issued by the resolution entity, while an internal loss absorption mechanism must be implemented

<sup>2</sup> EBA Report on covered bonds - Recommendations on harmonisation of covered bond frameworks in the EU (EBA-Op-2016-23).

<sup>3</sup> Internet link: [https://www.eba.europa.eu/documents/10180/1632518/EBA-report-on-the-review-of-the-large-exposures-regime-\(EBA-Op-2016-17\).pdf](https://www.eba.europa.eu/documents/10180/1632518/EBA-report-on-the-review-of-the-large-exposures-regime-(EBA-Op-2016-17).pdf)

<sup>4</sup> Article 493(3)(f) of the CRR: By way of derogation from Article 400(2) and (3), Member States may, for a transitional period until the entry into force of any legal act following the review in accordance with Article 507, but not after 31 December 2028, fully or partially exempt the following exposures from the application of Article 395(1): (...) (f) asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day and are not denominated in a major trading currency.



within the group. The report was published together with questions and answers and is available at <https://www.eba.europa.eu/documents/10180/1695288/MREL+Report+-+FAQ.pdf>.

## 1.2.7. Shadow banking

Under the global approach adopted by the Financial Stability Board (FSB) based on a framework to monitor systemic risks associated with shadow banking and on an appropriate regulatory framework allowing risk limitation, the FSB called on the Basel Committee on Banking Supervision to define an appropriate regulatory framework for the identification and quantification of the risks incurred by credit institutions owing to their exposures to shadow banking. In this context, the Basel Committee continued its work in relation to step-in risk (i.e. the relationships through which banks might be exposed to risks due to an implicit obligation to provide financial support beyond their contractual obligations in financial stress) by taking into account the feedback to the public consultation "Identification and measurement of step-in risk". A final text is expected for the end of 2017. It will take into account the responses to a second public consultation which will take place in spring 2017.

At European level, the EBA published its guidelines on the limits on exposures to shadow banking entities which carry out banking activities outside the CRR framework which entered into force on 1 January 2017. Specifying the types of entities likely to carry out shadow banking activities, these guidelines define the principles that apply to a shadow banking entity in the context of the regulations governing large exposures.

## 1.2.8. Implementation of the accounting standard IFRS 9

On 27 January 2016, the EBA launched its first impact study on the implementation of IFRS 9. This survey covered a sample of 58 European banking groups based on their consolidated balance sheets at the highest level of consolidation.

A report on the main results from this first study was published on 10 November 2016. The EBA stresses that the conclusions at this stage must be read and interpreted with great caution, notably for the following reasons:

- the responses to the survey were on a best-effort basis;
- the survey included some simplifications; the banks also specified that their responses/estimates were sometimes imperfect and/or incomplete (while the effect of these simplifications on the received estimates is not possible to be assessed);
- banks do not yet master the new standard perfectly;
- the new measurement models (and in particular those relating to the new expected loss accounting frameworks) are not fully achieved yet or are in a design phase, or building phase for the most advanced groups.

The key qualitative conclusions are the following:

- Banks are still in an early-design phase of implementation of the new standard<sup>5</sup> and, unsurprisingly, the smallest banks are even less advanced than the large groups active at international level.
- The involvement of some key stakeholders, including in particular Audit Committees and Boards of Directors, in the implementation of the standard seems too limited at this stage.
- To the extent possible (in general for IRB banks), banks are looking to leverage off existing prudential models in order to implement their new impairment requirements.
- Data quality and availability (notably historical data) are considered the most significant challenges for determining the inputs to feed into the model.

<sup>5</sup> It should be borne in mind that the survey is based on the situation of early 2016.

- Banks confirm that the interpretation of some of the principles is delicate. Among the topics most often cited were the point of migration between impairment stages 1 and 2 (in case of a significant increase in credit risk) and the definition of the thresholds for infrequent and insignificant sales when determining whether securities are eligible for the measurement at amortised cost. Applying judgement for these key issues is even more difficult in case of a lack of market consensus.
- 75% of the banks anticipate that IFRS 9 will significantly increase volatility in profit and loss, mainly due to the new expected loss accounting model.

The study revealed the following quantitative impacts:

- The banks state that the main impact of IFRS 9 is driven by impairment:
  - Estimated increase of provisions: banks estimate their provisions to grow by 18% on average. 86% of the banks estimate that their provisions will rise up to 30%.
  - Impact on regulatory capital: the estimated average impact on the capital ratio (CET1) is -59 basis points. 79% of the respondents estimate an impact on CET1 of up to 75 basis points. More specifically, stage 2 provisions (provisions relating to assets for which there is no credit loss yet, but which present a significant deterioration of the credit risk since their acquisition) mostly justify this impact. For this type of assets, IFRS 9 requires the total expected losses to be provisioned over their remaining lifetime.
  - Banks using the standardised approach (SA) for prudential reporting will be more heavily impacted than banks using the IRB.
- The impact of "classification and assessment" is more measured (up to 25 basis points on CET1 for 88% of the banks).

On 24 November 2016, the EBA launched its second "IFRS 9 Impact Assessment". A new survey was sent to the same European banks with responses expected by the end of February 2017.

This second study, which is the direct extension of the previous one, is based on the main findings of the first exercise. Most of the qualitative questions were reformulated and the EBA expects more granularity as regards the quantitative assessments. The objective is to measure, one year before the date of effective application of the new standard, the progress made by the institutions within a year.

### 1.2.9. Payment services

The EBA continued its work relating to Regulation (EU) 2015/751 on interchange fees for card-based payment transactions and with respect to Directive (EU) 2015/2366 on payment services (PSD2).

The EBA thus finalised and published the following two documents which were submitted to the European Commission for approval:

- EBA Final draft Regulatory Technical Standards on separation of payment card schemes and processing entities under Article 7(6) of Regulation (EU) 2015/751; and
- EBA Final draft Regulatory Technical Standards on the framework for cooperation and exchange of information between competent authorities for passport notifications under Directive (EU) 2015/2366.

### 1.2.10. Audit

On 26 July 2016, the EBA published the "Guidelines on the communication between competent authorities supervising credit institutions and the statutory auditor(s) and the audit firm(s) carrying out the statutory audit of credit institutions". These guidelines specify, in accordance with Article 12(2) of Regulation (EU) No 537/2014, the requirements for the establishment of an effective dialogue between competent authorities supervising credit institutions, on the one hand, and statutory auditor(s) and audit firm(s) carrying out the statutory audit of those institutions, on the other hand.

The objective of these guidelines is to facilitate the supervision of credit institutions through the promotion of effective communication between competent authorities and auditors.

### 1.2.11. Transparency

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

These guidelines do not amend the disclosure requirements in Part Eight of Regulation (EU) No 575/2013, but aim at harmonising the presentation of information to be disclosed. They will apply as from 31 December 2017 to the disclosures of G-SIIs in accordance with Delegated Regulation (EU) No 1222/2014 and of O-SIIs in accordance with Article 131(3) of Directive 2013/36/EU as specified in the EBA Guidelines (ref.: EBA/GL/2014/10).

### 1.2.12. Consumer protection

In respect of consumer protection, the EBA published the following documents in 2016:

- Consumer Trends Report 2016;
- Opinion of the European Banking Authority on the EU Commission's proposal to bring Virtual Currencies into the scope of Directive (EU) 2015/849 (4AMLD); and
- Discussion Paper on innovative uses of consumer data by financial institutions.

Moreover, FinTech and crowdfunding working groups were created during the year.

## 2. SUPERVISION OF FINANCIAL MARKETS

### 2.1. European Securities and Markets Authority - ESMA

All the publications of ESMA are available on the website [www.esma.europa.eu](http://www.esma.europa.eu). For 2016, the following topics in relation to the activities of ESMA, its working groups and its task forces should be highlighted.

#### 2.1.1. Implementation of the accounting standards IFRS 15 and IFRS 9

On 20 July 2016, ESMA released the public statement "Issues for consideration in implementing IFRS 15: Revenue from Contracts with Customers" (ref.: ESMA/2016/1148) in order to promote consistent and high-quality implementation of IFRS 15 as of 1 January 2018 and to stress the need for transparency on its impact to users of financial statements (good practices of disclosures in the financial statements and illustrative timeline).

On 10 November 2016, ESMA released the public statement "Issues for consideration in implementing IFRS 9: Financial Instruments" (ref.: ESMA/2016/1563) in order to:

- promote a consistent and high-quality implementation of IFRS 9 by all issuers;
- highlight the need for transparency on its impact to users of financial statements (including an illustrative timeline and good disclosure practices);
- communicate the expectations of the national competent authorities.

### 2.1.2. Collective investment management

As regards collective investment management, also called fund management, the following publications<sup>6</sup> were made in 2016, among others.

On 2 February 2016, ESMA released a public statement specifying its work on closet indexing among investment funds (with special ESMA focus on UCITS equity funds), i.e. funds presented to investors as actively managed funds with a corresponding fee structure, when in reality the manager stays close to a benchmark (ref.: ESMA/2016/165).

On 31 March 2016, ESMA released the final report on its "Guidelines on sound remuneration policies" (ref.: ESMA/2016/411) under 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 Directive) and Directive 2011/61/EU of 8 June 2011 on alternative fund managers (AIFMD). These guidelines apply as from 1 January 2017 and are in line with the remuneration policies for alternative investment fund managers. They have been established in cooperation with the EBA in order to ensure consistency with the requirements developed for other sectors, in particular credit institutions and investment firms. In this context, ESMA also sent a letter to the European Commission presenting the context and analysis leading up to the guidelines. Another objective of the letter was to bring to the attention of the European Commission the stance of its members that the principle of proportionality should remain applicable, notably in light of the specificities of the asset manager activity (ref.: ESMA/2016/412).

On 31 March 2016, ESMA published a form for reportings of infringements of national provisions transposing the UCITS Directive. This information will be used by ESMA to understand the issues relating to the implementation of the UCITS Directive rules and for the performance of its tasks in accordance with Regulation (EU) No 1095/2010.

On 7 April 2016, ESMA published its final draft regulatory technical standards with regard to Regulation (EU) No 1286/2014 on key information documents (KID) for packaged retail and insurance-based investment products (PRIIPs Regulation).

On 12 April 2016, ESMA issued an opinion for the attention of the European institutions (European Parliament, European Commission and Council of the EU) on the establishment of a framework on loan origination by investment funds (ref.: ESMA/2016/596).

On 8 June 2016, ESMA published its final draft regulatory technical standards under Regulation (EU) No 2015/760 on European long-term investment funds (ELTIF Regulation) (ref.: ESMA/2016/935).

On 15 July 2016, ESMA published a call forevidence on asset segregation and custody services under the UCITS Directive and the AIFMD (ref.: ESMA/2016/1137). The objective of this second consultation was to gather further evidence on the arguments set out by the stakeholders in their responses to the first consultation which took place in December 2014. Moreover, a round table on asset segregation was held on 20 July 2016 gathering the members of the IMSC Task Force on asset segregation and industry stakeholders. Given the scale of the task, the mandate of the Task Force was extended until June 2017.

On 12 September 2016, ESMA published its final advice, to the European Commission, on the extension of the application of the AIFMD passport to non-EU AIFMs according to Article 67(3) of the AIFMD (ref.: ESMA/2016/1140). This advice concerns the following 12 countries: Australia, Bermuda, Canada, Cayman Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Singapore, Switzerland and the United States of America.

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

On 30 January 2017, ESMA published an opinion (ref.: ESMA34-43-296) on share classes of UCITS. This opinion, addressed to national authorities, which aims at promoting consistency in supervisory practices, follows the consultation launched by ESMA on 6 April 2016 (ref.: ESMA/2016/570) and reflects ESMA's view

<sup>6</sup> <https://www.esma.europa.eu/regulation/fund-management>.



regarding the structuring of share classes, notably in order to ensure a common investment objective and avoid contagion among classes.

In the course of 2016, ESMA published several updates of its Q&A documents, i.e. the Q&As on the application of the AIFMD, the Q&As on the application of the UCITS Directive and the Q&As on the application of the EuVECA and EuSEF Regulations.

## 2.1.3. Post-trading

The role of the Post-Trading Standing Committee (PTSC) within ESMA is to discuss post-trading issues, notably relating to EMIR<sup>7</sup> and CSDR<sup>8</sup>. In addition, the PTSC contributed in 2016 to the development of regulatory and implementing technical standards under the SFTR<sup>9</sup>.

In the course of 2016, the PTSC performed a peer review on margin and collateral requirements for central counterparties. The report thereon was published on 22 December 2016. Moreover, the CSSF takes part in the PTSC working group the objective of which is to draw up a certain number of Level 3 measures under CSDR.

As regards EMIR, several reports were drawn up:

- the EU-wide CCP Stress test Report;
- the final report on draft regulatory technical standards on indirect clearing arrangements under EMIR and MiFIR;
- the final report on possible systemic risk and cost implications of interoperability arrangements;
- the final report on the review of Article 26 of Delegated Regulation (EU) No 153/2013 with respect to MPOR (margin period of risk) for client accounts;
- the final report on regulatory technical standards on access, aggregation and comparison of trade repositories data under Article 81 of EMIR; and
- the final report on the clearing obligation for financial counterparties with a limited volume of activity.

As regards CSDR, the PTSC drew up a consultation paper on the guidelines on participant default rules and procedures under CSDR.

## 2.1.4. Market analysis

The Committee of Economic and Markets' Analysis (CEMA) contributes to ESMA's mission by monitoring developments in financial markets, assessing systemic risks and providing economic background analysis for the general tasks of ESMA. More particularly, it assesses risks to investors and analyses markets and financial stability.

In 2016, ESMA extended and enhanced its regular supervision of securities markets with its half-yearly report "Trends, Risks and Vulnerabilities". Moreover, ESMA published four quarterly "Risk Dashboards".

During the year, CEMA launched three working groups that focussed on the following: "Analysis of the Interest Rate Swap market based on Trade Repository data", "Corporate bond liquidity – a European perspective" and "Development of AIFM risk indicators". The CSSF participates in the activities of the working group on AIFM risk indicators.

## 2.1.5. Convergence of supervisory approaches

In 2015, ESMA had decided to prioritise convergence of supervisory practices for the years to come. The work programme for 2016 was established with this in mind and an assessment of the supervisory practices by the competent authorities is planned in 2017.

<sup>7</sup> Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

<sup>8</sup> Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories.

<sup>9</sup> Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

In 2016, a peer review was carried out in order to verify compliance of the application of the ESMA Guidelines on the MiFID Compliance function. The report will be finalised in 2017.

Two reports on peer reviews conducted in 2015 were published in 2016. The objective of the first report, on MiFID suitability, was to analyse the national competent authorities' approach regarding compliance with the MiFID suitability requirements and to identify the areas that could benefit from greater supervisory convergence. The objective of the second report was to verify compliance of the prospectus approval procedure of competent authorities with the Prospectus Directive. In the context of this assessment, the CSSF participated in the assessment group.

It should be noted that ESMA decided to establish a methodology for peer reviews which are mandatory under certain European regulations.

Follow-up work on the peer review on best execution under MiFID was launched for 15 competent authorities that had been found non-compliant or partially compliant in the 2015 peer review.

### 2.1.6. Consumer protection

ESMA continued its work in relation to the sale of speculative financial instruments (contracts for difference - CFDs, binary options and rolling spot forex) by publishing a Q&A document "Questions and Answers Relating to the provision of CFDs and other speculative products to retail investors under MiFID" (ref.: ESMA/2016/1165) and a warning about these products ("Warning about CFDs, binary options and other speculative products", ref.: ESMA/2016/1166).

As regards consumer protection, the following documents were also published in 2016:

- Questions and Answers On MiFID II and MiFIR investor protection topics (ref.: ESMA/2016/1444);
- Discussion Paper - The Distributed Ledger Technology Applied to Securities Markets (ref.: ESMA/2016/773).

## 3. COOPERATION WITHIN OTHER EUROPEAN BODIES

### 3.1. European Insurance and Occupational Pensions Authority (EIOPA)

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

In 2016, the CSSF contributed to EIOPA's work on occupational pensions by participating in the following committees.

#### 3.1.1. Occupational Pensions Committee (OPC)

In 2016, the committee prepared a market development report on occupational pensions and cross-border institutions for occupational retirement provision based on data as at 31 December 2015. This report was published in the first quarter of 2017 on EIOPA's website<sup>10</sup>.

#### 3.1.2. Review Panel

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

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<sup>10</sup> <https://eiopa.europa.eu/Publications/Reports>.



In 2016, the CSSF contributed to the finalisation of a peer review launched in 2015 in order to assess the practices regarding the statement of investment policy principles of institutions for occupational retirement provision. Following this exercise, the CSSF received an assessment letter from EIOPA which did not state any observations or improvements to be made with respect to the CSSF's prudential supervision.

The final report of the Board of Supervisors on best practices is available on EIOPA's website.

### 3.2. European Audit Inspection Group (EAIG)

The CSSF took part in the work of the EAIG which continued its cycle of bilateral meetings with the main international audit networks in order to discuss, among other things, internal organisation and the procedures in place at European level in order to improve audit quality.

Since 2013, the EAIG's analyses refer to a database that collects the results of national inspections. For the exclusive use of the audit oversight authorities, it covers 10 audit networks.

Moreover, the EAIG adopted a common audit inspection methodology for the review of the audit firms' procedures and continues developing control programmes for audit mandates.

As from 10 November 2016, the EAIG's work was taken over by the Committee of European Auditing Oversight Bodies (CEAOB).


### 3.3. Committee of European Auditing Oversight Bodies (CEAOB)

Established by Regulation (EU) No 537 / 2014 which entered into force on 17 June 2016, the CEOB is the new 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 from the EEA national authorities also participate in the meetings, as well as the EBA and EIOPA as observers.

In November 2016, the CEOB adopted its 2017 work programme. The following priorities have been set: the establishment and functioning of sub-groups and colleges, sharing experiences following the implementation of the new audit legislation and development of a strategy for effective communication and outreach to external parties.





# CHAPTER III

## MACROPRUDENTIAL SUPERVISION WITHIN THE FINANCIAL SECTOR SUPERVISION

### 1. THE FRAMEWORK OF MACROPRUDENTIAL SUPERVISION

Macroprudential supervision aims at ensuring a global supervision of the financial system as a whole. This is essential for the proper functioning of the financial system and the mitigation of threats looming to the real economy. The macroprudential policy framework supplements the microprudential approach to banking supervision.

#### 1.1. European Systemic Risk Board (ESRB)

The European Systemic Risk Board (ESRB) is the authority in charge of the macroprudential oversight at European level. The field of investigation of the ESRB comprises the whole financial sector, including banks, insurance companies, financial markets and all the activities outside the regular banking system, the so-called shadow banking system. The systemic approach used by the ESRB involves analyses of the dependencies, interconnectedness and contagion mechanisms between sub-sectors. The work of the ESRB complements that of the Financial Stability Board (FSB) at an international level.

#### 1.2. European Central Bank (ECB)

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

### 1.3. Systemic Risk Board (SRB)

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

In 2016, the SRB met five times with one of the meetings being a thematic session. The discussions focussed on several issues like, for example, the actions to take following the publication of the ESRB warning on the risks and vulnerabilities in the Luxembourg residential real estate market. The SRB also issued four recommendations on the setting of the countercyclical buffer, an opinion on the institutions considered as systemically important at national level and an opinion and a recommendation on higher risk weights to be applied to retail exposures secured by residential property in Luxembourg.

#### Opinions and recommendations of the SRB and the corresponding CSSF decisions

SRB opinion/recommendation	CSSF decision	Description
Recommendation of the Systemic Risk Board of 2 December 2016 on the setting of the countercyclical buffer rate for the first quarter of 2017 (CRS/2017/001)	CSSF Regulation N° 18-15 on the setting of the countercyclical buffer rate for the first quarter of 2017	Based on the underlying data, the buffer rate has been set at 0% for the first quarter of 2017.
Opinion of the Systemic Risk Board of 28 November 2016 on the reciprocity of the systemic risk buffer rate of 1% adopted by Eesti Pank (Central Bank of Estonia) (CRS/2016/008)	CSSF Regulation N° 18-14 on the reciprocity of the systemic risk buffer rate of 1% adopted by the Central Bank of Estonia	The measure taken by the Central Bank of Estonia to apply a systemic risk buffer rate of 1% to all of the exposures of credit institutions authorised in Estonia in accordance with Article 133 of CRD IV is recognised by the CSSF pursuant to Article 50-11(1) of the Law of 5 April 1993 on the financial sector and applies to any Luxembourg credit institution, whose individual exposures, established based on its consolidated situation, vis-à-vis Estonia exceed the threshold of EUR 200 million.
Opinion of the Systemic Risk Board of 17 October 2016 on the annual identification and calibration review of the buffer for the other systemically important institutions (CRS/2016/007)	CSSF Regulation N° 18-08 concerning systemically important institutions authorised in Luxembourg	Five CRR institutions have been identified as other systemically important institutions based on their score, obtained in accordance with the EBA Guidelines and exceeding the threshold set specifically for Luxembourg at 325 points. Upon a discretionary data assessment, a sixth institution has been added to the list of O-SII.
Recommendation of the Systemic Risk Board of 22 August 2016 on the setting of a countercyclical buffer rate for the fourth quarter of 2016 (CRS/2016/006)	CSSF Regulation N° 18-05 on the setting of the countercyclical buffer rate for the fourth quarter of 2016	Based on the underlying data, the buffer rate has been set at 0% for the fourth quarter of 2016.

Recommendation of the Systemic Risk Board of 25 July 2016 on the reciprocity of the risk-weight add-on measure for exposures secured by residential property located in Belgium taken by the National Bank of Belgium (CRS/2016/005)	CSSF Regulation N° 16-04 on voluntary reciprocity for macroprudential policy measures	The measure taken by the National Bank of Belgium in accordance with Article 458 of the CRR to impose on credit institutions, using the internal ratings-based approach, a 5-percentage-point risk-weight add-on applied to retail mortgage loan exposures (non-SME) secured by residential property located in Belgium is recognised in Luxembourg under Article 458(5) of the CRR and applies to Belgian branches of Luxembourg credit institutions that apply the internal ratings-based approach.
Opinion and recommendation of the Systemic Risk Board of 1 July 2016 with respect to the risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg (CRS/2016/004)	Circular CSSF 16/643	The use of rating systems as part of the internal-ratings based approach for the calculation of risk-weighted exposure amounts for credit risk in accordance with Part Three, Title II, Chapter 3, Section 2 of the CRR should not result in an average risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg below 15%.
Recommendation of the Systemic Risk Board of 9 June 2016 on the setting of a countercyclical buffer rate for the third quarter of 2016 (CRS/2016/003)	CSSF Regulation N° 16-03 on the setting of the countercyclical buffer rate for the third quarter of 2016	Based on the underlying data, the buffer rate has been set at 0% for the third quarter of 2016.
Recommendation of the Systemic Risk Board of 15 February 2016 on the automatic recognition of countercyclical capital buffer rates during the transitional period (CRS/2016/002)	CSSF Regulation N° 16-01 on the automatic recognition of countercyclical capital buffer rates during the transitional period	The countercyclical buffer rates set by the designated authorities of the other Member States are automatically recognised up to 2.5% during the transitional period referred to in Article 160 of Directive 2013/36/EU, in accordance with the option chosen by the legislator not to adopt a transitional period in Luxembourg.
Recommendation of the Systemic Risk Board of 15 February 2016 on the setting of a countercyclical buffer rate for the second quarter of 2016 (CRS/2016/001)	CSSF Regulation N° 16-02 on the setting of the countercyclical buffer rate for the second quarter of 2016	Based on the underlying data, the buffer rate has been set at 0% for the second quarter of 2016.

## 2. IMPLEMENTATION OF MACROPRUDENTIAL POLICY

The CSSF has several tools, among which, for example, the possibility to require banks to build up additional capital buffers depending on the state of the financial cycle or on structural risks, or to reciprocate the macroprudential measures taken by other national authorities to ensure the consistency of macroprudential policy at European level. The CSSF activates its macroprudential tools when variations in systemic risk threaten the financial system and the real economy.

The decisions on macroprudential measures in Luxembourg are taken by the CSSF, in consultation with the BCL, after requesting the opinion or recommendation of the SRB and duly taking into account the comments of the ECB.



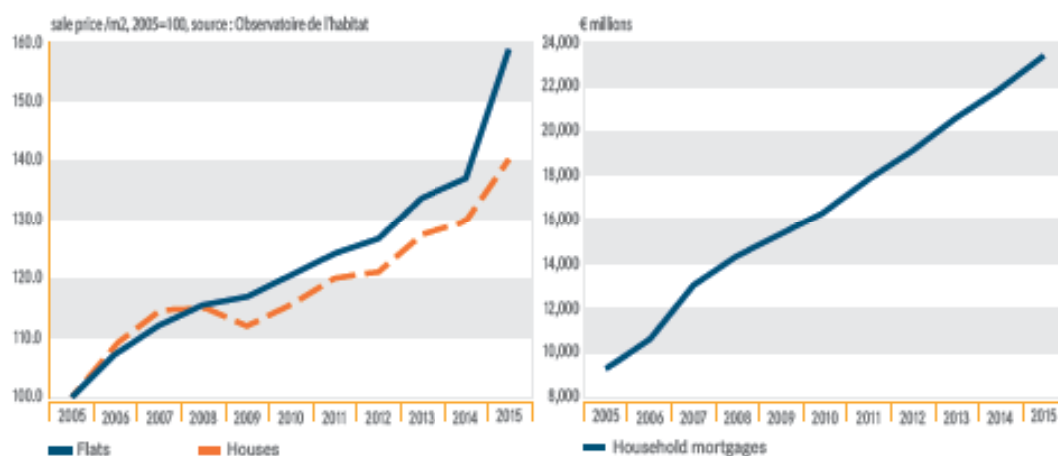
## 2.1. Luxembourg real estate market

The Luxembourg real estate market has been growing for many years. A strong growth in the population combined with a restricted supply drove up the residential property prices in the last years.

Banks accommodated the real estate demand through a strong increase in housing credit during the same period. This contributed to maintaining a healthy housing market, but the level of household indebtedness also rose, which generated a vulnerability at macroprudential level. The repayment capacity of households is strongly linked to the evolution of interest rates and the value of household wealth depends on the continuous growth of real estate prices.

For several years, the CSSF has been closely following the developments on the Luxembourg real estate market, together with the BCL. The follow-up of these developments is regularly on the agenda of the SRB meetings. In July 2016, as a follow-up of the SRB opinion, the CSSF issued a circular requiring the banks active in the residential property market to apply a floor for the average risk weights applied to retail property exposures. This circular also determines a minimum own funds amount that banks must hold for this type of exposures.

### Development of residential property prices and of mortgage credits to households<sup>1</sup>



In parallel, the CSSF contributed to the ESRB's work on the vulnerabilities of the residential real estate sector within the EU. The findings were published in a report which put forward a certain number of short-term vulnerabilities for Luxembourg, among which the combination of high and growing real estate property prices and an increasing household indebtedness. In November 2016, in the context of this systemic and forward-looking assessment, the ESRB issued public warnings for eight countries, including Luxembourg, on medium-term residential real estate vulnerabilities<sup>2</sup>. Moreover, the ESRB issued a recommendation titled "Recommendation on closing real estate data gaps" (ESRB/2016/14), inviting Member States to collect a set of indicators from the residential and commercial real estate market to better assess the risks arising from the real estate sector.

The SRB took into consideration the warnings and observations of the ESRB. The SRB invited the member institutions, notably the CSSF and the BCL, to continue their analytical work in this area and to follow up on the compliance with the data collection requirements of the ESRB in the context of its aforementioned recommendation.

## 2.2. Cyclical risk

In order to limit cyclical risk and mitigate pro-cyclicality of regulatory capital requirements, the Basel Committee on Banking Supervision suggested an arrangement that defines countercyclical capital buffers as a function of the credit cycle. The main objective of the countercyclical capital buffer (CCyB) as a macroprudential instrument is to prevent and mitigate systemic risk stemming from excessive credit growth.

<sup>1</sup> Sources: Observatoire de l'habitat, BCL.

<sup>2</sup> Details on the reports, recommendations and warnings are available on the ESRB website at <https://www.esrb.europa.eu>.



Every quarter, the CSSF calculates a benchmark to determine which rate has to be applied for the constitution of a capital buffer, which aims at providing a guide related to the adequacy of the countercyclical buffer rate currently in force. The buffer rate reflects the credit cycle and the risks due to excess credit growth in Luxembourg and takes into account the specificities of the Luxembourg economy. The countercyclical rate calibration must take into account a set of data in order to set the countercyclical buffer rate. The evolution of the credit to the Luxembourg non-financial sector remains in line with its fundamentals and the countercyclical buffer rate has been set at 0% by the CSSF for all quarters of 2016<sup>3</sup>.

### 2.3. Structural risk by six systemic institutions

In 2016, the CSSF, acting as designated authority, identified six domestic financial institutions as systemically important. The main identification criteria are the size, interconnectedness, complexity and importance and the lack of substitutability of the services provided<sup>4</sup>. Moreover, the buffer calibration is left to the appreciation of the national designated authority.

#### Buffer rates for systemically important institutions in Luxembourg

Denomination	2016	2017	2018	2019
Deutsche Bank Luxembourg S.A.	0.25%	0.50%	0.75%	1.00%
Société Générale Bank & Trust	0.25%	0.50%	0.75%	1.00% <sup>5</sup>
Banque et Caisse d'Épargne de l'État, Luxembourg	0.125%	0.25%	0.375%	0.50%
BGL BNP Paribas	0.125%	0.25%	0.375%	0.50%
CACEIS Bank Luxembourg <sup>6</sup>	0.125%	0.25%	0.375%	0.50%
Banque Internationale à Luxembourg S.A.	0.125%	0.25%	0.375%	0.50%

### 2.4. Shadow banking and interconnectedness between banks and investment funds

Shadow banking, defined as a parallel banking system, is gaining more and more attention at international level. An enhanced supervision of shadow banking has been put in place, for several years now, by several institutions, notably the ESRB at European level and the Financial Stability Board (FSB) at global level.

The CSSF closely follows the ESRB analyses on the parallel banking system and contributes to it. It should be noted that the ESRB will publish, in the coming months, the second edition of the report "EU Shadow Banking Monitor" jointly prepared by the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC). This report assesses structural changes in the shadow banking sector and gives an overview of the main risks associated with shadow banking activities that may affect financial stability in Europe. To this end, the ESRB suggests two risk measures. The first measure considers an entity-based monitoring approach, whereas the second measure refers to an activity-based monitoring approach that certain entities contributing to an accrued interconnectedness within the financial system may have. The two measures are meant to be complementary and ensure that all the aspects of shadow banking are covered.

Considering the importance of the subject for Luxembourg, and given the size of the banking sector and of the investment fund industry and the relatively important role of the OFI (Other Financial Institutions) sector, the SRB established two working groups mandated to study, on the one hand, the OFI sector and, on the other hand, the interconnectedness between banks and investment funds.

<sup>3</sup> Please refer to CSSF Regulations N° 16-05, N° 16-03, N° 16-02 and N° 15-04 (<http://www.cssf.lu/en/documentation/regulations/laws-regulations-and-other-texts/news-cssf/130/>).

<sup>4</sup> The identification of O-SII in Luxembourg is based on the scoring methodology specified in the EBA Guidelines (EBA/GL/2014/10) which determine the criteria and mandatory indicators to be used for assessing the systemic importance of national institutions.

<sup>5</sup> In accordance with Article 59-9(4) of the Law of 5 April 1993 on the financial sector, the buffer rate applicable to Société Générale Bank & Trust went down from 1.5% to 1%.

<sup>6</sup> CACEIS Bank Luxembourg, which had been identified as the sixth systemically important institution in Luxembourg, transformed itself into a branch as of 31 December 2016.

### 2.5. Reciprocation of macroprudential measures

The macroprudential measures implemented in a country may directly or indirectly impact other countries. To reduce potential arbitrages between Member States, the ESRB introduced, for the application of the principles in CRD IV, a framework relating to the implementation of reciprocating macroprudential measures of other concerned authorities.

In 2016, the CSSF applied this reciprocity principle twice:

- The CSSF reciprocated the macroprudential measure taken by Belgium in accordance with Article 458 of the CRR which consists in adding 5 basis points to risk weights on Belgian residential real estate property exposures. The measure taken by the National Bank of Belgium has been applied with immediate effect to the Belgian branches of the concerned Luxembourg credit institutions.
- The CSSF reciprocated the systemic risk buffer rate adopted by the Central Bank of Estonia (Eesti Pank) of 1% applied to national exposures of all credit institutions authorised in Estonia. The CSSF requested its application with immediate effect to the concerned Luxembourg credit institutions.



## CHAPTER IV

### THE INTERNATIONAL DIMENSION OF THE CSSF'S MISSION

#### 1. BASEL COMMITTEE ON BANKING SUPERVISION

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

In 2016, the Basel Committee sought to finalise the Basel III regulatory framework implemented according to the reform agenda decided by the G20 as a response to the 2008 financial crisis. In this context, the Basel Committee conducted several public consultations during the year concerning, in particular, the treatment of operational risks, the internal ratings-based approach and the leverage ratio.

As regards the leverage ratio, the Group of Central Bank Governors and Heads of Supervision (GHOS), the supervisory body of the Basel Committee, agreed in January 2016 that the Basel III leverage ratio should be based on a capital definition within the meaning of Tier 1 capital and be subject to a floor of 3%. Despite all progress, a final agreement on Basel III has not yet been reached at present. The main cause of disagreement is the calibration of the capital floor, which puts a floor on the risk amounts (to be sustained by capital) which are determined by the banks that use internal measurement approaches rather than standardised regulatory approaches.

Other regulatory developments with particular interest for Luxembourg banks include the publication on 21 April 2016 of the new prudential treatment for Interest Rate Risk in the Banking Book (IRRBB). These rules set out a stricter threshold for identifying outlier banks, whose ratio between simulated loss following a variation of interest rates and Tier 1 capital is less than -15%.

As for public consultations, there was the consultation on "Regulatory treatment of accounting provisions", the consultation on "Prudential treatment of problem assets", as well as the second consultation of the Basel Committee in order to finalise the new standards that should be applied with respect to implicit support (step-in risk).

In conjunction with its regulatory work, the Basel Committee further strengthened its monitoring and assessment programme for the implementation of the agreed reforms (RCAP programme). In 2016, RCAP reports covering solvency and/or liquidity were published regarding Argentina, Indonesia, Japan, Russia, South Korea and Turkey. For Luxembourg, which is host to many banks from other jurisdictions, including non-EU, the RCAP is a useful source of information helping assessing the regulatory framework applying to parent banks.

All the publications by the Basel Committee and information on its mission and organisational structure are available on the website [www.bis.org](http://www.bis.org).

## 2. INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

### 2.1. 41<sup>st</sup> Annual Conference of the International Organization of Securities Commissions (IOSCO)

The securities and futures markets regulators, including the CSSF, and other members of the international financial community met in Lima from 8 to 12 May 2016, on the occasion of the 41<sup>st</sup> Annual Conference of IOSCO.

During this conference, the members approved a new Enhanced Memorandum of Understanding (Enhanced MMoU) which aims at improving and strengthening cooperation between supervisory authorities, as laid down in the existing MMoU signed by 109 members. Indeed, IOSCO considered that additional powers are necessary for its member authorities to ensure their continued effectiveness in deterring cross-border misconduct and fraud. The Enhanced MMoU sets out five new powers in addition to those in the current MMoU:

- to obtain and exchange audit papers;
- to compel attendance for testimony (including persons not subject to supervision), by being able to apply a sanction in the event of non-compliance;
- to advise and provide existing information to another regulator on how to freeze assets, or to freeze assets on behalf of another regulator;
- to obtain existing Internet service provider records (not including the content of communications);
- to obtain existing telephone records (not including the content of communications).

Moreover, IOSCO continued its work on risk identification linked to securities markets and capacity building according to the needs of its members.

Finally, IOSCO will support a set of initiatives in order to improve investor protection and has already launched a campaign to coordinate an investor week.

### 2.2. Work of the IOSCO Committees

On 7 June 2016, IOSCO published the Statement on Non-GAAP Financial Measures, intended to assist issuers in providing disclosure of non-GAAP financial measures and to reduce the risk of a misleading presentation.

The principles that issuers should apply include:

- clear definition of the content and calculation;
- reconciliation to an item defined by the accounting framework (i.e. net result);
- less or equally prominent presentation compared to the item defined by the accounting framework;
- explanation of the usefulness.

On 15 December 2016, IOSCO issued the Statement on the Implementation of New Accounting Standards, presenting recommendations regarding the three new accounting standards (IFRS 15 - Revenue from Contracts with Customers, IFRS 9 - Financial Instruments and IFRS 16 - Leases) issued by the IASB and likely to significantly affect the financial statements of many issuers. The public statement stresses the importance of the implementation process by issuers, as well as a series of matters for their audit committees and auditors

to consider. IOSCO also insists on the need for transparent disclosure regarding the possible impact that these new standards will have on the financial statements, notably in a context of investor protection and financial stability.

In 2016, IOSCO published the following documents (co-)prepared by its Committee 5 on Investment Management:

- the report "Cyber Security in Securities Markets – An International Perspective/Report on IOSCO's cyber risk coordination efforts";
- the consultation paper "Good Practices for the Termination of Investment Funds".

Moreover, Committee 5 continued discussing the international work on the developments and potential vulnerabilities in the asset management sector. Following a consultation on a certain number of proposals for recommendations in this area, the Financial Stability Board (FSB) released its final recommendations on 12 January 2017. These recommendations cover the following aspects:

- liquidity mismatch of investment funds;
- leverage within investment funds;
- operational risks and challenges in transferring investment mandates in stressed conditions; and
- securities lending activities of investment funds and asset managers.

The Fourth Hedge Fund Survey was launched in 2016 in the industry of the participating member countries (including Luxembourg). The survey covered data as at 30 September 2016 collected by the supervisory authorities.





*Agents hired in 2016 and 2017: Legal Department and departments "Supervision of securities markets" and "Public oversight of the audit profession"*

Left to right: Gilles ASSA, Solange FAUST, Pedro DA COSTA, Anne-Cécile DELANNOY, Etienne DE RÉ, Florence BOULAY, Susanne VIEIRA, Alexandre CHRIST, Elena KALAMBOKIS, Jérôme WEICKER





## CHAPTER V

### FINANCIAL INNOVATION

Innovation has always been considered by the CSSF as an essential vector of the development of financial services and of the financial centre. Thanks to this approach, Luxembourg has become a European platform not only for the payment services and electronic money industry, but also for new players of the financial centre which develop ever more innovative products and services.

The financial technologies, commonly called FinTech, progressively invade all the financial sector activities and now impact their future and prospects. In this new and continuously evolving ecosystem, the CSSF shows its capacity to adopt a proactive approach. The CSSF is indeed in permanent contact with the existing and new market players in order to better understand their expectations and address the forthcoming challenges.

On 19 April 2016, the Minister of Finance authorised Bitstamp Europe S.A., a platform allowing its clients to exchange Bitcoins, EUR and USD. If the issue of virtual currencies as such is not subject to authorisation, the service provided by the intermediary - receiving funds from the buyer of Bitcoin in order to transfer them afterwards to the seller - is covered by the authorisation as payment institution. This authorisation echoed the CSSF's opinion which, in 2014, was the first regulator of the financial sector that was in favour of the regulation of platforms for the exchange of virtual currencies when exercising an activity of the financial sector.

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

#### • Identification through video chat

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

Following the discussions with the main market players, the CSSF published FAQs detailing the conditions for the use of services for the identification through video chat.

### • Permanent contact with market players

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

By enhancing the communication with the market players, the CSSF offers thus means to ensure appropriate information of the market players regarding regulation, whilst soaking up market evolution in order to anticipate challenges.

### • FinTech Working Group

The CSSF created a working group dedicated to the FinTech sector which is composed of financial sector and CSSF experts in this area. Its objective is to monitor the evolutions in FinTech in order to better identify the implications, in particular, for the financial sector and the associated regulation. Thanks to this initiative, the CSSF is able to understand the most innovative business models due to an extensive knowledge of the associated risks and advantages.

In 2016, the FinTech Working Group concentrated on topics such as robo-advice, blockchain or crowdfunding as well as the outsourcing of cloud services and KYC utilities (know-your-customer utilities), in order to determine if the current regulation is adaptable to the development of the market or if additional regulation is needed.

Thus, the CSSF carried out, closely with the market players, important work in order to propose a viable regulatory framework for the outsourcing by regulated entities using public clouds. A circular is planned to be published on this topic in 2017 (cf. also Chapter XIII "Supervision of information systems").

The working group also discussed the opportunity to prepare a regulation regarding KYC utilities which allow pooling KYC data and documents of banks' clients onto centralised platforms.

### • International working groups

Today, FinTech has, more than ever, a very strong international dimension which requires a common and harmonised response from the regulators of the financial sector.

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

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

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

It is important to point out that the thoughts and the opening-up take place by taking into account any possible risks arising from these new technologies, whether these risks relate to consumer protection or to the stability of the financial sector. The CSSF's mission is to mitigate the risks at best and to consider adapting the existing financial regulation in accordance with the development of the financial markets.

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



*Agents hired in 2016 and 2017: Departments "Resolution" and "Innovation, payments, market infrastructures and governance"*

Left to right: Charène HERBAIN, Nicolas MORENVILLE, Anne-Kathrin HASDORF, Maxime DANTEC, Nicolas BAEYENS, Sally RAAD, Bertrand TOULMONDE, Alexander HUMMEL

Absent: Dieter DE SMET, Kenny NÜRENBERG



# CHAPTER VI

## SUPERVISION OF BANKS

### 1. DEVELOPMENTS IN THE BANKING SECTOR IN 2016

#### 1.1. Characteristics of the Luxembourg banking sector

The Luxembourg banking legislation provides for two types of banking licences, namely that of universal banks (137 institutions had this status on 31 December 2016) and that of banks issuing covered bonds (four institutions had this status on 31 December 2016). The main characteristics of the banks issuing covered bonds are the monopoly of covered bonds issuance and the prohibition to collect deposits from the public.

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

- banks incorporated under Luxembourg law (97 on 31 December 2016);
- branches of banks incorporated in an EU Member State or assimilated (32 on 31 December 2016);
- branches of banks incorporated in a non-EU Member State (12 on 31 December 2016).

Furthermore, there is one special case: the *caisses rurales* (13 on 31 December 2016) and their central establishment, Banque Raiffeisen, are to be considered as a single credit institution, according to the law on the financial sector.

#### 1.2. Development in the number of credit institutions

With 141 entities authorised at the end of the financial year 2016, the number of banks dropped by two entities as compared to 31 December 2015 when 143 entities were active.



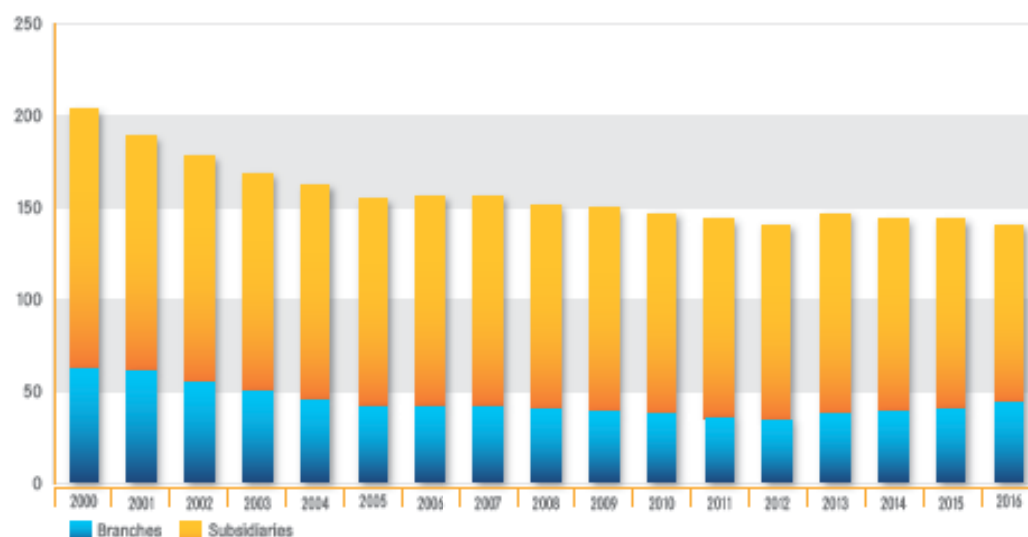
Seven banks were deregistered from the official list during the year:

- Citibank International Limited, Luxembourg Branch      Transfer of activities to Citibank Europe plc, Luxembourg Branch on 1 January 2016.
- Cornèr Banque (Luxembourg) S.A.      Cessation of activities on 1 April 2016.
- Bank Leumi (Luxembourg) S.A.      Cessation of activities on 13 July 2016.
- Europäische Genossenschaftsbank S.A.      Merger by acquisition with DZ Privatbank S.A. on 25 July 2016.
- BHF-Bank International      Cessation of activities on 15 November 2016.
- UBS (Luxembourg) S.A.      Cross-border merger with UBS Deutschland AG and transfer of activities to UBS Europe SE, Luxembourg Branch on 1 December 2016.
- CACEIS Bank Luxembourg      Cross-border merger with CACEIS Bank France and transfer of activities to CACEIS Bank Luxembourg Branch on 31 December 2016.

Five banks started their activities in 2016:

- Citibank Europe plc, Luxembourg Branch      1 January 2016: the bank continues the activities of Citibank International Limited, Luxembourg Branch.
- Rakuten Europe Bank S.A.      11 January 2016: the bank carries out corporate banking and payment services activities.
- Bank of Communications Co., Limited Luxembourg Branch      1 December 2016: the Chinese bank carries out corporate banking activities.
- UBS Europe SE, Luxembourg Branch      1 December 2016: the bank continues the activities of UBS (Luxembourg) S.A.
- CACEIS Bank Luxembourg Branch      31 December 2016: the bank continues the activities of CACEIS Bank Luxembourg.

## Development in the number of banks established in Luxembourg



The total number of branches established in other EU/EEA Member States amounted to 69 entities as at 31 December 2016. On the same date, the number of branches set up in Luxembourg by credit institutions originating from another EU/EEA Member State totals 32 entities.

**Branches established in the EU/EEA as at 31 December 2016 broken down by Member State**

Member State	Branches of Luxembourg banks established in the EU/EEA	Branches of EU/EEA banks established in Luxembourg
Austria	1	-
Belgium	10	1
Cyprus	1	1
Denmark	1	-
France	8	4
Germany	4	14
Greece	1	-
Ireland	2	1
Italy	9	-
Netherlands	6	1
Poland	2	-
Portugal	4	2
Spain	10	1
Sweden	2	2
United Kingdom	8	5
<b>Total</b>	<b>69</b>	<b>32</b>

### 1.3. Development in banking employment<sup>1</sup>

As at 31 December 2016, the number of employees in Luxembourg credit institutions amounted to 26,060, compared to 25,942 as at 31 December 2015 which is a slight increase by 118 people on an annual basis.

This annual increase results from the rise in staff members in over half of the banks which offsets for the reductions recorded in a third of the banks of the financial centre.

Compared to the figures of December 2015, the distribution of employment according to men and women remains almost unchanged. However, a net increase in the number of employees with an academic background higher than the "BAC+3" (bachelor) degree is noticeable (+4.8%), whereas employees whose education is equivalent or below the "BAC" degree declines (-3.0%).

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

#### 1.4.1. Balance sheet total of credit institutions

As from 31 December 2016, the FINREP reporting tables are only available in extended scope, i.e. including the foreign branches of Luxembourg credit institutions<sup>2</sup>. Consequently, the comparisons between the figures of 2016 (including these branches) and 2015 (excluding these branches) as presented below reflect both the development at constant scope and the extension of the scope.

As regards the increase of 3.6% of the balance sheet total of Luxembourg banks over a year, the estimated effect of the extension of the scope is about 1.7%. In that case, the growth (with equal scope) would amount to approximately 2%. Regarding individual items, the two effects were not broken down in the rest of this chapter.

<sup>1</sup> These data are based on a statistical reporting set up by the BCL in December 2014. Following the work on data quality carried out by the BCL after the publication of the 2015 data, the figures of employment were revised. Consequently, discrepancies with the data published in the 2015 Annual Report may appear.

<sup>2</sup> Cf. Circular CSSF 15/621.

While, following the financial crisis of 2008 and the decrease in financial intermediation activity on an international level, the balance sheet total of Luxembourg banks dropped by around one fourth, the banking sector experiences, since 2013, an increase of its activity as measured by the balance sheet total. In 2016, this growth is spread across 59% of the banks of the financial sector, which represent 70% of the balance sheet total.

### 1.4.2. Development of the aggregated balance sheet structure

It is worth pointing out three important developments in the aggregated balance sheet structure of credit institutions in 2016.

First, there is a significant decrease of **loans and advances to credit institutions** which have fallen to their lowest level since 13 years. This fall concerns mainly intra-group commitments of large banking groups that have to comply with the new liquidity standard, namely the Liquidity Coverage Requirement (LCR), since 1 October 2015.

In return, **loans and advances to central banks and central governments** rose sharply year-on-year. This increase mostly concerns the deposits with central banks whose amount now reaches EUR 133.1 billion (against EUR 66.9 billion in 2015). Thus, the placement of Luxembourg banks' excess liquidity has been diverted away from intra-group assets. This development has further fragmented interbank liquidity flows since October 2015.

Second, **loans and advances to customers** which include corporates and retail customers, increased significantly compared to the previous year. Among these loans and advances, the exposures to retail customers, mainly from Luxembourg, rose by 5.1% over a year to reach EUR 53.8 billion as at 31 December 2016. Loans and advances to corporates reached EUR 162.2 billion at the end of 2016 (+17.9%). The increase of the customer loans activity is partially due to the inclusion of foreign branches of Luxembourg banks in 2016 (extension of scope). However, the scale of the growth of the activity of loans and advances to customers was recorded for a small circle of banks, some of which have been established in Luxembourg for only a few years.

Finally, **amounts owed to customers**, consisting of deposits made by companies, private customers and/or retail customers, as well as of current accounts of investment funds, rose by 8.6% over a year. This positive development was registered despite the introduction of the automatic exchange of financial account information between the Member States on 1 January 2015.

## Aggregate balance sheet total – in million EUR

ASSETS	2015	2016 (*)	Variation	LIABILITIES	2015	2016 (*)	Variation
Loans and advances to central banks and central governments	75,710	142,437	88.1%	Amounts owed to central banks	7,290	10,834	48.6%
Loans and advances to credit institutions	298,584	239,349	-19.8%	Amounts owed to credit institutions	268,348	253,581	-5.5%
Loans and advances to customers	188,832	216,116	14.4%	Amounts owed to customers	324,540	352,584	8.6%
Financial assets held for trading	10,000	9,319	-6.8%	Amounts owed represented by securities	54,459	59,521	9.3%
Fixed-income transferable securities	144,658	137,619	-4.9%	Liabilities (other than deposits) held for trading	8,766	8,798	0.4%
Variable-yield transferable securities	11,221	9,793	-12.7%	Provisions	3,581	3,564	-0.5%
Fixed assets and other assets	14,017	15,442	10.2%	Subordinated liabilities	5,112	4,409	-13.8%
				Other liabilities	13,472	15,408	14.4%
				Capital and reserves	57,584	61,378	6.6%
<b>Total</b>	<b>743,154</b>	<b>770,076</b>	<b>3.6%</b>	<b>Total</b>	<b>743,154</b>	<b>770,076</b>	<b>3.6%</b>

(\*) Preliminary figures.

## Structure of the aggregated balance sheet

ASSETS	2015	2016 (*)	LIABILITIES	2015	2016 (*)
Loans and advances to central banks and central governments	10.19%	18.50%	Amounts owed to central banks	0.98%	1.41%
Loans and advances to credit institutions	40.18%	31.08%	Amounts owed to credit institutions	36.11%	32.93%
Loans and advances to customers	25.41%	28.06%	Amounts owed to customers	43.67%	45.79%
Financial assets held for trading	1.35%	1.21%	Amounts owed represented by securities	7.33%	7.73%
Fixed-income transferable securities	19.47%	17.87%	Liabilities (other than deposits) held for trading	1.18%	1.14%
Variable-yield transferable securities	1.51%	1.27%	Provisions	0.48%	0.46%
Fixed assets and other assets	1.89%	2.01%	Subordinated liabilities	0.69%	0.57%
			Other liabilities	1.81%	2.00%
			Capital and reserves	7.75%	7.97%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

(\*) Preliminary figures.

## 1.4.3. Use of derivative financial instruments by credit institutions

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

**Notional amounts of derivative financial instruments**

Notional amounts (in bn EUR)	2015	2016 (*)	Variation		Structure	
			in volume	in %	2015	2016 (*)
Interest rate derivatives	161.1	167.9	6.8	4.2%	23.4%	22.2%
Equity derivatives	23.8	18.8	-5.0	-21.2%	3.5%	2.5%
Foreign exchange derivatives	497.3	563.2	65.9	13.3%	72.1%	74.5%
Credit derivatives	7.2	6.1	-1.1	-15.6%	1.0%	0.8%
<b>Total</b>	<b>689.4</b>	<b>755.9</b>	<b>66.5</b>	<b>9.7%</b>	<b>100.0%</b>	<b>100.0%</b>

(\*) Preliminary figures.

**1.4.4. Off-balance sheet**

As at 31 December 2016, the contingent exposures of the Luxembourg banking sector through loan commitments and financial guarantees amounted to EUR 168.1 billion, against EUR 140.5 billion at the end of 2015, which represents a 19.7% rise over one year. This upward trend depended on a limited number of the financial centre's banks.

**1.5. Development in the profit and loss account**

The significant improvement of the net result in 2016 (+18.4%) is the result of an increase of the net interest income and other net income, which, however, was partially mitigated by declining net fee and commission income and by sharply increasing provisions in 2016.

**Development in the profit and loss account – in million EUR**

	2015	Relative share	2016 (*)	Relative share	Variation	
					in volume	in %
Net interest income	4,496	39%	4,734	38%	238	5.3%
Net fee and commission income	4,720	41%	4,613	37%	-107	-2.3%
Other net income	2,262	20%	3,029	25%	767	33.9%
<b>Banking income</b>	<b>11,477</b>	<b>100%</b>	<b>12,375</b>	<b>100%</b>	<b>898</b>	<b>7.8%</b>
General expenses	-5,942	-52%	-6,014	-49%	-72	1.2%
<i>of which: staff costs</i>	-3,065	-27%	-3,068	-25%	-4	0.1%
<i>of which: general administrative expenses</i>	-2,878	-25%	-2,946	-24%	-68	2.4%
<b>Profit before provisions</b>	<b>5,535</b>	<b>48%</b>	<b>6,361</b>	<b>51%</b>	<b>826</b>	<b>14.9%</b>
Net creation of provisions	-577	-5%	-733	-6%	156	27.1%
Tax	-888	-8%	-809	-7%	-79	-8.9%
<b>Net profit for the year</b>	<b>4,070</b>	<b>35%</b>	<b>4,819</b>	<b>39%</b>	<b>748</b>	<b>18.4%</b>

(\*) Preliminary figures.

**1.5.1. Positive developments of the profit and loss account**

The positive development of the **net interest income** (+5.3%) was shared by 53% of the credit institutions, representing 57% of the aggregated banking income of the financial centre. For these banks, several major



factors explain individually or collectively the improvement of the net interest income recorded in 2016. Thus, 64% of these credit institutions recorded a growth in the volume of activities and 65% managed to improve their average return on assets. 33% of banks even experienced a joint effect of both factors. Some banks also started passing through negative interest rates to their institutional customers. Nevertheless, it should be noted that the magnitude of the increase is due to a limited number of credit institutions. Irrespective of the positive development of the net interest income over the last two years, the persistence of extremely low interest rates reduces significantly the profitability outlook of the intermediation activity and constitutes a real challenge for banks which, in the long run, will have to take exceptional measures such as the application of negative interest rates.

**Other net income**, an item that is very volatile and that mostly includes non-recurring effects generally registered by a limited number of banks, improved substantially year-on-year (+33.9%). The strong annual growth of this item mainly comes from a gain realised following an exceptional transaction by one bank of the financial sector. Excluding this exceptional element, other net income only rose by 1.1% to reach EUR 2,288 million. With the same adjustment, the net profit for the year 2016 would have shown a slight increase of 0.2% year-on-year (compared to the observed unadjusted growth of 18.4%).

### 1.5.2. Negative developments of the profit and loss account

**Net fee and commission income**, which mainly results from asset management activities on behalf of private and institutional clients, including the financial services provided to investment funds, decreased in 2016. This source of income of the credit institutions was impacted by less favourable stock market conditions as compared to the previous year and was only partially compensated by the strong growth in the financial markets during the last quarter of 2016.

**Net creation of provisions** recorded a sharp increase of 27.1% as compared to 2015. Due to a limited number of banks, the scale of this increase is attributable to reasons specific to each bank. In the past, this item was always characterised by significant volatility (cf. table "Long-term development of profit and loss account - in million EUR" below). It should be noted that, in comparison to other European countries, Luxembourg remains among the countries with the lowest rate of non-performing loans.

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

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015 (*)	2016 (**)
Net Interest Income	3,848	4,595	5,792	5,807	4,761	4,960	4,671	4,281	4,066	4,496	4,734
Net fee and commission income	3,674	4,010	3,644	3,132	3,587	3,832	3,727	3,962	4,101	4,720	4,613
Other net income	3,278	2,371	1,001	1,614	1,201	76	1,401	2,213	2,217	2,262	3,029
<b>Banking Income</b>	<b>10,800</b>	<b>10,976</b>	<b>10,437</b>	<b>10,553</b>	<b>9,549</b>	<b>8,868</b>	<b>9,800</b>	<b>10,455</b>	<b>10,384</b>	<b>11,477</b>	<b>12,375</b>
General expenses	-3,961	-4,420	-4,560	-4,451	-4,609	-4,789	-4,994	-5,198	-5,005	-5,942	-6,014
of which: staff costs	-2,100	-2,372	-2,401	-2,440	-2,407	-2,535	-2,622	-2,745	-2,624	-3,065	-3,068
of which: general administrative expenses	-1,821	-2,048	-2,000	-2,002	-2,112	-2,253	-2,372	-2,453	-2,381	-2,878	-2,946
<b>Profit before provisions</b>	<b>6,819</b>	<b>6,556</b>	<b>5,877</b>	<b>6,102</b>	<b>4,939</b>	<b>4,080</b>	<b>4,806</b>	<b>5,258</b>	<b>5,379</b>	<b>5,535</b>	<b>6,361</b>
Net creation of provisions	-305	-1,038	-5,399	-3,242	-498	-1,572	-765	-865	-327	-577	-733
Tax	-843	-780	-259	-804	-625	-18	-503	-762	-799	-888	-809
<b>Net profit for the year</b>	<b>5,671</b>	<b>4,739</b>	<b>218</b>	<b>2,056</b>	<b>3,817</b>	<b>2,490</b>	<b>3,538</b>	<b>3,631</b>	<b>4,253</b>	<b>4,070</b>	<b>4,819</b>

(\*) These figures were adjusted following the extension of the scope to foreign branches of Luxembourg banks.

(\*\*) Preliminary figures.

### 1.6. Prudential ratios

#### 1.6.1. Solvency ratios

##### • Regulatory framework and calculation approaches implemented

In accordance with Article 92 of Regulation (EU) No 575/2013 (CRR), Luxembourg credit institutions must comply with the following three structural ratios relating to solvency since 1 January 2014:

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

These ratios include the eligible own funds in the numerator and the total risk exposure amount in the denominator as defined in Article 92 of the CRR.

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

In addition, pursuant to CSSF Regulation N° 16-08 and the opinion of the Systemic Risk Board, the CSSF designated six credit institutions as other systemically important institutions within the meaning of Article 59-3 of the above-mentioned law. As "other systemically important institutions", these banks must hold additional capital buffers of 0.5% or even 1%. These capital buffers must be phased in over three years as from 1 January 2016.

Finally, in accordance with Article 59-6 of the Law of 5 April 1993, the banks maintain a countercyclical capital buffer which varies according to the geographical composition of assets held by banks and the countercyclical buffer rates that the macroprudential authorities apply at national level so as to mitigate the risk of excessive credit growth in their respective countries. The countercyclical buffer rate applicable to the relevant exposures located in Luxembourg is set at 0% in CSSF Regulation N° 16-15.

As at 31 December 2016, nine banks were authorised to use the internal ratings-based approach regarding credit risk, six of which have used advanced methods allowing not only own estimates of probabilities of default but also of the loss given default and/or of the conversion factors. These banks are exclusively significant banks within the meaning of the SSM. They represent 28.1% of the aggregate balance sheet total of the financial centre as at 31 December 2016. Compared to the end of 2015, the number of banks using the IRB approach decreased by one entity, one bank having received authorisation by the ECB to return to the standardised approach.

As regards operational risk, 10 banks (among which eight significant banks within the meaning of the SSM) have an authorisation to use the AMA approaches. The other banks used the basic indicator approach (77 banks) and the standardised approach (19 banks) to determine the capital requirements for operational risk.

Moreover, only one Luxembourg bank (significant within the meaning of the SSM) used an internal model for calculating own funds requirements for market risk. No bank established in Luxembourg submitted an application file in order to use the IMM approach.

Information on internal models used by banks is also available under point 2.4. below.

##### • Solvency ratios

At aggregate level, the total capital ratio for the financial centre was 24.8% as at 31 December 2016 which represents an increase compared to the ratio of 20.7% as at 31 December 2015. Hence, it largely exceeds the minimum threshold of 8% and 10.5% (minimum threshold of 8% plus the capital conservation buffer of 2.5%), respectively.

The Tier 1 capital ratio, whose numerator only includes own funds which absorb losses in going concern situations, was 24.1% as at 31 December 2016 (a rise compared to 20.0% at the end of 2015). The Common Equity Tier 1 capital ratio (CET1 ratio) was 24.0% as at 31 December 2016 (a rise compared to 19.9% at the end of 2015). The levels of the CET1 and Tier 1 capital ratios, which largely exceed the regulatory minima (including the capital conservation buffer) of 7% and 8.5% respectively, bear witness to the robust solvency and to the preponderance of high-quality capital items in the banking sector.

The high level of capitalisation is also reflected at disaggregated level. As illustrated in the following table, no bank was within the weaker capitalisation bands with respect to the total capital ratio, as at 31 December 2016. However, it should be remembered that for banks whose ratio falls below 10.5%, restrictions in terms of bonus and dividend payments apply (Article 59-13 of the Law of 5 April 1993 on the financial sector). The recommendation of the ECB of 13 December 2016 (ref.: ECB/2016/44) on dividend distribution policies lies within the same context and addresses possible distribution of dividends based on the results of 2016.

#### Distribution of the solvency ratios

Common Equity Tier 1 capital ratio (CET1)	Number of banks	Tier 1 capital ratio	Number of banks	Total capital adequacy ratio	Number of banks
0%-4.5%	0	<6%	0	<8%	0
4.5%-7%	0	6%-8.5%	0	8%-10.5%	0
7%-8%	0	8.5%-10%	0	10.5%-12%	4
8%-9%	0	10%-11%	3	12%-14%	6
9%-10%	0	11%-12%	4	14%-16%	11
>10%	98	>12%	91	>16%	77
<b>Total</b>	<b>98</b>		<b>98</b>		<b>98</b>

#### • Elements of own funds

Aggregate own funds, eligible for compliance with the minimum solvency requirements, amounted to EUR 50,120.4 million as at 31 December 2016.

**Elements of own funds**

	2015		2016	
	Amount (in million EUR)	Relative share	Amount (*) (in million EUR)	Relative share
<b>Own funds</b>	<b>47,600.8</b>	<b>100.0%</b>	<b>50,120.4</b>	<b>100.0%</b>
<b>Tier 1 capital</b>	<b>45,893.7</b>	<b>96.4%</b>	<b>48,693.1</b>	<b>97.2%</b>
<b>Common Equity Tier 1 capital (CET1)</b>	<b>45,736.2</b>	<b>96.1%</b>	<b>48,533.8</b>	<b>96.8%</b>
Capital instruments that qualify as CET1 capital	26,424.1		27,748.5	
Retained earnings, other reserves, funds for general banking risks	23,623.6		24,449.1	
Other accumulated comprehensive income	2,284.9		1,426.9	
Minority interests	0.3		0.1	
Adjustments of CET1 deriving from prudential filters	-93.0		-153.6	
(-) Intangible assets, goodwill and deferred tax assets	-2,115.3		-1,925.2	
(-) Holdings in financial instruments of financial sector entities	-940.0		-328.7	
(-) Other deductions	-3,448.1		-2,683.3	
<b>Additional Tier 1 capital (AT1)</b>	<b>157.5</b>	<b>0.3%</b>	<b>159.3</b>	<b>0.3%</b>
Capital instruments that qualify as AT1 capital	157.5		159.2	
Other items that qualify as AT1 capital	0.0		0.0	
(-) Deductions from AT1 capital	0.0		0.1	
<b>Tier 2 capital (T2)</b>	<b>1,707.0</b>	<b>3.6%</b>	<b>1,427.3</b>	<b>2.8%</b>
Capital instruments and subordinated loans that qualify as T2 capital	1,667.2		1,407.5	
Other items that qualify as T2 capital	83.7		94.2	
(-) Deductions from T2 capital	-43.8		-74.4	

(\*) Preliminary figures.

**• Risk exposure amounts**

The risk exposure amounts fell by EUR 27,472.5 million between the end of 2015 and the end of 2016 to EUR 202,365.1 million (-12.0%). This development is mainly influenced by the reduction of risk-weighted exposure amounts for credit risk which dropped by EUR 27,171,3 million. This decrease mainly results from the transformation of some credit institutions into EU branches which are not subject to Article 92 of the CRR.

As at 31 December 2016, the average credit risk weight of banks in the financial centre amounts to 28%. The above reflects the fact that the banks have exposures to counterparties which benefit from a good credit assessment (mainly to rated institutions, rated corporations and central administrations) as well as exposures for which the credit risk is mitigated by recognised mitigation techniques. These weights are in line with the low ratio of non-performing loans of 1.6% at the end of December 2016.

**Risk exposure amounts**

<i>(in million EUR)</i>	2015	in %	2016 (*)	in %
Total risk exposure amount	229,837.6	100.0%	202,365.1	100.0%
Exposure amounts for credit risk, counterparty risk and dilution risks and free deliveries	203,526.7	88.6%	176,566.2	87.3%
of which: Standardised Approach (STA)	158,877.2	69.1%	131,705.8	65.1%
of which: Internal ratings-based approach (IRB)	44,647.0	19.4%	44,859.5	22.2%
Total clearing/settlement risk exposure amount	0.5	0.0%	0.5	0.0%
Total position risk, foreign-exchange risk and commodity risk exposure amount	1,888.6	0.8%	2,446.5	1.2%
Total operational risk exposure amount	22,351.4	9.7%	21,763.9	10.8%
Total credit valuation adjustment risk exposure amount	1,816.4	0.8%	1,047.5	0.5%
Other risk exposure amount	254.1	0.1%	540.6	0.3%

(\*) Preliminary figures.

**1.6.2. Liquidity ratios****• Regulatory framework**

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

- Liquidity Coverage Requirement (LCR) in accordance with Delegated Regulation (EU) 2015/61;
- a ratio on the asset encumbrance pursuant to Implementing Regulation (EU) 2015/79; and
- Net Stable Funding Ratio or NSFR. In accordance with the Basel III Agreement, the NSFR should enter into force in January 2018 as a binding standard. Currently, it only represents an instrument to monitor liquidity.

**• Liquidity Coverage Requirement (LCR)**

As at 31 December 2016, the weighted average of the LCR of Luxembourg banks and Luxembourg branches of banks that have their registered office outside the EU amounted to 230% as compared to 157% at the end of December 2015. The regulatory minimum to be observed amounted to 70% at the end of December 2016.

On the aggregated level, a significant concentration of the liquid assets buffer in Level 1 assets stands out. The short-term deposits made at the BCL represent the major part of Luxembourg banks' liquid assets.

During 2016, the CSSF was confronted with a small number of breaches of the minimum regulatory threshold of 70%. After analysis, these breaches are rather explained by involuntary negligence at the level of the management of liquidity than by real liquidity insufficiencies. Every breach led to a monitoring of the swift restoration of the compliance with the regulatory minimum as well as to an examination of the root causes of the breach in order to determine the proper measures required so as to avoid repetition, in particular with respect to internal control.

Finally, it should be noted that Implementing Regulation (EU) 2016/322 of 10 February 2016 introduced new reporting tables of the LCR.

**• 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 assessment tool developed by the EBA, amounted to 130% in December 2016. This assessment tool remains approximate until new reporting tables are implemented which will be based on common rules introducing the NSFR as binding management standard for EU credit institutions.



### • Asset encumbrance risk ratio

Luxembourg banks have a low asset encumbrance risk ratio. As at 31 December 2016, this ratio amounted to 7.24% on aggregated basis against 7.40% on 31 December 2015, which shows that most of the Luxembourg banks' assets are unencumbered. Only 10 banks have an asset encumbrance risk ratio exceeding 15% due to their business model. This is, in particular, the case of banks issuing covered bonds. As a consequence, these banks are subject to additional reporting requirements.

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

### • General situation regarding liquidity

Generally, the overall liquidity situation in the Luxembourg banking sector may be considered as comfortable. The year 2016 did not witness any particular event leading to liquidity strains for banks.

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

## 1.6.3. Interest Rate Risk in the Banking Book (IRRBB)

### • Regulatory framework

As regards interest rate risk in the banking book, Article 30(4) of CSSF Regulation N° 15-02 relating to the supervisory review and evaluation process that applies to CRR institutions provides that the CSSF shall take measures at least in the case of CRR institutions whose economic value declines by more than 20% of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or equivalent as given in the EBA guidelines. The review and evaluation are governed by the provisions of Circular CSSF 08/338 regarding the implementation of a stress test in order to assess the interest rate risk arising from non-trading book activities.

### • Structural interest rate risk evaluation ratio

The analysis of the stress test results according to Circular CSSF 08/338 confirmed that, as at 30 June 2016, the Luxembourg banking sector as a whole is only moderately exposed to structural interest rate risk. Indeed, the average of regulatory ratios (reporting simulated losses following a scenario of changes in the interest rates over eligible own funds) amounts to -3.8%. In other words, the impact of an immediate 2% rise in overall interest rates would cut the intrinsic value of the financial centre's banks only by about 3.8% of their own funds.

On 30 June 2016, the structural interest rate risk was fairly stable compared to the results as at 31 December 2015 where the average ratio amounted to -4.1%. Whereas the regulatory ratio remained fairly stable over the year, there is an important heterogeneity across the banks. Thus, the regulatory ratio deteriorated for approximately half of the banks of the financial sector.

As far as dispersion of results is concerned, 70% of the banks of the financial centre had a ratio higher than or equal to -5% and only 4% of the banks had a ratio of less than -15%. In 2016, the CSSF identified two banks whose regulatory ratios were less than -20%, a threshold which requires the authorities to take measures pursuant to CRD IV. Hence, the CSSF entered into contact with these banks to receive supplementary information. After analysis, it was decided that an on-site inspection will be carried out at one of these banks in 2017.

Supervision of the interest rate risk according to Circular CSSF 08/338 did not lead the CSSF to adopt other specific measures in 2016. Given the current context of historically low interest rates and the concomitant pressure on income, the CSSF continues to closely monitor the taking of structural interest rate risk. The CSSF reminds banks of their obligation to manage interest rate risks in a prudent and sound manner in accordance with Article 14 of CSSF Regulation N° 15-02 and with the new Chapter 8 of Part III of Circular CSSF 12/552.

In April 2016, the Basel Committee on Banking Supervision published new rules for interest rate risk in the banking book. These rules provide for a stricter threshold for identifying risky banks. Any bank whose ratio of simulated loss, resulting from a variation of interest rates, over Tier 1 capital becomes lower than -15% will be considered an "outlier". Moreover, the Basel Committee calls for more effective prudential measures when a risky bank is identified.

## 2. PRUDENTIAL SUPERVISORY PRACTICE

### 2.1. Organisation of the supervision

Since 4 November 2014, the direct supervision of significant banks has been carried out by the ECB. Less significant entities continue to be supervised directly by the CSSF, under the control of the ECB. This control framework, called Single Supervisory Mechanism (SSM), provides that the ECB authorises any new bank which intends to be established in Luxembourg.

At the end of 2016, 58 banks established in Luxembourg were directly supervised by the ECB, either because they exceeded the criteria for being considered as significant institutions (SIs) at solo or consolidated level, or because they were part of a group considered significant. These banks represented 69.7% of the total assets of the Luxembourg banks.

Seventy-one banks were considered as less significant institutions (LSIs) and 12 banks were branches of banks whose registered office was established outside the EU and which did not fall within the scope of the SSM.

The supervision of SIs is exercised by the Joint Supervisory Teams (JSTs) formed of staff members from the ECB and from the national competent authorities. The CSSF is taking part in 28 JSTs for as many banking groups. Twenty-nine CSSF agents and 10 CSSF experts are directly or indirectly (as support) involved in this supervisory framework.

#### Banks established in Luxembourg by category

SSM status	Number of banks	In % of assets
Significant institutions - SIs	40	51.5%
Branches of an SI	18	18.2%
High-priority less significant institutions - High-priority LSIs	3	3.8%
Less significant institutions - LSIs	61	16.3%
Branches of an LSI	7	1.3%
Outside the scope of SSM	12	8.9%
<b>Total</b>	<b>141</b>	<b>100.0%</b>

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

The SSM's supervisory approach is described in detail in the document "Guide to banking supervision"<sup>2</sup>.

<sup>2</sup> Weblink: <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidebankingsupervision201411en.pdf?404fd6cb61dbdc0095c8722d5aff29od>. In this regard, see also the annual reports of the ECB published under <https://www.ecb.europa.eu/pub/annual/html/index.en.html>.

### 2.2. Authorisations

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

#### 2.2.1. Authorisation of new credit institutions

Since the introduction of the SSM, the authorisation of new credit institutions in all euro area countries is granted exclusively by the ECB. The CSSF remains competent for the authorisation of branches of third-country credit institutions.

However, the CSSF is still the entry point for the submission of all the authorisation files. When receiving an application, the CSSF first informs the ECB and then analyses the file in order to verify compliance with the legal and regulatory requirements. After the examination of the file, the CSSF prepares a proposal and submits it to the ECB, in the case of Luxembourg credit institutions, or to the Minister of Finance, in the case of branches of third-country institutions, for a decision.

In 2016, the CSSF worked on eight authorisation requests for new credit institutions. Two authorisation requests for branches of third-country banks were approved by the Minister of Finance. The examination of six authorisation files continues in 2017.

#### 2.2.2. Authorisation for acquisitions of qualifying holdings

Like the authorisation of a new institution which requires prior examination of the file by the CSSF, including the authorisation of its shareholders, the subsequent acquisition of holdings that reach or exceed 10% of the capital (known as qualifying holdings) must also be examined by the CSSF and authorised by the ECB. In 2016, the CSSF examined 16 files regarding acquisitions of qualifying holdings, 12 of which were authorised by the ECB during the year.

#### 2.2.3. Authorisation of directors and managers of banks

In 2016, the CSSF dealt with 232 files regarding the nomination of new directors and authorised managers in Luxembourg credit institutions. The nominations in significant institutions (SIs) which are subject to direct supervision of the ECB under the SSM are transferred to the ECB for authorisation, following the examination of the file by the CSSF, whereas the nominations in less significant institutions (LSIs) are directly authorised by the CSSF.

### 2.3. Banking supervision

#### 2.3.1. Supervisory review and evaluation process (SREP)

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

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

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

### • Off-site supervision

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

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

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

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

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

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

The CSSF requires, on a yearly basis, a long form report from every Luxembourg credit institution as well as from Luxembourg branches of non-EU credit institutions. Furthermore, the credit institutions supervised on a consolidated basis are required to submit, on a yearly basis, a consolidated long form report and individual long form reports for each subsidiary included in the consolidation and carrying out an activity of the financial sector.

The CSSF examines the individual and consolidated long form reports drawn up by the *réviseurs d'entreprises agréés* as well as the long form reports of Luxembourg banks' subsidiaries. These documents contribute to the assessment of the quality of the organisation and of the exposure to the different risks of credit institutions. By design, the above complete the on-site supervision carried out by the CSSF teams.

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

The CSSF meets, when need be and at least once a year, representatives of the main audit firms in order to discuss topics relating to the audit work in banks.

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



Pursuant to the good practices in prudential supervision, the off-site supervisory framework of the CSSF includes regular meetings with the authorised management and the responsables of the internal control functions of the banks.

## Number of meetings

	2015	2016
Meetings with the <i>dirigeants</i> (managers) of banks or persons responsible for the control functions	185	273
Meetings with the other stakeholders (including other supervisors or external auditors)	44	50

## • On-site supervision

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

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

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

## 2.3.2. Summary of the SREP

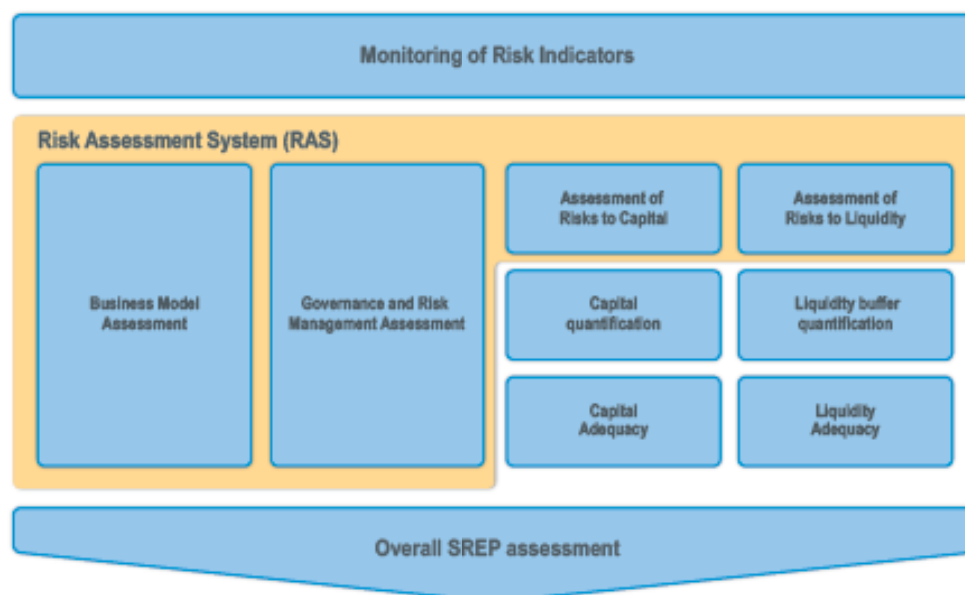
At least once a year, the analyses, information and insights of the on-site and off-site supervision are gathered and completed by specific analyses in order to reach an overall assessment in line with the relevant guidelines issued by the EBA (EBA/GL/2014/13). To this end, these analyses, information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

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

The RAS includes the following four elements:

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



**Overview of the SREP framework**

In accordance with the guidelines EBA/GL/2014/13, the conclusions of the assessments of the different SREP elements are translated into an overall score ranging from 1 (no discernible risk for the viability of the institution) to 4 (high risk for the viability of the institution). A score of F may be given, meaning that the institution is deemed to be failing or likely to fail. Based on this overall assessment, the CSSF decides whether to apply the supervisory measures as laid down in Article 53-1 of the Law of 5 April 1993 on the financial sector.

On average, as regards the SREP 2016, the overall score was 2.1 for less significant banks that remain under the direct supervision of the CSSF. The CSSF decided to require additional own funds for 10 banks, deeming, with regard to the SREP assessments, that the minimum requirements for own funds according to the CRR do not cover appropriately the risks incurred. These credit institutions are subject to Pillar 2 capital add-ons ranging from 0.5% to 4%. Moreover, the CSSF has taken other supervisory measures to address risks and weaknesses, particularly in terms of internal governance or business strategies deemed too aggressive.

All in all, the CSSF sent 185 observation letters to banks of the financial sector during 2016.

## 2.4. Review of the approaches used to calculate the risk exposure amounts

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

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

The CSSF supports the ECB, as the competent authority for the supervision of significant banks, in the implementation of prudential processes relating to the use of internal models: network of experts in internal models, handling of authorisation files, planning and performance of on-site inspections or monitoring process for internal models, including relevant supervisory measures. In 2016, the CSSF analysed, among others, the

adequacy of the internal model validation as well as the EBA benchmarking results for Luxembourg significant banks whose group head is domiciled in Luxembourg.

Regarding credit risk, the ECB had two on-site inspections carried out at Luxembourg banks using the internal ratings-based approach, in 2016. These inspections, which were under the authority of a CSSF head of mission and which included, among others, CSSF agents, were linked to requests for the authorisation of new models as well as to changes of internal models requiring permission. With the implementation of the SSM, these inspections are governed by common processes and procedures within the SSM.

As regards operational risk, in 2016, the CSSF carried out an on-site inspection at one bank that uses an advanced approach (AMA) to determine the operational risk exposure amount. For these types of internal models, developed for the whole banking group and deployed at the constituent entities, among which the Luxembourg bank, the CSSF, acting in its capacity as competent authority, expects that within the Luxembourg entity, the capital allocated to operational risks is duly analysed, argued and justified as to its adequacy for the entity's operation in Luxembourg. The comparison of scenarios with historic losses, the extent of expected losses as well as the analysis of adequacy of scenarios with respect to local characteristics must enable Luxembourg banks to make judgements on the adequacy of the AMA approach implemented at local level.

In 2016, the ECB continued the initialisation of the TRIM project (Targeted Review of Internal Models) which aims to bring back trust and reliability in the internal ratings-based approaches. This major project mobilises significant resources, including at the CSSF.

### 2.5. Supervision of Luxembourg branches of banks having their registered office in another EU Member State

Pursuant to EU regulations on the European passport for financial services, the responsibility of the prudential banking supervision of these branches lies with the supervisory authority of the country where the registered office is. The prudential banking supervision includes mainly the supervision of financial and operational risks.

Besides the prudential banking regulations, the legislator attributed to the CSSF the task of supervising other regulations, most importantly the supervision of professional obligations regarding the fight against money laundering and financing of terrorism as well as the supervision of the provisions relating to consumer protection (MiFID). Moreover, the CSSF is responsible for the supervision of obligations in respect of the depositary bank function arising from the sectoral regulations on UCIs. The supervision of these regulations, which is outside the remit of the ECB, is mainly performed through reports of the *réviseurs d'entreprises* and on-site inspections carried out by CSSF agents.

### 2.6. Supervision on a consolidated basis

As at 31 December 2016, 23 banking groups are supervised on a consolidated basis. The consolidated supervision is carried out based on the consolidated situation of the parent institutions, among which 19 are banks incorporated under Luxembourg law (20 in 2015), three are financial holding companies incorporated under Luxembourg law (*idem* in 2015) and one is a financial holding company incorporated under foreign law established in another EU Member State (none in 2015).

Thirteen (*idem* in 2015) of the 19 banks are part of banking groups considered as significant and their supervision, including the consolidated supervision, is exercised by the ECB. The consolidated supervision of the other six banks, considered as less significant according to the criteria laid down in the SSM regulation, continues to be exercised by the CSSF, under the control of the ECB.

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

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

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

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

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

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

## 2.7. International cooperation in banking supervision

### 2.7.1. Supervisory colleges

The cooperation between European competent authorities by way of supervisory colleges, as governed by Articles 112 to 118 of Directive 2013/36/EU, did not become entirely unnecessary with the implementation of the SSM and these colleges continue to be in place at national level for less significant banks. This cooperation also extends to non-European authorities. In order to improve the functioning of the colleges of supervisors, the EBA drew up regulatory technical standards on the functioning of colleges of supervisors (Commission Delegated Regulation (EU) 2016/98 and Commission Implementing Regulation (EU) 2016/99).

In 2016, the CSSF organised three supervisory colleges for the supervision of less significant banking groups for which it exercises an ultimate consolidated supervision at European level (Quilvest Wealth Management S.A., EFG Investment (Luxembourg) S.A. and Banque Havilland S.A.).

As a large number of banking groups are present in the Luxembourg financial centre via subsidiaries which, on the one hand, are subject to the supervision of the CSSF on an individual basis and, on the other hand, belong to the scope of consolidated supervision carried out by their home authorities, the CSSF participates, as host supervisor, in many colleges of supervisory authorities set up for these banking groups. In 2016, the CSSF participated in 38 meetings of supervisory colleges, among which four supervisory colleges organised by the supervisory authorities from non-EEA countries, which concerned in total 23 banking groups.

The establishment and functioning of the colleges are based on written agreements (Memorandum of Understanding, MoU) and Written Coordination and Cooperation Arrangements (WCCA) signed between the different authorities participating in the colleges. In 2016, 31 MoUs were in force and the CSSF was party to eight WCCAs. However, some MoUs will be replaced by MoUs signed by the ECB instead of the CSSF, thus reflecting the new organisation of the banking supervision within the euro area.

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

Furthermore, the colleges aim at promoting joint missions carried out by the authorities from different countries participating in the colleges and the delegation of work between authorities.



### 2.7.2. Cooperation with other authorities

Besides the institutionalised cooperation in JSTs and colleges, the CSSF works closely with the foreign supervisory authorities within the context of the consultations provided for by the European directives and in all circumstances in which cooperation is needed. Cooperation generally takes place in the form of requests for advice, information or assistance initiated or received by the CSSF. In this context, the CSSF sent 109 letters to supervisory authorities in 2016.

The CSSF also cooperates with the national judicial and law enforcement authorities in accordance with Article 2 of the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de Surveillance du Secteur Financier) and Article 9-1 of the Law of 12 November 2004 on the fight against money laundering and terrorist financing. Moreover, within the context of the assessment of the professional standing conditions to be complied with by the persons called upon to form part of the authorised management or the Board of Directors of a bank, the CSSF refers to the State Prosecutor's office of the *Tribunal d'Arrondissement* (District Court) of Luxembourg and to the Grand-ducal Police.

### 2.8. EMIR (European Market Infrastructure Regulation)

Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR) introduced a set of new rules and requirements aiming to improve transparency and reduce the risks related to the derivatives markets. EMIR requires all derivatives contracts to be reported to trade repositories and over-the-counter derivatives contracts to be centrally cleared. It sets a framework that enhances the safety of central counterparties and trade repositories and introduces a series of risk mitigation techniques aiming to create sounder financial markets.

Commission Delegated Regulation (EU) 2015/2205 with regard to regulatory technical standards on the clearing obligation of certain classes of interest rate derivatives entered into force on 21 December 2015. In addition, Commission Delegated Regulation (EU) 2016/2251 with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty has been adopted by the European Commission on 4 October 2016 and entered into force on 4 January 2017. These standards foresee procedures for the counterparties and the competent authorities to be followed when applying exemptions for intragroup transactions for collateral. Following the entry into force of these delegated regulations, affected market participants have started to apply to the CSSF or notify to the CSSF that they wish to exempt intragroup transactions from these requirements.

The CSSF has developed an interactive form to be used for the application/notification of intragroup exemptions from clearing and collateral. Until the beginning of April 2017, 39 requests to exempt intragroup transactions from the clearing requirement and eight from the collateral requirement were submitted.

### 2.9. Recovery plans

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

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

The BRRD also requires banks to prepare recovery plans to overcome financial distress.

In 2016, the CSSF has received 21 recovery plans and provided feedback regarding their overall completeness, quality and credibility. It also contributed to the assessment of recovery plans of significant institutions consolidating in Luxembourg. Furthermore, the CSSF actively participated in different working groups and drafting teams involved in the wider context of the BRRD and the crisis management framework at the EBA and SSM level.



*Agents hired in 2016 and 2017: Departments "Supervision of banks", "Single Supervisory Mechanism", "Supervision of investment firms" and Internal audit*

Left to right: Eugénie STRADIOT, Nicolas BERNON, Christelle FAËDDA, Louay KHEDER, Mélanie FRANSSSEN, Jessica GONÇALVES, Dirk MEVIS, Rositsa IVANOVA, Laura FABER

Absent : Louis LANG







## CHAPTER VII

### SUPERVISION OF PFS

#### 1. INVESTMENT FIRMS

##### 1.1. Development of investment firms in 2016

###### 1.1.1. Development in the number of investment firms

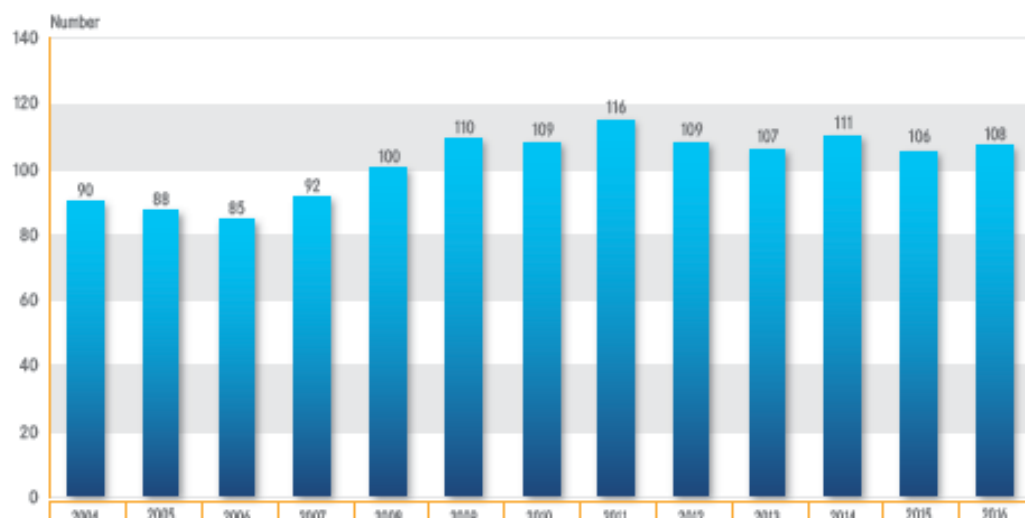
The number of investment firms subject to the CSSF's supervision increased from 106 units as at 31 December 2015 to 108 units at the end of 2016, i.e. a slight rise following the five-unit drop recorded in 2015.

Nine entities have been granted an authorisation as investment firm in 2016, against seven new entities in 2015.

Seven entities gave up their investment firm status during the year under review, compared to 11 in 2015. These seven entities gave up their investment firm status for the following reasons:

- change or cessation of activities, implying that the entity no longer required an authorisation as investment firm, as it no longer fell within the scope of the Law of 5 April 1993 on the financial sector (two entities);
- judicial liquidation (one entity);
- merger (three entities);
- change into specialised PFS (one entity).

## Development in the number of investment firms



Among the investment firms, the activity of private portfolio manager was the most widespread with 84 entities authorised in this respect as at 31 December 2016. It is also worth mentioning that the majority of the new entities registered on the official list, i.e. seven out of nine entities, adopted the status of private portfolio manager.

### 1.1.2. CRR investment firms

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

The number of CRR investment firms falling within the scope of the CRR amounted to 30 units as at 31 December 2016, as against 35 units as at 31 December 2015. Among the nine investment firms newly authorised in 2016, none fall within the scope of the CRR.

### 1.1.3. Development in employment

After an employment decline over the last three years, mainly due to transfers of activities between entities of the financial sector which had no impact on the aggregate number of jobs in the financial sector, the investment firms' staff stabilised in 2016. Indeed, employment in all investment firms amounted to 2,285 people as at 31 December 2016, as against 2,278 people at the end of December 2015, i.e. an increase of +0.31%.

The upward variations of a certain number of players noticed in 2016 as well as staff variations related to new authorisations as investment firms enabled to counteract the downward development of total staff due to the deregistration of seven investment firms from the official list and the staff reduction recorded in some investment firms.

**Employment in investment firms**

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

It should be noted that the deregistrations in 2016, in particular the mergers by takeover by entities of the financial sector and the change of an investment firm into a specialised PFS, do not necessarily reflect a loss of jobs in the financial sector. These transfers of activities do not impact employment in the financial sector as a whole, but only affect the breakdown between the different categories of financial players.

It should also be noted that, as at 31 December 2016, about half of the investment firms had eight or less employees.

**1.1.4. Development of balance sheets and profit and loss accounts**

The provisional balance sheet total of all investment firms established in Luxembourg amounted to EUR 3,164 million<sup>1</sup> as at 31 December 2016, against EUR 6,004 million as at 31 December 2015, i.e. a substantial decrease of 47.30%. This fall is mainly attributable to one investment firm with a very high balance sheet total and deregistered from the official list in 2016. The rising balance sheet total recorded for a certain number of players and, in particular, for one investment firm with a very high balance sheet total as well as the increase due to the investment firms newly authorised in 2016 were unable to foil the reduction of the balance sheets related to deregistrations from the official list in 2016 and, to a lesser extent, to the decreasing balance sheet total of some players.

Investment firms also recorded a negative development in their net results. Indeed, provisional net results amounted to EUR 132.1 million<sup>2</sup> as at 31 December 2016, against EUR 249.3 million as at 31 December 2015, representing a substantial decrease of 47.03%. This drop was largely driven by a player deregistered from the official list of investment firms in 2016 and having shown a significant profit as at 31 December 2015.

It should also be noted that approximately one third of the investment firms, including notably several players authorised during the last three years, registered a negative result as at 31 December 2016.

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

(in million EUR)	2015	2016	Variation in %
Balance sheet total	6,004	3,164	-47.30%
Net results	249.3	132.1	-47.03%

<sup>1</sup> 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.

<sup>2</sup> Cf. footnote No 1 above.

### 1.1.5. International expansion of investment firms

#### • Subsidiaries created and acquired abroad during 2016

In 2016, one Luxembourg investment firm opened a subsidiary in France.

#### • Freedom of establishment

In 2016, two branches were established in other EU/EEA Member States by one investment firm incorporated under Luxembourg law and one branch was closed. The total number of branches of Luxembourg investment firms in other EU/EEA Member States amounted to 28 entities at the end of the year, compared to 27 entities as at 31 December 2015.

Following the opening of a branch originating from Germany, the number of branches established in Luxembourg by investment firms originating from other EU/EEA Member States totals 10 entities as at 31 December 2016.

There are no branches established by Luxembourg investment firms in a country outside the EU/EEA.

#### • Freedom to provide services

In 2016, 15 investment firms incorporated under Luxembourg law applied to pursue business in one or several EU/EEA Member States by way of free provision of services. The total number of investment firms which were active in one or more EU/EEA countries following a notification amounted to 78 entities as at 31 December 2016 (76 in 2015). The majority of the investment firms concerned carried out their activities in several EU/EEA countries by way of free provision of services.

## 1.2. Prudential supervisory practice

### 1.2.1. Compliance with the quantitative standards by investment firms

#### • Capital base

In accordance with Articles 24 to 24-9 of the Law of 5 April 1993 on the financial sector, the authorisation of investment firms is subject to the production of evidence showing the existence of minimal capital base. This capital base consisting of a subscribed and paid-up share capital, relevant share premiums, legally formed reserves and profits brought forward, after deduction of possible losses for the current financial year, must be permanently available to the investment firm and invested in its own interest.

The CSSF reminds that the subordinated loans or the profits for the current financial year must not be taken into account for the determination of the minimum capital base of a professional of the financial sector<sup>3</sup>.

Based on the financial data that investment firms must provide to the CSSF on a monthly basis in accordance with Circular CSSF 05/187 (completed by Circular CSSF 10/433), the CSSF verifies particularly the compliance of investment firms with the minimal capital base conditions. In 2016, the CSSF intervened at five investment firms for non-compliance with the legal provisions relating to capital base.

#### • Capital ratio

Investment firms falling within the scope of Circular CSSF 07/290 (as amended by Circulars CSSF 10/451, 10/483, 10/497 and 13/568) defining the capital ratios pursuant to Article 56 of the Law of 5 April 1993 on the financial sector and investment firms falling within the scope of the CRR<sup>4</sup> must permanently fulfil the capital ratio requirements.

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

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



During 2016, the CSSF recorded 10 cases of non-compliance with the capital adequacy ratio. Most investment firms concerned regularised meanwhile the situation of non-compliance or are in the process of being regularised. The CSSF used its right of injunction in accordance with Article 59 of the Law of 5 April 1993 on the financial sector in one of the aforementioned cases. The CSSF attaches utmost importance to permanent compliance with the structural ratios that investment firms are required to observe and closely monitors the regularisation processes implemented by investment firms in case of capital adequacy ratio deficiency.

#### • Large exposure limits

In the context of the supervision of compliance with large exposure limits<sup>5</sup>, the applicable limits were not exceeded in 2016, so that the CSSF did not have to intervene.

### 1.2.2. Supervision on a consolidated basis

Following the Law of 23 July 2015 repealing Chapter 3a of Part III of the Law of 5 April 1993 on the financial sector and introducing a common chapter governing the supervision of CRR institutions on a consolidated basis (Chapter 3 of Part III), only investment firms subject to Regulation (EU) No 575/2013 fall within the scope of supervision on a consolidated basis<sup>6</sup>. The relevant articles define the scope and parameters of the supervision on a consolidated basis. The content and means of consolidated supervision as well as cooperation with other supervisory authorities with respect to consolidated supervision are also defined therein.

As at 31 December 2016, the following three investment firms were submitted to the supervision on a consolidated basis by the CSSF:

- CapitalatWork Foyer Group S.A.
- FIL (Luxembourg) S.A.<sup>7</sup>
- Fund Channel S.A.

## 2. SPECIALISED PFS

### 2.1. Development of specialised PFS in 2016

#### 2.1.1. Development in the number of specialised PFS

After several years of stability, the number of specialised PFS drifted downwards in the financial year 2016 to 119 units (against 124 at the end of 2015).

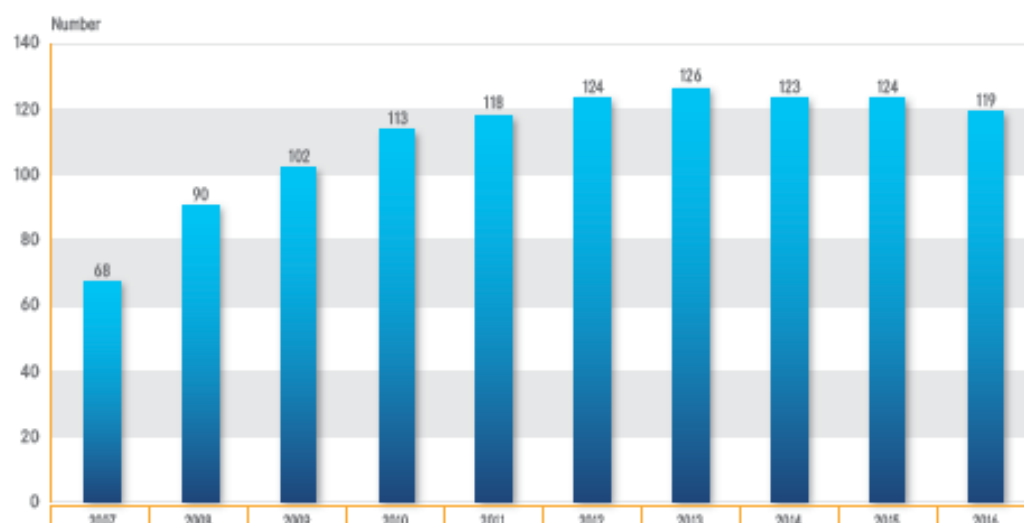
Five entities were authorised as specialised PFS in 2016 (idem in 2015). However, 10 entities gave up their status of specialised PFS in 2016, against four in 2015.

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

<sup>6</sup> Investment firms which do not fall within the scope of the CRR are no longer subject to consolidated supervision carried out by the CSSF.

<sup>7</sup> Consolidated supervision by the CSSF on the parent financial holding company in Luxembourg, i.e. FIL Holdings (Luxembourg) S.A.

### Development in the number of specialised PFS



Among the specialised PFS, the statuses of corporate domiciliation agent and professional providing company incorporation and management services are the most prevalent with 94 and 99 entities, respectively, authorised under these statuses as at 31 December 2016 (2015: 93 and 98 entities, respectively), followed by the status of registrar agent with 60 entities authorised at the same date (2015: 58 entities).

### Breakdown of specialised PFS according to status

Status	Number
Professionals providing company incorporation and management services	99
Corporate domiciliation agents	94
Registrar agents	60
Family Offices <sup>a</sup>	36
Professional depositaries of assets other than financial instruments	12
Professionals performing lending operations	7
Professional depositaries of financial instruments	4
Debt recovery	2
Mutual savings fund administrators	1
Operators of a regulated market authorised in Luxembourg	1
Financial postal services	1

Out of the five entities registered on the official list of specialised PFS in 2016, three applied for and exercise the activity of Family Office, two requested the status of corporate domiciliation agent, two that of professional providing company incorporation and management services, two that of registrar agent and one that of professional depositary of assets other than financial instruments.

### 2.1.2. Development in employment

During 2016, the number of people employed by all specialised PFS rose by 187, representing an increase of 4.9% as compared to the end of the financial year 2015.

<sup>a</sup> The item "Family Office" only includes the entities authorised and carrying out this activity.

This growth is mainly the result of a significant rise in staff of eight entities, most of which operating in the field of central administration of investment funds (+237 people). Specialised PFS which returned their authorisation in 2016 represent a staff decrease of 112 people.

According to the figures as at 31 December 2016, 12 specialised PFS employed more than 100 people (against 10 at the end of 2015) and 55 specialised PFS employed 10 or less people (against 61 at the end of 2015).

#### Development in employment of specialised PFS

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

### 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 411.4 million as compared to 2015 (-5.8%) is mainly attributable to one large entity. With the exception of this entity and the entities created or closed during the financial year, the balance sheet total of the other entities, however, rose by EUR 666 million over one year (+12.2%).

Over a one-year period, the specialised PFS show an overall rise in their net results of EUR 114.2 million (+56.6%), also mainly attributable to one large entity. With the exception of this entity and the entities created or closed during the financial year, the net results of the other entities, however, rose by EUR 13.3 million over one year (+4.5%).

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

(in million EUR)	2015	2016	Variation in %
Balance sheet total	7,089.6	6,678.2	-5.8%
Net results	201.8	316.0	+56.6%

### 2.1.4. International expansion of specialised PFS

During the financial year 2016, one specialised PFS closed its branch in the United Kingdom and another one opened a branch in Malta. Thus, as at 31 December 2016, two specialised PFS (idem in 2015) were represented by means of branches abroad, one in Malta and one in Denmark.

## 2.2. Prudential supervisory practice

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

### 2.2.1. Capital base

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

In 2016, the CSSF registered cases of non-compliance with the legal provisions in this respect by 11 entities (against six entities in 2015). Their situation was regularised in a satisfactory manner within the months following the non-compliance.

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

In 2016, the CSSF intervened three times (against 14 times in 2015) by way of deficiency letters due to a situation of non-compliance in the day-to-day management of specialised PFS, mainly linked to insufficient presence and/or effective involvement of one of the two daily managers in the day-to-day management of the entity or to the need for reorganisation of the composition of the administrative or management body of the entity.

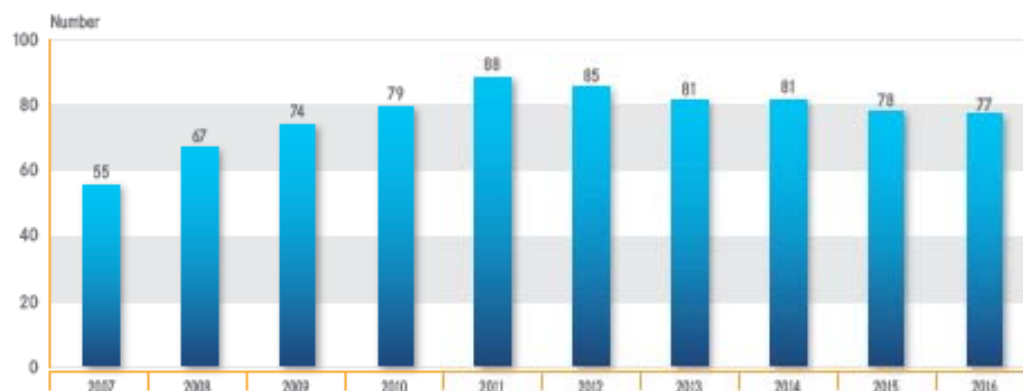
## 3. SUPPORT PFS

### 3.1. Development of support PFS in 2016

#### 3.1.1. Development in the number of support PFS

In 2016, the number of support PFS fell by one entity to 77 entities as at 31 December 2016, against 78 entities at the end of 2015.

Development in the number of support PFS



Six support PFS were authorised in 2016, including two secondary IT systems and communication networks operators (OSIS), one client communication agent (ACC), one administrative agent (AA), one support PFS cumulating ACC and OSIS statuses and one support PFS cumulating AA and OSIS statuses.

Seven support PFS were deregistered from the official list for the following reasons: three for merger, two for renunciation of authorisation, and two for liquidation (including one voluntary liquidation).

### Breakdown of support PFS according to status



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

### 3.1.2. Development in employment

The number of staff of support PFS dropped from 9,218 people as at 31 December 2015 (78 active entities) to 9,185 people as at 31 December 2016 (77 active entities), representing an annual decrease of 33 positions (-0.36%).

#### Development in support PFS employment

Year	Number of support PFS	Total staff
2010	79	8,249
2011	88	8,879
2012	85	9,016
2013	81	8,971
2014	81	9,043
2015	78	9,218
2016	77	9,185

### 3.1.3. Development of balance sheets and profit and loss accounts

The balance sheet total of all support PFS established in Luxembourg reached EUR 1,127.8 million as at 31 December 2016, as against EUR 1,107.2 million as at 31 December 2015, i.e. an increase of 1.86%.

Over one year, support PFS show a drop in their net results from EUR 68.1 million as at 31 December 2015 to EUR 66.5 million as at 31 December 2016 (-2.35%).

## 3.2. Prudential supervisory practice

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

The CSSF's work in order to align its supervisory approach more with the continuously evolving specificities of the activities of the various categories of support PFS continued in 2016. Taking into account the weaknesses identified over the last years both in terms of quality and consistency of the Risk Assessment Reports (RAR) plays a major role in this context.







## CHAPTER VIII

### SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

#### 1. PAYMENT INSTITUTIONS

The Law of 10 November 2009 on payment services (hereinafter LPS) transposed Directive 2007/64/EC of 13 November 2007 on payment services in the internal market into national law. This directive aims at establishing a coherent legal framework in order to establish a single European market for payment services and to ensure its proper functioning.

The LPS introduced the financial institution status of payment institution authorised to provide and execute payment services, and imposes authorisation, exercise and supervisory conditions on these payment institutions. The relevant payment services are specifically listed in the annexe to the LPS.

Following the authorisation of two new payment institutions and the cessation of the activity of three payment institutions in 2016, eight Luxembourg payment institutions were listed in the public register of payment institutions established in Luxembourg as at 31 December 2016. Moreover, one branch of a payment institution established in another EU Member State ceased its activities in Luxembourg.

The balance sheet total of payment institutions amounts to EUR 418.0 million as at 31 December 2016, which represents a 55% increase compared to the end of 2015 when the balance sheet total reached EUR 269.9 million.

In 2016, two payment institutions infringed the provisions regarding own funds laid down in Article 16(1) of the LPS. Following the CSSF's intervention, these institutions took appropriate measures in order to rectify their capital situation.

### 2. ELECTRONIC MONEY INSTITUTIONS

Directive 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions, repealing the first Directive 2000/46/EC on electronic money, was transposed into national law by the Law of 20 May 2011, amending the LPS.

The major purpose of this directive is to provide electronic money with a sustainable and attractive regime and, in particular, to make the prudential supervisory regime of electronic money institutions consistent with that applicable to the payment institutions governed by Directive 2007/64/EC.

Following the authorisation of one new electronic money institution and the cessation of the activity of two electronic money institutions in 2016, four electronic money institutions were listed in the public register of electronic money institutions authorised in Luxembourg as at 31 December 2016.

The balance sheet total of electronic money institutions amounted to EUR 794.6 million as at 31 December 2016, which represents a 16% increase compared to the end of 2015 when the balance sheet total reached EUR 684.1 million.

In 2016, two electronic money institutions infringed the provisions regarding own funds laid down in Article 24-12(1) of the LPS. Following the CSSF's intervention, these institutions took appropriate measures in order to rectify their capital situation.



## CHAPTER IX

### SUPERVISION OF INVESTMENT FUND MANAGERS AND UCIS

#### 1. AUTHORISED INVESTMENT FUND MANAGERS

Authorised investment fund managers (authorised IFMs)<sup>1</sup> comprise the following types of fund managers:

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

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

##### 1.1. Development in numbers

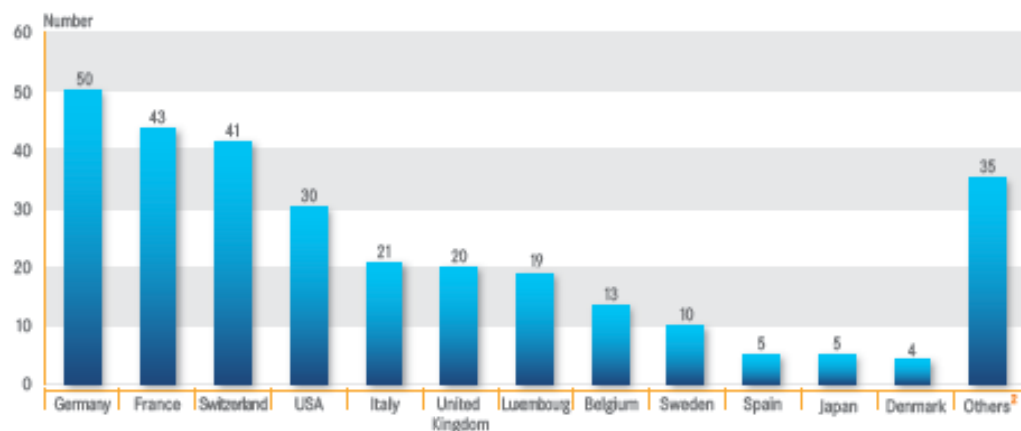
The total number of authorised IFMs amounted to 296 as at 31 December 2016, compared to 282 as at 31 December 2015. This net increase of 14 entities is the result of 21 registrations and seven withdrawals in 2016. Among the new registrations, only one entity exercised activities in the investment funds sector in Luxembourg for the first time.

##### 1.2. Geographical origin

As in previous years, the main countries of origin of authorised IFMs are Germany, France, the United States of America and Switzerland. It should be pointed out that most managers registered in 2016 are of German or French origin.

<sup>1</sup> It should be noted that this section's statistics do not include the 44 internally authorised managers, namely 32 SICAVs which did not designate a management company under Article 27(1) of the Law of 17 December 2010 relating to undertakings for collective investment and 12 internally managed alternative investment funds (AIFs), as laid down in Article 4(1)(b) of the Law of 12 July 2013 on alternative investment fund managers.

## Geographical origin of authorised IFMs



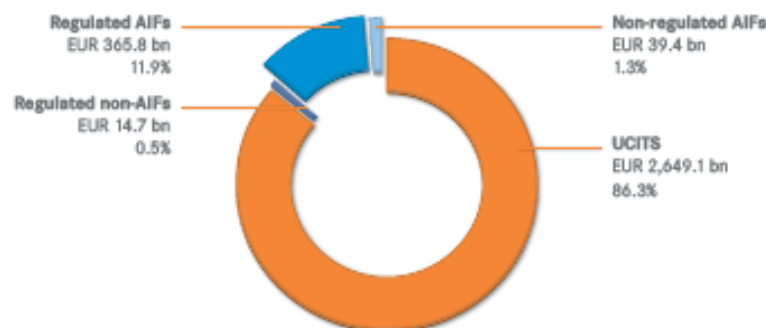
### 1.3. Development in employment

As at 31 December 2016, total staff of authorised IFMs amounted to 4,513 employees, as against 4,232 employees as at 31 December 2015, i.e. an increase of 281 employees. This rise results, on the one hand, from a general increase of the number of employees within the existing authorised IFMs and, on the other hand, from the arrival of new entities in 2016.

### 1.4. Assets under management

As at 31 December 2016, authorised IFMs managed assets of EUR 3,069 billion. The share of assets under management of UCITS remains preponderant at 86.3%. The share of the 387 non-regulated AIFs managed by authorised IFMs is marginal in terms of managed assets (EUR 39.4 billion).

#### Breakdown of assets under management according to type of product



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

<sup>2</sup> Others: Andorra (3), Australia (2), Austria (2), BVI (1), Canada (3), Chili (1), Finland (2), Greece (3), Jersey (2), Liechtenstein (2), Malta (2), Mauritius (1), the Netherlands (2), Norway (1), Poland (1), Portugal (2), Qatar (2), Russia (2), the United Arab Emirates (1).



It should be noted that the 50 authorised IFMs which are the most significant in terms of assets under management manage 90% of the assets.

## 1.5. Investment strategies

The following table shows the breakdown of the investment strategies of UCITS and regulated or non-regulated AIFs managed by authorised IFMs according to the categorisations laid down in Commission Delegated Regulated (EU) No 231/2013.

**Breakdown of investment strategies**

Investment strategies	UCITS	Regulated AIFs	Non-regulated AIFs	Total
Fixed income	37.7%	2.8%	0.4%	40.9%
Equities	37.5%	1.4%	0.2%	39.1%
Funds of funds	3.6%	3.1%	0.3%	7.0%
Real estate	0.0%	1.1%	0.1%	1.2%
Capital investment	0.0%	0.4%	0.1%	0.5%
Speculative	0.0%	0.2%	0.1%	0.3%
Commodities	0.0%	0.1%	0.0%	0.1%
Infrastructures	0.0%	0.2%	0.0%	0.2%
Others	9.1%	1.6%	0.0%	10.7%
<b>Total</b>	<b>87.9%</b>	<b>10.9%</b>	<b>1.2%</b>	<b>100.0%</b>

With respect to all the funds managed by authorised IFMs, the most representative investment strategy is "Fixed income". Within the UCITS, the second most representative strategy is "Equities" whereas, within the regulated and non-regulated AIFs, the strategy "Funds of funds" represents the second largest category.

## 1.6. Discretionary management

The 2010 Law and the 2013 Law allow authorised IFMs to benefit from an extended scope of activity, in particular for the provision of discretionary management services. As at 31 December 2016, 42 authorised IFMs (idem in 2015) provided this service for a total of EUR 42.5 billion of assets under management (compared to EUR 44.4 billion in 2015).

## 1.7. Financial situation

The provisional balance sheet total of all authorised IFMs, including their branches, reached EUR 14.5 billion as at 31 December 2016, as against EUR 13.0 billion as at 31 December 2015, i.e. an increase of 11.5%. This positive development is due to a significant increase of "loans and advances" and "amounts owed", respectively, correlated with an increase of assets under management. Nevertheless, this rise in assets under management did not allow the authorised IFMs to increase their net results, due to a downward trend of operating margins. Indeed, provisional net results amounted to EUR 2.6 billion as at 31 December 2016, as against EUR 2.7 billion as at 31 December 2015, representing a decrease of 3.3%. Finally, from the 296 authorised IFMs, 232 recorded a net profit and 64 a net loss. Among the authorised IFMs that recorded a loss, 12 are newly created authorised IFMs.

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

(in bn EUR)	2015	2016	Variation in %
Balance sheet total	13.0	14.5	11.5%
Net results	2.7	2.6	-3.3%

The financial data of authorised IFMs also shows that:

- liquidities held by the authorised IFMs cover 118% of their own funds, showing a sound and prudent management;
- staff costs increased by 8.3%, due mainly to the strengthening of the presence of authorised IFMs.

## 2. OTHER INVESTMENT FUND MANAGERS

The following other investment fund managers are present in Luxembourg:

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

At EUR 98.9 billion, the share of the assets under management of these other IFMs remains moderate compared to the authorised IFMs. The other IFMs mainly manage UCITS and AIFs.

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



The following table shows the main investment strategies of UCITS, regulated AIFs and non-regulated AIFs managed by the other IFMs.

#### Breakdown of investment strategies

Investment strategies	UCITS	Regulated AIFs	Non-regulated AIFs	Total
Fixed income	30.1%	1.8%	0.0%	31.7%
Equities	29.9%	1.1%	0.2%	31.2%
Funds of funds	2.9%	6.7%	0.7%	10.3%
Real estate	0.0%	2.1%	0.2%	2.3%
Capital investment	0.0%	6.5%	0.5%	7.0%
Speculative	0.0%	0.8%	0.0%	0.8%
Commodities	0.0%	0.5%	0.0%	0.5%
Infrastructures	0.0%	2.3%	0.0%	2.3%
Others	7.2%	5.0%	1.7%	13.9%
<b>Total</b>	<b>70.1%</b>	<b>26.6%</b>	<b>3.3%</b>	<b>100.0%</b>

With respect to all the funds managed by the other IFMs and similarly to the authorised IFMs, the most representative investment strategy is "Fixed income".

Within UCITS, the second most representative strategy is "Equities", whereas within the regulated and non-regulated AIFs, the second most representative strategy is "Funds of funds".

At EUR 2.5 billion, the share of non-regulated AIFs managed by registered IFMs remains marginal in terms of assets under management for 51 vehicles, similarly to the trend observed in authorised IFMs.

#### • EuVECA and EuSEF

In 2016, six EuVECA registration requests under Regulation (EU) No 345/2013 of 17 April 2013 on European venture capital funds were submitted to the CSSF. From these six requests, four entities were registered by the CSSF and can use the denomination EuVECA, which brings the total number of registered EuVECAs to seven as at 31 December 2016.

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

## 3. CROSS-BORDER ACTIVITIES

### 3.1. IFMs established in another EU Member State

IFMs established in another EU Member State and ensuring the management of Luxembourg UCITS or AIFs under Article 119 of the 2010 Law and/or Article 33 of the 2013 Law manage EUR 487.9 billion of assets.

#### Breakdown of products managed on a cross-border basis<sup>2</sup>



<sup>2</sup> Data not available for non-regulated AIFs.

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

- 68 managers manage UCITS;
- 116 managers manage regulated AIFs;
- seven managers manage both UCITS and regulated AIFs.

Among these 191 IFMs, five managers originating from Germany, France, Malta and Sweden provide management services for UCITS and AIFs via a branch in Luxembourg as at 31 December 2016.

### 3.2. IFMs established in Luxembourg

#### 3.2.1. Freedom to provide services under the UCITS Directive

In 2016, seven authorised IFMs (compared to five in 2015) notified their intention to carry out the functions included in the collective management activities in another EU Member State in the framework of freedom to provide services. The host Member States are Germany, Belgium, France, Ireland, the Netherlands and the United Kingdom.

#### 3.2.2. Freedom to provide services under the AIFMD

In 2016, 13 authorised IFMs (compared to 12 in 2015) notified their intention to manage AIFs under the freedom to provide services in one or several other EU Member States. As in 2015, the host Member States are Germany, Finland, France, Italy, the United Kingdom and Sweden.

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

As at 31 December 2016, 28 authorised IFMs (compared to 26 in 2015) were represented by a branch in one or several EU Member States under the UCITS Directive or the AIFMD. This corresponds to a total of 60 branches (compared to 54 in 2015).

#### 3.2.4. Subsidiaries/joint ventures created and acquired abroad during 2016

In 2016, two authorised IFMs opened a subsidiary abroad (one in Spain and one in Slovakia). Another authorised IFM took part in a joint venture in the United Kingdom.

## 4. EVOLUTION OF THE UCI SECTOR IN 2016

As at 31 December 2016, 4,144 UCIs were registered on the official list, compared to 4,160 UCIs at the end of the previous year (-0.4%). This decrease is linked to a consolidation trend in the UCI sector, combined with a preference to create umbrella structures.

From the 4,144 UCIs, 2,656 had adopted an umbrella structure, representing an increase of 40 entities compared to the previous year. Traditionally structured UCIs decreased by 56 entities.

The total number of fund units rose from 14,496 as at 31 December 2015 to 14,595 as at 31 December 2016. This rise results from the net creation of 115 sub-funds within UCIs with an umbrella structure.

Through the inflow of new capital and the positive developments in the financial markets, total net assets of Luxembourg UCIs grew by EUR 197.7 billion over one year to reach EUR 3,741.3 billion as at 31 December 2016 (+5.6%). This increase originates for 52.8% from net subscriptions and for 47.2% from a positive impact of the

financial markets. Net capital investments in Luxembourg UCIs amounted to EUR 104.4 billion in 2016, which provides evidence of investors' confidence in the financial markets.

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

Year	Total number of UCIs	Number of fund units	Net assets (in bn EUR)
2006	2,353	9,588	1,856.4
2007	3,050	11,297	2,076.8
2008	3,592	12,548	1,576.5
2009	3,699	12,472	1,858.4
2010	3,914	13,203	2,220.4
2011	4,121	13,595	2,120.0
2012	4,117	13,757	2,413.7
2013	4,181	14,048	2,645.7
2014	4,193	14,237	3,127.7
2015	4,160	14,496	3,543.6
2016	4,144	14,595	3,741.3

Similarly to preceding years, the Luxembourg UCITS sector benefited from a positive balance between mergers in which the receiving UCITS is domiciled in Luxembourg (77 projects) and those in which the receiving UCITS is domiciled in another EU Member State (52 projects).

## 5. PRUDENTIAL SUPERVISORY PRACTICE

### 5.1. Prudential supervision

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

Prudential supervision is exercised via:

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

### 5.2. Off-site supervision

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

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

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

The deadline to transmit the monthly financial information is 10 days following the reference date, which is in principle the last day of each month. The deadline for communicating the half-yearly financial information is



45 days after the reference date. As regards annual financial information, the reference date depends on the closing date of the financial year and of the legal deadline for filing the annual accounts. Consequently, the deadline for transmitting the information is four months for UCITS governed by Part I of the 2010 Law and six months for UCIs governed by Part II of the 2010 Law and SIFs.

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

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

Data collected in the framework of prudential supervision are shared with the BCL and STATEC for statistical purposes.

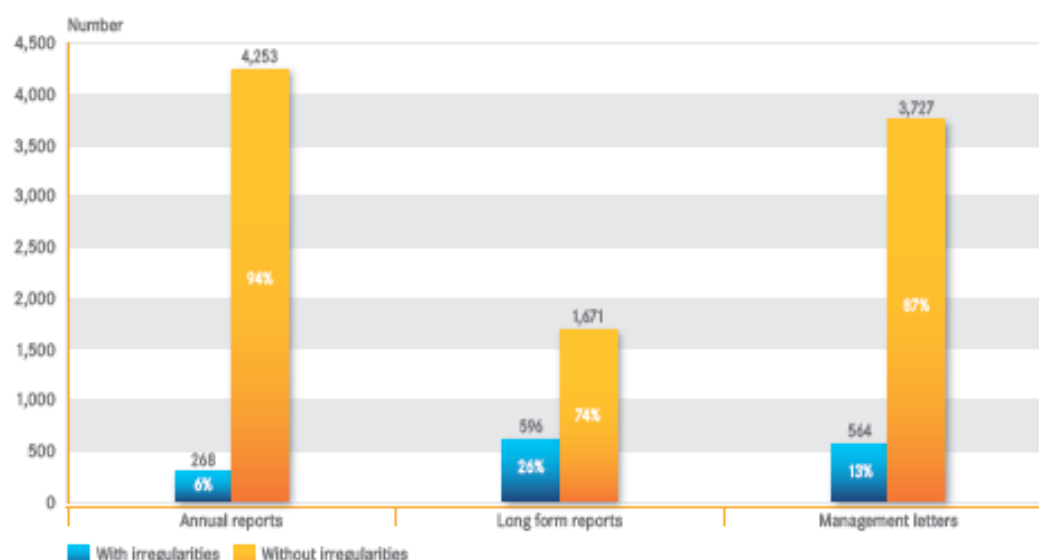
## 5.2.2. Supervision based on annual and half-yearly reports, management letters and long form reports of the UCI activity

In the framework of the review of annual and half-yearly reports, management letters and long form reports<sup>4</sup>, the CSSF had to take decisions, in the form of injunctions, formal requests and recommendations for the attention of the *dirigeants* (directors) of some UCIs. These decisions were designed to remedy organisational deficiencies noted by the *réviseurs d'entreprises agréés* in their reports or management letters.

In 2016, the CSSF sent 90 letters to require corrective measures in order to remedy more serious deficiencies identified during the review of the above-mentioned documents. Besides the formal interventions and pursuant to a risk-based supervision, the CSSF intervened in 2016 increasingly via telephone or email to clarify or deal with less critical deficiencies.

The following chart highlights, per type of report, the number and proportion of reports in which one or several deficiencies were noted by the *réviseur d'entreprises agréé* and which were subject to a review by the CSSF<sup>5</sup>.

**Number and share of reports with or without deficiencies noted**



<sup>4</sup> 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.

<sup>5</sup> It should be noted that the reports and management letters received in 2016 mostly concerned the year 2015.

In 2016, the CSSF's interventions via letter, addressed mostly to SIFs, mainly concerned the valuation of assets, non-compliance with investment rules or asset eligibility and the fight against money laundering and terrorist financing.

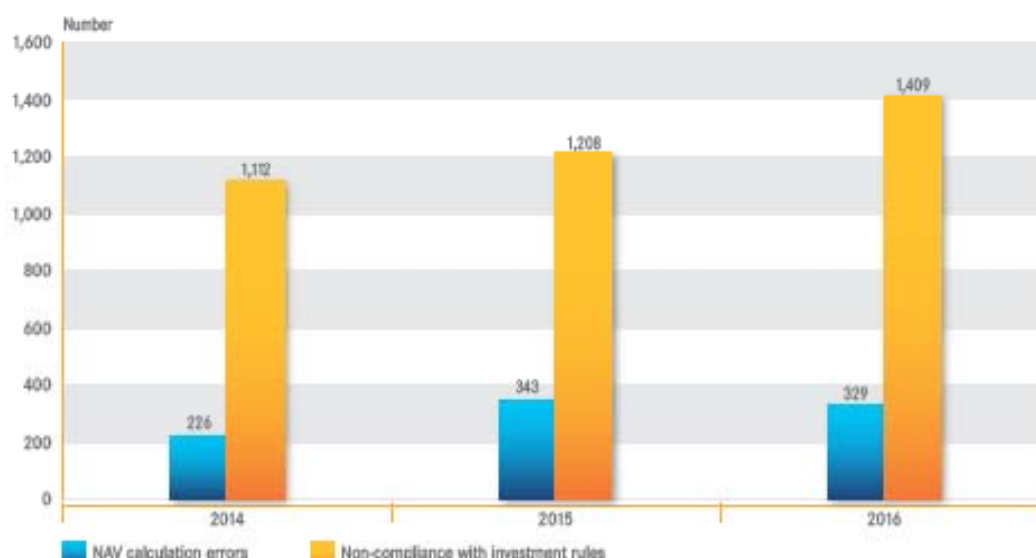
Given that the observed valuation deficiencies notably concerned the absence of independent valuation or the lack of documentation supporting the valuation process, the CSSF reiterates that the *dirigeants* of the entities must ensure that appropriate and coherent procedures are established so that an appropriate and independent valuation of the UCI's assets may be performed in accordance with the applicable regulations and constitutional documents of the UCI.

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

### • Declarations made in 2016

In 2016, the CSSF received 1,738 declarations on the basis of Circular CSSF 02/77<sup>4</sup>, compared to 1,551 declarations in 2015, representing an increase of 12.0% that is entirely attributable to non-compliance with investment rules (+16.6%).

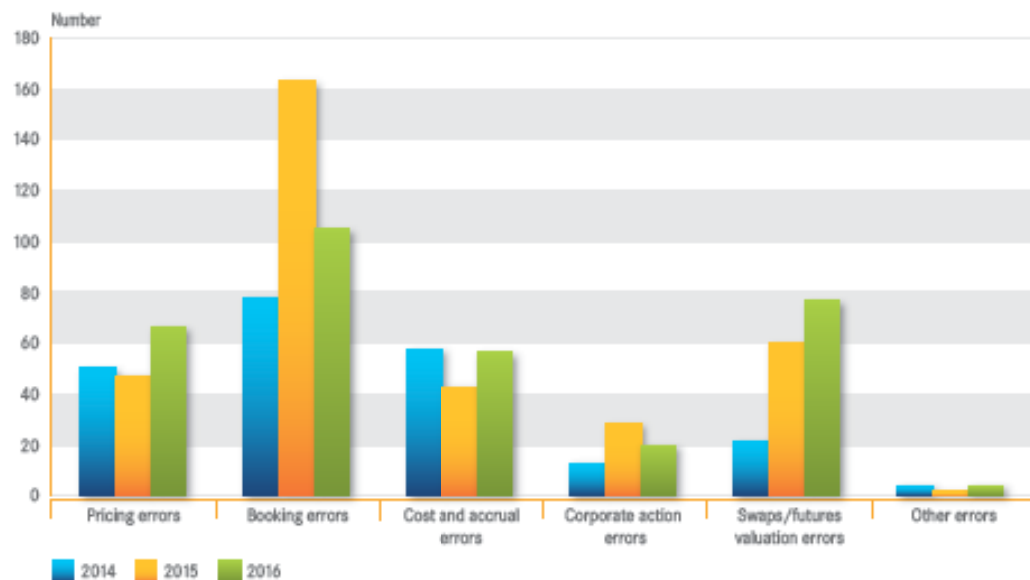
### Evolution of the number of NAV calculation errors and instances of non-compliance with investment rules reported to the CSSF over the last three years



As in previous years, the simplified procedure could be applied in most cases of NAV calculation errors and non-compliance with investment rules.

<sup>4</sup> Even if Circular CSSF 02/77 does not automatically apply to SIFs, the CSSF, nevertheless, considers that SIFs may either opt for the application of Circular CSSF 02/77 or set other internal rules that must remain within reasonable limits with respect to the SIF's investment policy. In this context, the CSSF considers that SIFs, that have not set specific internal rules, must apply Circular CSSF 02/77.

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

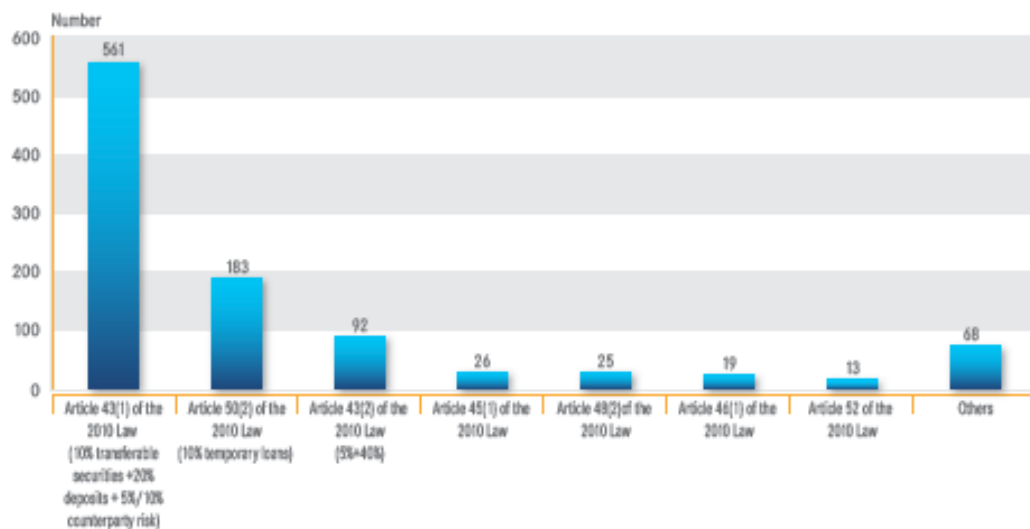


Although the number of booking errors is declining, they remain the main cause of NAV calculation errors.

Failure to observe legal limits of diversification, holding and borrowing remains the main source of non-compliance with investment rules with 987 cases (816 cases in 2015, i.e. +21.0%). This was followed by 317 cases of exceeding internal limits defined in sales documents (305 cases in 2015, i.e. +3.9%) and 105 cases of legal constraints breaches as regards asset eligibility (87 cases in 2015, i.e. +20.7%).

The 16.6% increase in instances of non-compliance with investment rules is mainly linked to a rise of notifications regarding the 20% limit in deposits as laid down in Article 43(1) of the 2010 Law.

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



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

#### Compensation in 2015 and 2016<sup>7</sup>

	Investors			UCI/Sub-fund		
	2015	2016	Variation in %	2015	2016	Variation in %
Total amount of compensation following NAV calculation errors	7,147,140.79	3,150,381.34	-55.0%	4,990,726.44	5,748,612.81	+15.2%
Total amount of compensation following non-compliance with investment rules	6,337.90	338,411.11	+5,239.5%	3,351,160.95	1,914,231.14	-42.9%

As in previous years, the large variations of the compensation amounts (increase or decrease) are the result of a few isolated cases requiring more significant compensation. Overall, the total amount of compensation remains moderate as compared to the amount of assets under management.

#### • New form file for notifications

As announced in Press release 17/01<sup>8</sup> of 3 January 2017, the CSSF introduced a form file for the transmission to the CSSF of information relating to non-compliance with investment rules or NAV calculation errors. This form file is applicable to UCIs subject to the 2010 Law and to SIFs subject to the Law of 13 February 2007.

The CSSF expects that the notifications collected in this manner will contribute to the standardisation of the process both in the industry and at the CSSF.

### 5.3. Ad hoc surveys

In 2016, the CSSF carried out various ad hoc surveys within the context of the supervision of UCIs and in order to meet a specific information request from IOSCO.

#### 5.3.1. Stress testing and confirmed credit lines

In June 2016, the CSSF carried out a survey on the following aspects:

- confirmed credit lines made available by Luxembourg and foreign credit institutions to IFMs and/or Luxembourg UCIs (UCITS and non-UCITS);
- the market and liquidity stress testing applied by Luxembourg and foreign IFMs to the Luxembourg UCITS they manage.

This survey was carried out with a representative sample composed of the 50 IFMs domiciled in Luxembourg with the highest net assets.

In particular, the survey showed that overall, the use of confirmed credit lines was very limited. As regards the existing credit lines, confirmed credit lines concluded between Luxembourg UCIs and credit institutions were predominant.

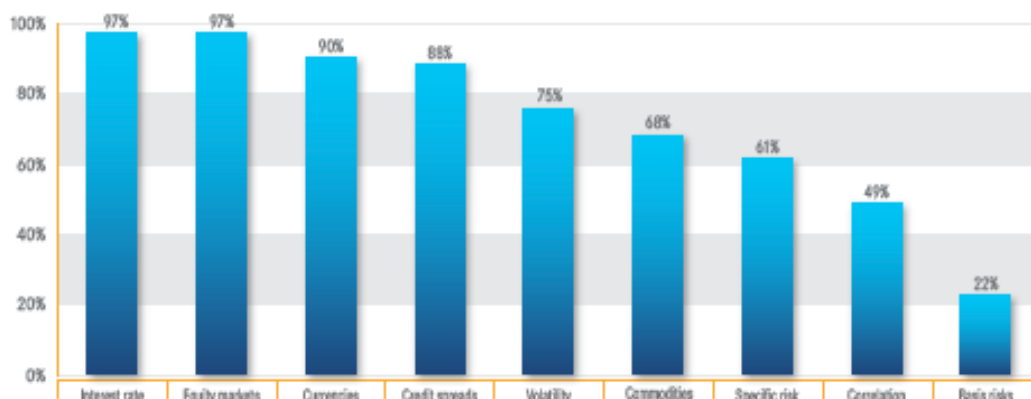
As far as stress testing is concerned, the survey showed that most of the sampled IFMs apply market stress tests consistently on all UCITS. Where necessary, they are supplemented with customised stress tests, including for certain UCITS that use the commitment approach for the calculation of the global exposure.

The risk factors used for these calculations come from both historical and hypothetical scenarios.

<sup>7</sup> The data as at 31 December 2016 are incomplete as the final compensation amounts had not yet been finalised for some files.

<sup>8</sup> Weblink: [http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués\\_2017/PR1701\\_form\\_file\\_circular\\_02\\_77\\_030117.pdf](http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués_2017/PR1701_form_file_circular_02_77_030117.pdf).

Risk factors used by IFMs for stress test scenarios



Moreover, a large majority of the sample carries out, for all or part of the managed UCITS, liquidity stress tests on both the assets and liabilities of the UCITS.

Thus, with respect to asset liquidity risk, 90% of the sample uses either a measurement of loss incurred following the liquidation of assets, or an estimate of the liquidation time needed to sell the assets and, frequently, both approaches simultaneously. As far as fund liabilities are concerned, the approach of basing estimates on historic redemptions is used as often as an approach based on hypothetical redemption scenarios.

Following the recommendations of the FSB ("Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities") published in January 2017 and the current European and international discussions on asset management, the CSSF expects that future additional effort will be required from IFMs in order to enhance their stress testing frameworks.

Therefore, the CSSF wishes to remind the industry that, in accordance with Articles 45(2)(c) and 45(3) of CSSF Regulation N° 10-04, IFMs must, where applicable, carry out market and liquidity stress tests in order to take into account the risks resulting from possible market condition developments likely to negatively impact UCITS and in order to assess UCITS' liquidity risk exposure in exceptional circumstances.

Pursuant to the requirements in place, the CSSF expects that IFMs carry out stress tests on the UCITS they manage by duly taking into account their risk profile. Consequently, the CSSF considers that for UCITS invested, for example, in risky assets (e.g. high yield bonds, emerging markets or ABS/MBS), the IFMs must carry out market and liquidity stress tests. Thus, it is not sufficient to limit market stress tests only to UCITS using the VaR calculation method for the calculation of the global exposure.

### 5.3.2. Other surveys

Following a referendum on the EU membership of the United Kingdom in June 2016, the CSSF implemented a follow-up on a sample of IFMs managing Luxembourg UCIs and Luxembourg self-managed investment companies. This was to obtain information on possible significant developments or problems (for example, large redemptions or assessment problems) encountered in the UCIs they manage and on the decisions or measures taken in this respect. Generally, this review did not highlight major problems in the companies.

In November 2016, the CSSF participated in a survey on behalf of IOSCO. This questionnaire concerned UCIs that follow so-called alternative strategies and had over USD 500 million in net assets as at 30 September 2016.

## 5.4. UCITS Risk Reporting

In April 2016, the CSSF implemented, via circular-letter, a new half-yearly risk reporting, called UCITS Risk Reporting, for 307 Luxembourg and foreign IFMs managing UCITS domiciled in Luxembourg or self-managed investment companies. The purpose of this reporting is to increase the CSSF's data on different risk indicators



of UCITS. It was put in place as part of European and international discussions during which organisations, such as IOSCO or the FSB, recommended enhancing the collection of data in the asset management field. By this initiative, the CSSF would like to be proactive at the European level in order to set up a common reporting for UCITS, similar to the one in place for AIFMs.

The first UCITS Risk Reporting covered a period of six months ending on 31 March 2016, whereas the subsequent reporting covered the second half of 2016 ending on 31 December 2016 in order to adjust to calendar half years.

The UCITS Risk Reporting applies to all UCITS domiciled in Luxembourg, with a more significant granularity of the information requested from UCITS fulfilling at least one of the following two criteria:

- net assets above EUR 500 million;
- use of VaR for the calculation of global exposures covered by Article 42(3) of the 2010 Law with an average gross leverage<sup>9</sup> used in the first half year that exceeds 250%.

This additional information concerns, in particular, the applicable investment strategy, the leverage used, the risk indicators such as volatility or the application of univariate stress tests, the use of efficient portfolio management techniques, the counterparty risk, the liquidity and credit risks, as well as a decomposition of the leverage coming from derivatives per underlying type.

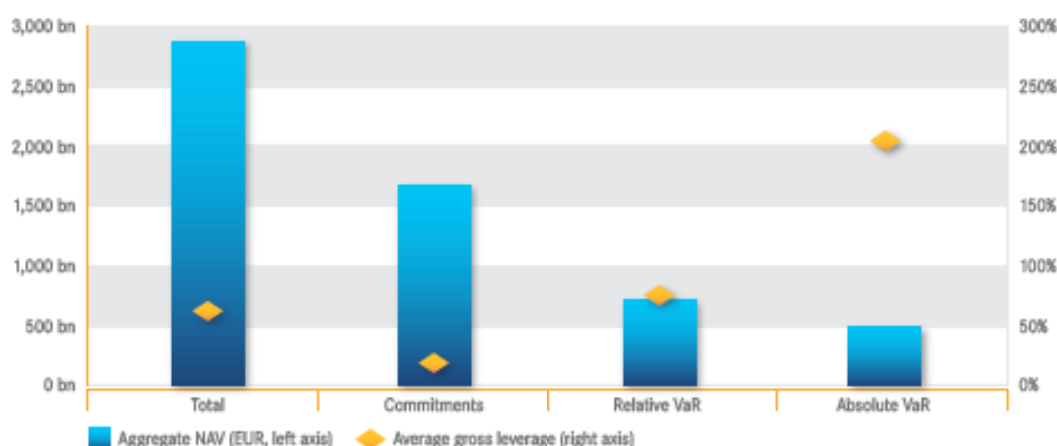
The first exercise concerned 10,323 UCITS (sub-funds) together totalling EUR 2,850 billion in net assets as at 31 March 2016. Based on the above criteria, 1,474 UCITS (sub-funds) with an aggregate outstanding amount of EUR 2,100 billion were concerned by all the information in the reporting.

This first exercise gave rise to some important statistics which are presented below.

## 5.4.1. Methods for calculating global exposures and the level of gross/net leverage

Around 66% of the 10,323 UCITS (sub-funds) concerned by the reporting use the commitment approach for the calculation of global exposures, whereas 19% use the relative VaR and 14% the absolute VaR approach. In regard to the total net assets of EUR 2,850 billion, UCITS using the commitment approach represent 58%, whereas UCITS using the relative VaR approach represent 25% and those using the absolute VaR approach represent 17%.

**Average<sup>10</sup> gross<sup>11</sup> leverage of UCITS categorised by the calculation method of the global exposure**

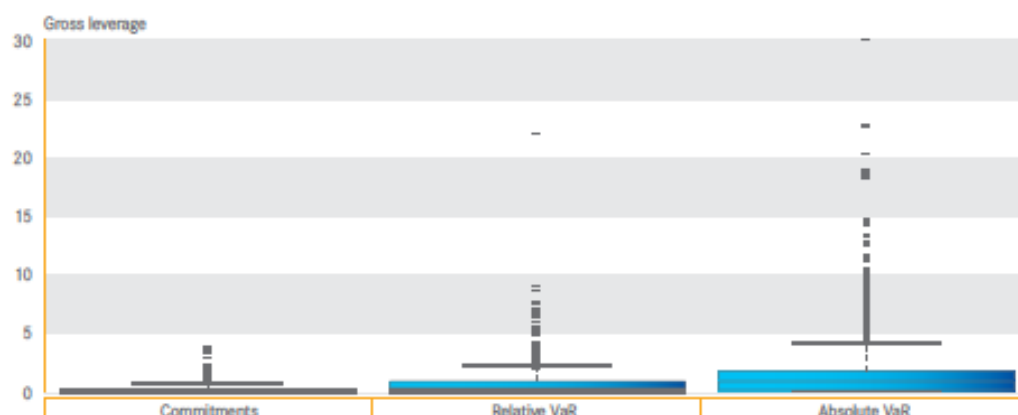


<sup>9</sup> In accordance with the rules set in the regulation, the gross leverage is calculated as the notional sum of the derivatives used.

<sup>10</sup> For each UCITS, the value adopted for the gross leverage is the average of the reference half-year for UCITS using the VaR and the value at the end of the half-year for UCITS using the commitment approach and with net assets exceeding EUR 500 million. As regards UCITS using the commitment approach and with net assets below EUR 500 million, the gross leverage is estimated as the average (weighted by net assets) of gross leverage of all UCITS using the commitment approach and with net assets exceeding EUR 500 million.

<sup>11</sup> The average leverage figures are weighted by the net assets of the respective UCITS.

### Breakdown of the gross leverage of UCITS categorised by the calculation method of the global exposure<sup>12</sup>



The following elements in relation to the graphs should also be pointed out:

- UCITS with net assets exceeding EUR 500 million and using the commitment approach to calculate the global exposure, report an average net leverage level of 6% (after taking into account the netting effects) for a gross leverage (calculated via the nominal sum) of 19%. On average, bond or mixed UCITS have a net leverage above that of equity UCITS.
- UCITS calculating global exposure via the absolute VaR approach report, on average, a gross leverage of 206%. Among these UCITS, the maximum gross leverage reached over this period is 3,030%, and the second highest is 2,277%.
- UCITS calculating global exposure via the relative VaR approach report, on average, a gross leverage of 75%. Among these UCITS, the maximum gross leverage reached over this period is 2,220%, and the second highest is 910%.
- Among the UCITS calculating global exposure via the VaR approach and fulfilling the requirements of additional information described above, over half of currency derivatives and short-term rate derivatives contribute to the leverage usage.
- The analyses performed do not show strong correlation between gross leverage and the UCITS' volatility. In addition, UCITS reporting a high gross leverage do not necessarily have the highest stress test results.

#### 5.4.2. Use of securities-financing transactions by UCITS

At the end of March 2016, about 30% of UCITS fulfilling the detailed information criteria reported that they carry out securities lending activities for an average amount<sup>13</sup> of 11% of net assets. These activities concern bond UCITS as well as equity UCITS.

2% of this sample's UCITS held repo transactions for an average amount of 7% of net assets. These repo transactions concern mainly bond UCITS.

Finally, the reverse repo transactions concern 2.6% of UCITS for an average amount of 12% of net assets and are mainly used by money market UCITS.

<sup>12</sup> Explanations for the "plot box" diagrams: the first and third quartile of the sample delineate the blue box so that 50% of the sample is in the box. The horizontal line going through the blue box is the median so that 50% of the sample is underneath and 50% is above this line. The length of the "plots" outside the box equals 1.5 times the interquartile range. The observations which are greater than 1.5 times the interquartile range of the box are marked individually.

<sup>13</sup> The average levels indicated are weighted by net assets of the respective UCITS.

**Securities-financing transactions of UCITS categorised by investment policy<sup>14</sup>**

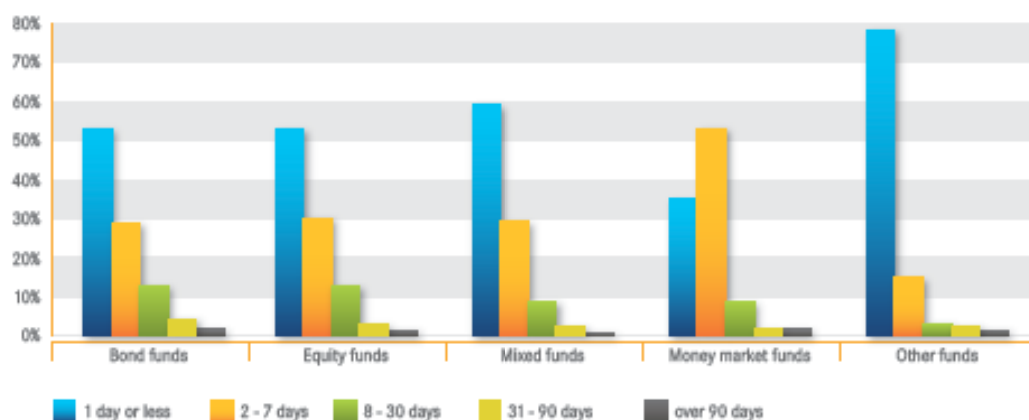
	Bond UCITS	Equity UCITS	Mixed UCITS	Money market UCITS	Other UCITS	Total
Proportion of funds carrying out securities lending	32.2%	37.6%	21.9%	4.2%	14.3%	30.1%
Average proportion of the securities lending NAV	4.9%	3.1%	2.8%	0.4%	4.4%	3.5%
Proportion of funds carrying out repos	4.4%	0.8%	0.8%	0.0%	0.0%	2.0%
Average proportion of the repo NAV	0.5%	0.0%	0.0%	0.0%	0.0%	0.2%
Proportion of funds carrying out reverse repos	2.3%	1.0%	0.8%	33.3%	5.7%	2.6%
Average proportion of the reverse repo NAV	0.5%	0.1%	0.1%	7.3%	0.1%	0.9%

**5.4.3. Liquidity profile of the UCITS' assets and liabilities**

The following chart highlights the assessment by the IFMs and self-managed investment companies of the liquidity profile<sup>15</sup> of UCITS assets in normal market conditions. It should be pointed out that among the bond UCITS, those with high yield strategies benefit from a lesser liquidity estimate with 30% of assets likely to be liquidated within one day.

In this context, the CSSF stresses that IFMs must take the necessary measures in order to be able to provide an asset liquidity profile, even when markets are under stress, at least for bond, mixed and money market UCITS<sup>16</sup>.

**Aggregated profile of the UCITS' assets liquidity by BCL investment policy**



The CSSF observations show that IFMs and self-managed investment companies may sometimes have difficulty in providing information on the typology and concentration of investors in the managed UCITS. In this context and according to discussions at European and international level, the CSSF highlights that, for the purposes of adequate liquidity risk management, it is essential to develop knowledge in relation to the

<sup>14</sup> Investment policy according to the BCL classification.

<sup>15</sup> In the chart, the money market funds show a low value under the one-day liquidity category due to one major player that calculated the portfolio liquidity by using the maturity of the assets without taking into account the possibility to resell the assets on the secondary market.

<sup>16</sup> The field "UCITS portfolio liquidity profile in stressed market conditions at semester-end" of the UCITS Risk Reporting is still optional at the moment.

"liabilities" component of UCITS (for example, investor typology, possible concentration of investors, investors' redemption behaviour).

The reporting confirmed that, in general, the liquidity management tools such as suspension and gating are, in accordance with the prospectus and constitutional documents, available at the level of UCITS.

## 5.5. On-site supervision

In 2016, the "UCI on-site inspections" department increased to seven agents. It is planned to substantially increase the number of agents over the next two years. The team's mission is to prepare, carry out and follow up on-site inspections in relation to the governance of IFMs, based on a long-term inspection plan using a risk-based approach. Moreover, the department also coordinates and follows up on all the on-site inspections conducted within the UCI departments.

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 addition, the "On-site inspection" department may carry out thematic on-site inspections at IFMs in relation to the central administration activity, MIFID regulations and the fight against money laundering and terrorist financing.

### 5.5.1. Statistics

In 2016, the CSSF carried out 36 on-site inspections at UCI departments' level.

Authorised IFMs inspected represent about 15% in terms of assets under management of the IFMs. Moreover, the inspections concerned nine authorised IFMs whose assets under management exceed EUR 15 billion.

#### Themes of the UCI departments' on-site inspections in 2016



### 5.5.2. Main findings

Enhanced monitoring of delegates is currently being carried out within authorised IFMs, which is encouraged by the CSSF. However, the CSSF noted that monitoring activities that were delegated by the authorised IFM to one or several entities of the group were still incomplete.

The CSSF stresses that an authorised IFM must have an appropriate infrastructure in order to manage, among others, its tasks in the framework of the monitoring/follow-up of delegates. This means that the authorised IFM must prove the presence of sufficient numbers of competent staff as well as an appropriate technical, IT and accounting infrastructure. Furthermore, the authorised IFM must have proper documentation in relation to the tasks/operations performed directly by the authorised IFM and those performed by the delegates on behalf of the authorised IFM.

<sup>17</sup> Missions carried out by the "On-site inspection" department.



The above principles of substance and implementation of equipped and competent monitoring units are also applicable if the authorised IFM uses external services such as investment advice and risk management support, compliance, internal audit and assessment.

Among the other most recurrent findings, the CSSF noted that several authorised IFMs carried out the initial due diligence on service providers or delegates after entry into a business relationship. In addition, the CSSF observed that some initial due diligences were not sufficiently substantiated to allow appropriate identification and assessment of the risks related to delegation.

The CSSF also noted during the on-site inspections that part of the continuous monitoring arrangements of authorised IFMs relies on key performance indicators (KPI) from different reports transmitted by delegates. In this context, it was observed that the controls carried out on the correctness of these entry data are not sufficiently formalised.

In the framework of the on-site inspections regarding risk management, the CSSF noticed that some authorised IFMs did not have a risk management policy in line with the regulations, since it was inadequately documented and lacked a detailed description of the manner in which each risk is measured, monitored and managed by the manager. It should be pointed out that, in view of the above, the risk management policy and the risk management procedure must be dealt with as two distinct documents.

As for the reporting of risk management information to the *dirigeants* of the IFMs, it was observed that the *dirigeants* did not regularly and consistently receive sufficiently detailed information to support decision making or, where appropriate, the establishment of corrective measures. In this context, the CSSF stresses that the *dirigeants* must, among others, regularly receive clear, precise and detailed information via reports on the current risk level incurred by the UCITS they manage. The information must take into account the established risk profile together with explanations for any breaches of internal or regulatory limits.

Finally, the CSSF noted weaknesses/shortcomings in relation to the following:

- compliance with the provisions on capital adequacy;
- compliance with the submission deadlines and the comprehensiveness of prudential reports;
- compliance with the deadlines for sending quarterly reports;
- poor quality of the data transmitted in the framework of the AIFM reporting.

In this context, the CSSF reiterates that authorised IFMs must always comply with their legal and regulatory requirements and adequately prepare for report submission deadlines.

## 6. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

On 11 October 2016, the CSSF published Circular CSSF 16/644 on the provisions applicable to credit institutions acting as UCITS depositary subject to Part I of the 2010 Law and to all UCITS, where appropriate, represented by their management company.

This circular follows the entry into force of the Law of 10 May 2016 transposing into Luxembourg law Directive 2014/91/EU of 23 July 2014 amending the UCITS Directive (2009/65/EC) as regards depositary functions, remuneration policies and sanctions (UCITSV Directive) and amending, among others, the Law of 17 December 2010 relating to undertakings for collective investment. It also follows Commission Delegated Regulation (EU) 2016/438 with regard to obligations of depositaries which entered into force on 13 October 2016. These texts provide for a set of (partially new) requirements on the duties of the depositaries regarding the safekeeping of assets, supervisory obligations as well as the monitoring of cash flows and they modified the liability regime of depositaries towards UCITS and unit-holders. The circular specifies organisational obligations applicable to UCITS depositaries subject to Part I of the 2010 Law by clarifying, among others, certain aspects of the above-mentioned Law of 10 May 2016 and/or Commission Delegated Regulation (EU) 2016/438 in the Luxembourg context. This circular repeals and replaces Circular CSSF 14/587 as amended by Circular CSSF 15/608.







## CHAPTER X

### SUPERVISION OF SECURITISATION UNDERTAKINGS

During 2016, the CSSF received two applications for registration on the official list of authorised securitisation undertakings subject to the Law of 22 March 2004 on securitisation.

Four multiple-compartment securitisation undertakings were granted authorisation by the CSSF whereas two securitisation undertakings were deregistered from the official list of authorised securitisation undertakings in 2016.

As at 31 December 2016, 34 securitisation undertakings were registered on the official list of authorised securitisation undertakings, against 32 entities at the end of 2015. The balance sheet total of authorised securitisation undertakings amounted to EUR 35.2 billion at the end of 2016, representing an increase of EUR 4.9 billion against 2015.

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

In general, the securities issued by securitisation undertakings are bonds and subject to foreign law. It is also possible for some securitisation undertakings to issue warrants. As at 31 December 2016, 12 of the 34 authorised securitisation undertakings issued securities admitted to trading on a regulated market.

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

The CSSF expects securitisation activities to continue their slow but ongoing pace in 2017.



*Agents hired in 2016 and 2017: Departments "Coordination of the UCI departments' specific IT tools" and "UCI Operations"*

Left to right: Sandra PALETTA, Anouk KALMES, Hugues PECHEUR, Mandy FLORIJAN, Audrey DUMAIT, Edwige MUTESI, Florian COLLIGNON, Caroline ANDLAUER, Stefan LORETZ

Absent : Lucas DEHANDSCHUTTER



## CHAPTER XI

### SUPERVISION OF PENSION FUNDS

#### 1. DEVELOPMENT OF PENSION FUNDS IN 2016

##### 1.1. Major events and trends observed in 2016

As at 31 December 2016, 14 pension funds subject to the Law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (SEPCAVs) and pension savings associations (ASSEPs) were registered on the CSSF's official list of pension funds (idem in 2015). During the year, one new cross-border pension fund was registered on the official list and one pension fund was deregistered from this list as it decided to transfer its commitments to a group insurance.

The year 2016 was mainly marked by the development of new cross-border pension schemes within existing pension funds. Within the framework of the Budapest Protocol, which organises the practical implementation of the relations between authorities for cross-border activities, two notifications were sent by the CSSF to the competent authorities acting as host Member State and five pension schemes have been approved by the CSSF.

The CSSF notes that the trend towards increased cross-border activities already observed in 2015 continues, notably through the setting-up of pension schemes conceived for international groups.

##### 1.2. Pension fund activities

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

As at 31 December 2016, three pension funds managed cross-border pension schemes. These pension funds provide their services to sponsoring undertakings established in Ireland, the Netherlands, the United Kingdom, Germany, Italy and Belgium, as well as to non-EU sponsoring undertakings.

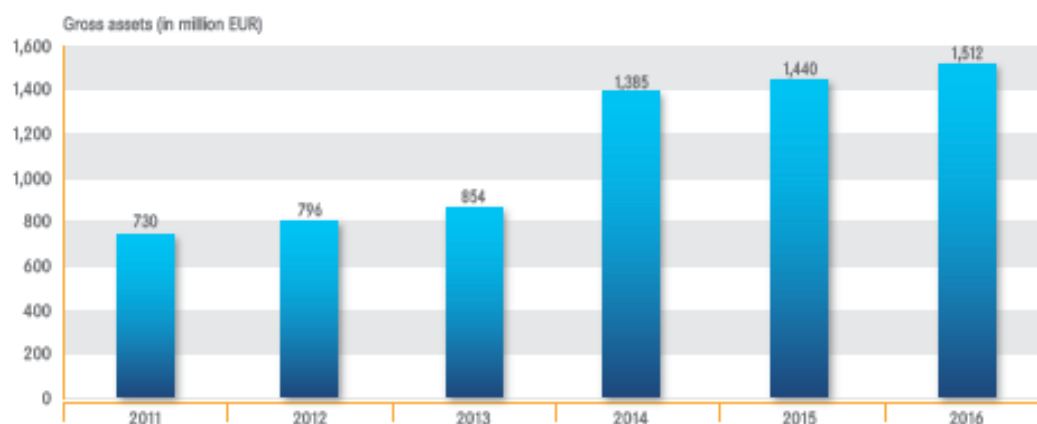
Out of the 14 pension funds registered on the official list, 12 have adopted the legal form of a pension savings association and two have adopted the legal form of a pension savings company with variable capital.

## 1.3. Development of pension fund assets

At the end of 2016, gross assets of pension funds amounted to EUR 1,512 million against EUR 1,440 million as at 31 December 2015, representing a 5% growth.

The assets of cross-border pension schemes amounted to EUR 463 million as at 31 December 2016.

### Developments of pension fund assets

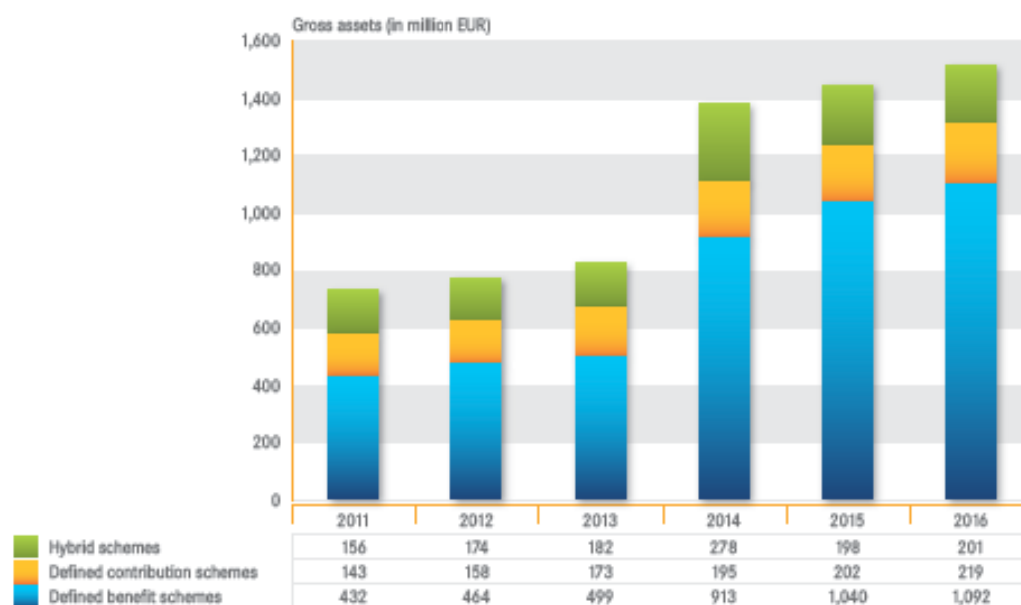


## 1.4. Development of assets according to the type of pension scheme

At the end of 2016, gross assets of the defined benefit schemes amounted to EUR 1,092 million and represented 72.2% of overall gross assets of pension funds. Gross assets of the defined contribution schemes amounted to EUR 219 million and represented 14.5% of overall gross assets of pension funds.

The following table highlights the breakdown of assets between defined benefit schemes, hybrid schemes and defined contribution schemes.

### Development of assets according to the type of pension scheme





### 1.5. Allocation of pension fund assets

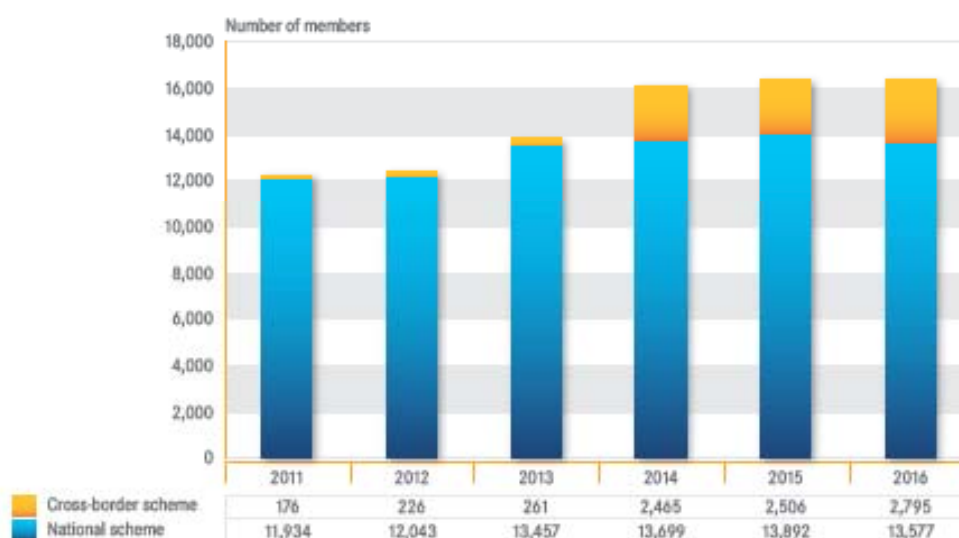
In 2016, pension funds invested primarily in bonds, representing a total of EUR 650 million, i.e. 42.9% of total gross assets of pension funds. Total investment of pension funds in investment funds amounted to EUR 772 million, 46.9% (EUR 362 million) of which were exposed on the equity market and 45.9% (EUR 354 million) on the bond market. The remaining 7.2% (EUR 56 million) were invested in mixed funds, monetary funds and alternative investment funds.

### 1.6. Development in the number of pension fund members

At the end of 2016, the pension funds had 16,372 members against 16,398 as at 31 December 2015.

Analysing the member population of the pension funds supervised by the CSSF confirms the trend towards increasing internationalisation of certain pension funds via schemes offered in multiple host countries. This trend is reflected by an increasing proportion of international members compared to the previous years (2,795 members as at 31 December 2016 compared to 2,506 as at 31 December 2015). Five new cross-border pension schemes were authorised in 2016.

#### Development in the number of pension fund members



## 2. DEVELOPMENT OF LIABILITY MANAGERS IN 2016

In 2016, the number of liability managers of pension funds subject to the Law of 13 July 2005 and approved by the CSSF has increased by one to 18 as at 31 December 2016.



*Agents hired in 2016 and 2017: Departments "International, regulation and enforcement", "UCI on-site inspections" and "Authorisation and supervision of UCITS and pension funds"*

Left to right: Dominique LIMPACH, Anne-Catherine SCHEWE, Sophie MINETTE, François RAGAZZONI, Etienne RAULT, Patrick PEREIRA, Kai NEMEC, Peter WAHLE, Elizabeth MACHADO, Jérôme PHAN



## CHAPTER XII

### SUPERVISION OF SECURITIES MARKETS

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

##### 1.1. Application of the Law of 10 July 2005 on prospectuses for securities (Prospectus Law)

In 2016, only Commission Delegated Regulation (EU) 2016/301 dated 30 November 2015, which entered into force on 25 March 2016, amended the regulations on prospectuses for securities. This delegated regulation supplements Directive 2003/71/EC (Prospectus Directive) with regard to regulatory technical standards for approval and publication of the prospectus as well as the dissemination of advertisements and amends Commission Regulation (EC) No 809/2004 (Prospectus Regulation). Its entry into force led the CSSF to publish Circular CSSF 16/635 amending, among others, the procedure for the submission of documents for approval.

In this context, reference should also be made to the publication of Circular CSSF 16/636 in order to reflect the ESMA Guidelines on Alternative Performance Measures which must be complied with in relation to prospectuses, *inter alia*.

In 2016, the CSSF contributed to the drafting of the new Prospectus Regulation (New Regulation) which will replace the Prospectus Directive. After the adoption by the European Parliament, this regulation should enter into force in 2019. Consulted as an expert during the negotiations on the text within the Council of the EU, the CSSF made many comments on the different articles of the New Regulation in order to take into account the objective sought in the framework of the Capital Markets Union.

The New Regulation should facilitate the access of the issuers to capital markets by simplifying procedures for secondary issuances of issuers whose securities have already been admitted to trading on a market, for small and medium-sized enterprises (SME), for issuers frequently using capital markets and for those carrying out issues of which the denomination per unit exceeds EUR 100,000 or which are exclusively intended for qualified investors.

The reliefs in question affect not only the level of information to be included in the prospectuses, but also the form of the documentation and the approval deadlines.

As regards the approval deadlines in particular, the CSSF, which has always been aware of the fact that undertakings generally need access to the capital markets as fast as possible, constantly makes all the means necessary available to its prospectus reviewers, in order to reduce as much as possible the approval deadlines, whilst maintaining a high level of quality of review.

Thus, it should be noted that, in 2016, the average deadline for dispatching the final comments was 5.29 working days and the average deadline for dealing with a file was about 24 working days.

In this context, the CSSF encourages the issuers whose base prospectuses expire in May, June or July, to introduce their updates as soon as possible, since, in general, the deadlines for responses slightly exceed the average deadlines during this period, whereas they are a little shorter than the average at the beginning of the year.

As regards the questions sent via the address [prospectus.help@cssf.lu](mailto:prospectus.help@cssf.lu) before the actual submission of documents to be approved, the CSSF notes that the number of requests for an advice was quite high once again with 115 requests dealt with in 2016. Most of these requests concerned questions on alternative performance measures, financial statements regarding the issuer or the guarantor or even submission of final terms.

The CSSF appreciates such initiatives because these questions, dealt with and discussed before the submission of the files, often saved substantial time during the instruction of the files concerned. Moreover, as some of these requests for an advice concerned the fees for the submission of final terms, the CSSF reminds that the regulation in force does not provide for such a fee.

In 2016, in accordance with Article 23(4) of the Prospectus Regulation, the CSSF approved two prospectuses, each with an omission of information due to non-pertinence.

Finally, the CSSF received and accepted four requests for omission of information pursuant to Article 10 of the Prospectus Law.

### 1.2. Approvals and notifications in 2016

#### 1.2.1. Documents approved by the CSSF in 2016

The number of documents approved by the CSSF marginally decreased compared to 2015, with a total of 1,560 documents approved in 2016 (of which 343 prospectuses, 309 base prospectuses, six registration documents and 902 supplements) against 1,569 in the previous year (-0.57%). The number of base prospectuses approved in 2016 remained stable compared to the preceding year, whereas the number of approved prospectuses declined by 7.55%. However, there has been a 2.97% rise in the number of approved supplements.

#### 1.2.2. Documents drawn up under the European passport regime in 2016

In 2016, the CSSF received 1,296 notifications (relating to 254 prospectuses and base prospectuses and to 1,042 supplements) from the competent authorities of several EEA Member States, against 1,241 notifications (relating to 286 prospectuses and base prospectuses and to 955 supplements) in 2015 (+4.43%). Thus, the number of notifications from EEA Member States slightly increased between 2015 and 2016.

In 2016, the CSSF sent notifications for 892 CSSF-approved documents (283 prospectuses and base prospectuses and 609 supplements) to the competent authorities of EEA Member States, i.e. the same number but a somewhat different distribution than in 2015: 291 prospectuses and base prospectuses and 601 supplements.



### 1.2.3. ESMA statistics

The last statistics released in 2016 by ESMA refer to the year 2015 and show that Luxembourg still comes first with respect to the number of approved documents by the competent authorities of the EEA Member States. The CSSF approved 18% of the approved documents in the EEA, i.e. 684 prospectuses and base prospectuses.

### 1.2.4. Approvals

In 2016, the development of the activity did not follow a clear trend with some months recording significant rises and others recording significant decreases compared to 2015. Overall, the CSSF notes that until June and, in particular, until 23 June (Brexit), the activity progressed compared to the same period of the previous year; then it sharply fell over the following four months and stabilised towards the end of the year.

It should be pointed out in this context that the CSSF may rely year-on-year on a solid basis of about 300 issuers which submit their base prospectuses for approval, whether these documents are new or updated.

As regards prospectus approvals, 97 of them were approved in the framework of issues of asset-backed securities. This number is relatively stable compared to the preceding year during which the CSSF approved 93 files of this category.

This year again, the CSSF observed great diversity in the geographical origin of the issuers, whether in relation to prospectuses or base prospectuses. The top three geographical origins are composed of issuers from Germany (15.83%), Luxembourg (14.46%) and the United Kingdom (11.32%). As far as the other issuers are concerned, 38.61% come from EEA Member States other than the above-mentioned ones and 19.78% come from third countries.

With respect to Luxembourg issuers, the CSSF approved 238 files relating to Luxembourg issuers, among which 55 prospectuses, 51 base prospectuses, one registration document and 131 supplements.

## 2. TAKEOVER BIDS

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

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

On 8 June 2016, CPI Property Group S.A. acting on behalf of its wholly-owned subsidiary Nukasso Holdings Limited (hereinafter Nukasso) announced the launch of a mandatory takeover bid on the shares of the company Orco Property Group S.A. (hereinafter OPG) as the control threshold had been exceeded. OPG has its registered office in Luxembourg and its shares are admitted to trading on the regulated markets Luxembourg Stock Exchange (since autumn 2015) and Warsaw Stock Exchange. According to CPI Property Group S.A., the obligation to launch a mandatory takeover bid on the shares of OPG by Nukasso and the persons acting in concert with the latter (hereinafter Offerors) arose in 2016 due to direct and indirect acquisitions of OPG shares carried out by Nukasso on 8 June 2016 when Nukasso acquired the whole share capital of the three companies Aspley Ventures Limited, Fetumar Development Limited and Jagapa Limited (holding each 30.4% of OPG shares) and when Nukasso directly acquired about 6% of OPG shares. In total, Nukasso acquired over



95% of OPG shares on 8 June 2016 and exceeded the control threshold set in Article 5(3) of the Law on Takeover Bids for the companies having their registered office in Luxembourg at 33 1/3% of the voting rights of the company concerned.

Since OPG has its registered office in Luxembourg and since its shares are admitted to trading on the regulated market Luxembourg Stock Exchange, the CSSF is the competent authority under the Law on Takeover Bids for the supervision of the bid, including the control of the price of the mandatory takeover bid which, pursuant to Article 5(1) of the Law on Takeover Bids, must be equitable.

On 1 August 2016, the CSSF asked the Offerors to submit proposals for the appointment of an independent expert for the determination of an equitable price of the mandatory takeover bid in question. On 22 September 2016, Mr Grégoire Huret from Pricewaterhouse Coopers société coopérative was appointed as independent expert by the CSSF upon proposal by the Offerors.

The file has not been finalised in 2016; for the follow-up, reference is made to CSSF communications on its website.

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

On 15 September 2016, the Luxembourg company Marsella Holdings S.à r.l. (hereinafter Offeror), a wholly-owned subsidiary of the American company Standard Industries Inc. (hereinafter Standard Industries), announced the launch of a voluntary takeover bid on the shares of the company Braas Monier Building Group S.A. (hereinafter Braas Monier), a company with registered office in Luxembourg. The shares of Braas Monier are admitted to trading on the regulated market Frankfurt Stock Exchange. The CSSF cooperated with the competent authority of Germany, BaFin, with respect to the review of the offer document which was published on 14 October 2016 by the Offeror after being approved by BaFin.

On 28 October 2016, the Board of Directors of Braas Monier published a reasoned opinion on the bid of Standard Industries in which it recommended to the shareholders not to accept this offer for reasons relating, in particular, to the price. On 29 November 2016, the Board of Directors of Braas Monier announced its intention to increase the share capital of Braas Monier by 10% by incorporation of reserves and to distribute an interim dividend of EUR 0.57 per share. By way of amendment to the offer document on 20 December 2016, the Offeror decided to increase its offer with an extension of the acceptance period of the takeover bid until 6 January 2017 in accordance with the applicable German law. On 30 January 2017, Standard Industries and the Offeror announced that, at the end of the (additional) acceptance period according to the applicable German law, the voluntary takeover bid was accepted for a total of 38,853,708 shares (equalling over 90% of the share capital and voting rights attached to the shares of Braas Monier), including the shares held by certain parties acting in concert with the Offeror at the time of the voluntary takeover bid announcement.

According to the offer document, the voluntary takeover bid of Standard Industries on the shares of Braas Monier is subject to the condition that the competent competition authorities approve the transaction referred to in the offer document by 14 October 2017 at the latest (hereinafter Regulatory Condition). At the time of the announcement of the results of the voluntary takeover bid at the end of the (additional) acceptance period according to the applicable German law, the Regulatory Condition has not yet been realised. As long as the Regulatory Condition is not fulfilled, the shareholders have the right to withdraw their acceptance of the offer (hereinafter Right of Withdrawal) pursuant to the offer document. The CSSF considered that due to the Right of Withdrawal, one should await the realisation of the Regulatory Condition before determining whether the conditions for a possible mandatory squeeze-out or sell-out under Articles 15 and/or 16 of the Law on Takeover Bids are met. By extension, the CSSF considered that, in this case, due to the Right of Withdrawal, the deadline of three months provided for in Article 15(4) of the Law on Takeover Bids for the exercise of a mandatory squeeze-out or sell-out must be interpreted as starting from the moment when the Regulatory Condition is realised rather than from the end of the period laid down in the applicable German law on the acceptance of the offer.

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

In the cases and under the conditions laid down in the Law on Takeover Bids, the CSSF may grant derogations from certain provisions restrictively listed in the Law on Takeover Bids in particular circumstances and by way of a specifically reasoned decision. The possibility to request derogations exists, in particular, for Article 5(1) of the Law on Takeover Bids which lays down the obligation to launch a mandatory takeover bid in case of excess of the control threshold set at 33 1/3% of the voting rights of the company in Article 5(3) of the Law on Takeover Bids with respect to companies having their registered office in Luxembourg.

During 2016, one derogation request was submitted to the CSSF. The request concerned the issuer KSG Agro S.A., a company with registered office in Luxembourg and whose securities are admitted to trading on the regulated market Warsaw Stock Exchange. In this case, the derogation was granted by the CSSF.

### 2.4. Offer file not falling under the scope of the Law on Takeover Bids

On 6 July 2016, the company Quilvest announced its intention to make a limited and conditional buyback offer concerning a certain amount of shares (hereinafter Buyback Offer) and to launch a process aiming to withdraw all its shares from trading on the regulated market and from the official listing on the Luxembourg Stock Exchange. The Buyback Offer started on 6 July 2016 and closed on 29 July 2016, whereas the last day of trading of the Quilvest shares on the Luxembourg Stock Exchange was on 26 August 2016.

The Buyback Offer was carried out outside the scope of the Law on Takeover Bids. Nevertheless, the CSSF reviewed the documentation and monitored the Buyback Offer process and the above-mentioned withdrawal in its capacity as competent authority under Luxembourg law, particularly, pursuant to the Law of 23 December 1998 establishing a financial sector supervisory commission (Commission de Surveillance du Secteur Financier) and the regulations on markets in financial instruments, transparency requirements for issuers and market abuse.

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

### 3.1. Procedures monitored by the CSSF under the Law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public (Squeeze-Out/Sell-Out Law)

As the competent authority under the Squeeze-Out/Sell-Out Law, the CSSF monitors the mandatory squeeze-out and sell-out procedures which derive from this law. The CSSF also receives majority shareholder notifications as laid down in Article 3 of the Squeeze-Out/Sell-Out Law and publishes a list of companies for which it received such notifications on its website.

In 2016, the CSSF decided on a fair price in two mandatory squeeze-out procedures under the Squeeze-Out/Sell-Out Law with respect to the shares of Metro International S.A. and the shares of Colt Group S.A. These two procedures were initiated in 2015 and were finalised at the beginning of 2016<sup>1</sup>.

### 3.2. Clarification on the coordination of the Squeeze-Out/Sell-Out Law with the Law on Takeover Bids

The CSSF dealt with requests from minority shareholders of a Luxembourg company which was previously subject to a takeover bid in another Member State where its shares were admitted to trading on a regulated market. This takeover bid, which took place in accordance with Directive 2004/25/EC of 21 April 2014 on takeover bids (Takeover Directive) as transposed in the Member State concerned, was followed by a mandatory sell-out in Luxembourg pursuant to Articles 15 and 16 of the Law on Takeover Bids. Following this mandatory sell-out procedure under the Law on Takeover Bids, some minority shareholders contemplated to exercise their

<sup>1</sup> Cf. CSSF Annual Report 2015 (pp. 200-201).

right of sell-out under the Squeeze-Out/Sell-Out Law. After analysis, the CSSF considered that by laying down in Article 2(3) of the Squeeze-Out/Sell-Out Law that the Squeeze-Out/Sell-Out Law does not apply as long as the takeover bid and other procedures under the Takeover Directive are in progress and until six months after the end of these procedures (or expiry of the deadline for carrying them out) (hereinafter Suspension Period), the intention of the Luxembourg legislator was to clearly separate the mandatory sell-out rights set out in the Law on Takeover Bids and in the Squeeze-Out/Sell-Out Law, respectively. Therefore, a person who could have requested the mandatory sell-out of his/her/its securities under the Law on Takeover Bids but who did not do so, cannot request the mandatory sell-out of his/her/its securities under the Squeeze-Out/Sell-Out Law after expiry of the Suspension Period if the conditions laid down by the Squeeze-Out/Sell-Out Law for exercising the right of mandatory sell-out are not fulfilled, since the Squeeze-Out/Sell-Out Law requires, in particular, the acquisition or holding of additional securities of the company concerned by the majority shareholder within the meaning of this law.

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

### 4.1. Issuers subject to supervision

Pursuant to the Law of 11 January 2008 on transparency requirements for issuers (Transparency Law), the CSSF is in charge of the supervision of issuers falling within the scope of this law. As at 20 March 2017, 668 issuers were subject to the supervision of the CSSF as Luxembourg was their home Member State within the meaning of this law. This number greatly increased compared to March 2016, notably due to the fact that, since 31 August 2016, Luxembourg has been imposed as home Member State by default on issuers which omitted to disclose their home Member State in accordance with Article 1(1)(9) of the Transparency Law.

Overall, during 2016, Luxembourg was confirmed as the home Member State of 166 issuers, whereas 80 issuers no longer fall within the scope of the Transparency Law. The list of issuers supervised by the CSSF as well as the issuers on which the home Member State has been imposed is available on the CSSF's website (Supervision > Securities markets > Transparency > Information on the population of issuers).

Out of the 668 issuers supervised by the CSSF, 187 are Luxembourg issuers, of which 44 issuers of shares and three issuers whose shares are represented by depositary receipts in respect of shares admitted to trading on a regulated market. Among these Luxembourg issuers, 13 are banks, 11 are securitisation undertakings authorised pursuant to the Law of 22 March 2004 on securitisation and three are UCIs.

216 issuers have their registered office in another EEA Member State and 265 issuers are established in a third country (outside the EEA).

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

### 4.2. Reviews in relation to the Transparency legislation

#### 4.2.1. Periodic information

The review of the periodic information to be drawn up by issuers of securities of which Luxembourg is the home Member State pursuant to the Transparency Law continued during the 2016 review campaign. The CSSF sent 18 reminders, issued 16 injunctions and imposed 10 administrative fines pursuant to Article 25 of the Transparency Law related to annual and half-yearly financial reports. The work carried out shows that, overall, the issuers were aware of their obligations in relation to the Transparency legislation and maintained their level of compliance in this regard.

The CSSF published the names of the Luxembourg issuers subject to the Transparency Law which failed to publish their annual and half-yearly financial reports as required by Articles 3 and 4 of the Transparency Law. In accordance with Article 26b of the Transparency Law, the administrative sanctions imposed under



Article 25 of this law are also being published since the entry into force of the Law of 10 May 2016 amending the Transparency Law. This information is available on the CSSF's website (Supervision > Securities markets > Transparency > Information on the population of issuers).

#### 4.2.2. Ongoing information

In 2016, the CSSF continued its reviews of notifications relating to the acquisition or disposal of major holdings. In total, the CSSF received about 200 notifications relating to major holdings. The review of these notifications led the CSSF to issue 16 warnings and one injunction.

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

## 5. ENFORCEMENT OF FINANCIAL INFORMATION

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

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

### 5.1. General framework of consistent enforcement of accounting standards

#### 5.1.1. Legal and regulatory framework

##### • Transparency Law

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

The powers and penalties available to the CSSF as regards enforcement are set out in Articles 22, 25 and 26 of the Transparency Law.

##### • ESMA Guidelines on enforcement of financial information

The CSSF complies with the ESMA Guidelines on enforcement of financial information since their entry into force on 29 December 2014. These guidelines are based on principles that describe, among others, the selection techniques to be followed, the types of enforcement decisions and actions that enforcers may use and explain how enforcement activities are coordinated within ESMA. These guidelines are available on the CSSF's website (Supervision > Securities markets > Enforcement of financial information)<sup>2</sup>.

#### 5.1.2. Population of issuers subject to enforcement

Under the Transparency Law and taking into account the exemptions provided for in Article 7 of this law, the population of issuers falling within the scope of enforcement as at 1 January 2016 amounted to 224 entities (2015: 218 entities).

The characteristics of these issuers (registered office, types of securities issued and accounting standards used) are available on the CSSF's website (Supervision > Securities markets > Enforcement of financial information > Statistics)<sup>3</sup>.

<sup>2</sup> <http://www.cssf.lu/en/supervision/securities-markets/enforcement/esma-guidelines/>.

<sup>3</sup> <http://www.cssf.lu/en/supervision/securities-markets/enforcement/statistics/>.

### 5.1.3. European cooperation

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

### 5.2. Enforcement process

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

#### 5.2.1. Selection method

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

#### 5.2.2. Types of examination

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

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

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

#### 5.2.3. Types of decisions

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

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



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

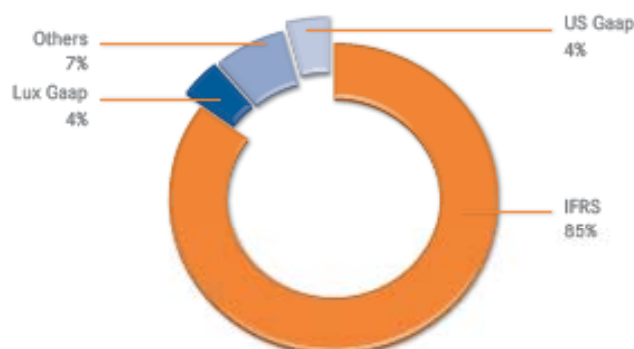
## 5.3. Activities and results in 2016

### 5.3.1. Summary of the enforcement activities in 2016

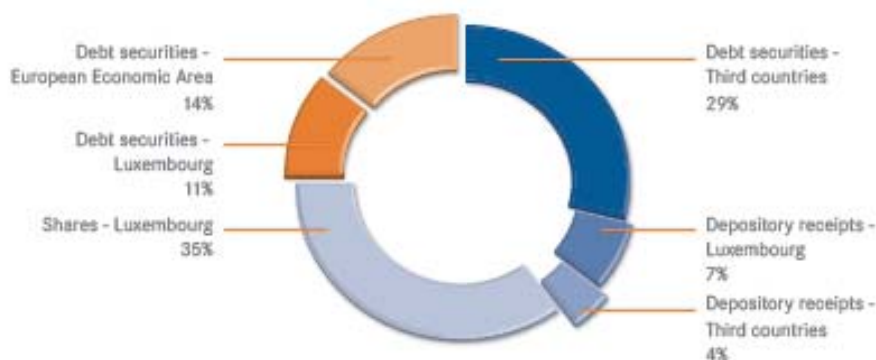
#### • Unlimited scope examinations

During the 2016 enforcement campaign, the unlimited scope examinations carried out by the CSSF covered 16% of the issuers falling within the scope of enforcement (compared to 16% in 2015 and 15% in 2014). As the tables below show, the unlimited scope examinations applied to different categories of issuers and accounting standards, covering a representative sample of the population of issuers supervised by the CSSF.

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



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



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

During the 2016 enforcement campaign, the CSSF notified on average 6.2 misstatements/irregularities per issuer (compared to 4.2 in 2015).

**Breakdown by topic of notifications issued to issuers by the CSSF following the unlimited scope examinations carried out in 2015 and 2016**

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

• **Focussed scope examinations**

Several focussed scope examinations were carried out on different samples of issuers during the 2016 campaign. During these examinations, the CSSF particularly ensured that these issuers comply with the main requirements set forth by:

- IAS 34, "Interim financial reporting", ensuring that the main presentation and disclosure requirements have been properly addressed in the notes to the half-yearly financial statements;
- IAS 7, "Statement of cash flows"; or
- ESMA Guidelines on Alternative Performance Measures.

• **Follow-up examinations**

Issuers subject to an examination during the 2015 campaign, and whom the CSSF requested to modify or improve the 2015 financial statements concerned, were subject to a follow-up examination in order to ensure compliance with the decisions taken by the CSSF.

Administrative sanctions were imposed on two issuers which did not comply with the injunctions and measures required by the CSSF. Except for these two cases, all the decisions taken by the CSSF were respected by the issuers.

• **Examination within the context of the issue of prospectuses**

As in the previous years, in 2016, enforcement examinations were carried out within the context of the prospectus approval process, and, in particular, in the event of an application for the admission to trading on a regulated market. Besides the aspects directly related to accounting standards, the topics covered concerned, notably, the preparation of consolidated financial statements, certain issues regarding the valuation of financial assets as well as compliance with the ESMA Guidelines on Alternative Performance Measures following their entry into force in the second half of 2016.

### 5.3.2. Main observations and recommendations issued in 2016

The findings and recommendations described below provide an indication of the CSSF's main observations in 2016. Although this information could be useful for the issuers and their auditors, it consists, however, of specific questions which do not directly apply to all issuers and must, therefore, be considered in view of their relevance and materiality. In particular, these observations must not be considered as interpretations of the international accounting standards for which only the IASB and its interpretation committee, the IFRS IC, are competent.

## • Presentation of financial statements and general and specific disclosures in accompanying notes

Given the significant number of decisions which are related to the quality of the disclosures and the presentation of financial statements, the CSSF draws, once more, to the attention of issuers that they must ensure the disclosures are relevant, coherent and readable and that compliance with the standards does not only depend on the volume of data but also on the quality of the disclosures.

Considering all the disclosures required by IFRS standards, the materiality and specificities of the information provided in the financial statements should be taken into account in order to favour the relevance of the information to be disclosed against an essentially quantitative approach aiming at including all requirements and descriptions presented in the standards. Indeed, this approach does not, or only marginally, allow the identification of material issues and topics of issuers for the use of financial statements.

Thus, the CSSF requests issuers to ensure that the information presented in their financial statements is relevant, adapted to their market and activities and that it allows the users to understand the financial situation, the performance and the significant issues of the entity.

Finally, during the focussed scope examinations concerning the half-yearly financial statements drawn up in accordance with IAS 34, the CSSF noted that, as in the past, qualitative as well as quantitative information on the fair value of financial instruments was still incomplete for a great number of examined half-yearly financial statements. The CSSF observed again misstatements concerning the presentation of comparative information. Therefore, the CSSF reminds that the comparative periods to be presented in the interim financial statements are clearly defined by paragraph 20 of IAS 34. Issuers concerned are requested to comply with these requirements.

## • Impairment of assets and disclosure of detailed quantitative and qualitative information about the impairment tests

This year again, the CSSF thoroughly examined the impairment tests carried out on intangible and tangible assets by issuers. Thus, the CSSF noted that significant information relating to estimates and data used to measure the recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives were not always disclosed. Indeed, it is important to remember that, for each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant, in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, IAS 36 requires quantitative and qualitative information to be disclosed in the notes to the financial statements. Paragraph 134 of IAS 36 requires, among others, to provide information as to the basis on which the unit's recoverable amount has been determined (i.e. value in use or fair value less costs of disposal) and, if the unit's recoverable amount is based on the value in use, the discount rate applied, a description of each of the key assumptions on which the management has based the cash flow projections for the period covered by the most recent budgets/forecasts as well as the key assumptions to which the unit's recoverable amount is the most sensitive. The period over which the management has projected cash flows and the key assumptions must be justified (past experience, external sources or other reasons). Furthermore, IAS 36 requires the disclosure of information and justifications on the growth rate used to extrapolate the cash flow projections beyond the period covered by the most recent budgets/forecasts and on the discount rate applied.

Finally, the CSSF draws the attention of the issuers to the sensitivity analysis required by paragraph 134(f) of IAS 36. This analysis must be disclosed in the financial statements if a reasonably possible change in a key assumption on which the management has based its determination of the unit's recoverable amount would cause the unit's carrying amount to exceed its recoverable amount.

## • Fair value measurement: disclosure of information on the methods for fair value measurement and assumptions retained

During the review campaign, the CSSF reviewed the quality and relevance of the fair value measurement and the related information disclosed in the issuers' financial statements. As regards the information on fair value

measurement to be provided, the CSSF considers that this information is often essential for users of financial statements in order to be able to assess the accuracy of the valuations presented in the financial statements.

The CSSF reminds that IFRS 13 "Fair Value Measurement" requires from issuers to provide detailed information on the fair value measurement, the methods chosen and the relevant assumptions. In some cases, sensitivity analyses of fair values to the possible change of some assumptions are also required, allowing the users of financial instruments to better apprehend the impact of these fair values on the issuer's financial situation.

Moreover, as required by IFRS 13, the CSSF ensured, while performing its examinations, that the entities concerned also reflected the effect of non-performance risk in the measurement of a liability's fair value. Non-performance risk includes, but may not be limited to, an entity's own credit risk (defined in IFRS 7 "Financial instruments: Disclosures"). Considering the fair value measurement of financial derivatives and in addition to taking into account non-performance risk for derivative financial liabilities (Debit Value Adjustment, DVA), the CSSF ensured that entities included in the fair value measurement of derivative financial assets (Credit Value Adjustment, CVA) the effect of the entity's net exposure to the credit risk to any counterparties. In this context, the CSSF recommends issuers to provide in their financial statements qualitative and quantitative information in relation to the fair value adjustments referred to above, if such adjustments are deemed material.

### • Alternative performance measures

Alternative performance measures are financial measures that are not defined by the applicable financial reporting framework (examples: EBITDA, free cash flow, etc.). They are used by issuers in their financial information in order to provide additional clarifications on the performance measure.

In 2016, during the focussed scope examinations, the CSSF noted some irregularities related to compliance with the ESMA Guidelines on Alternative Performance Measures in the issuers' annual or half-yearly reports. In particular, the CSSF found a lack of information concerning the definitions of the measures used and their reconciliation to one/several item(s) of the financial statements, and a lack of justifications put forward for the use of alternative performance measures.

In this context, the CSSF published, on 22 December 2016, Press release 16/46 concerning the compliance of the issuers with the ESMA Guidelines on Alternative Performance Measures<sup>4</sup>.

## 5.4. Prospects for the 2017 campaign

The enforcement campaign for the financial year 2017 will follow an approach similar to the one of the preceding financial year. The selected issuers will be subject to unlimited and focussed scope examinations. In addition, within the context of the 2016 closing of accounts, the CSSF announced in Press release 17/03, published on 16 January 2017, a certain number of topics and issues which will be specifically monitored during the 2017 campaign of enforcement examination of issuers preparing their financial statements in accordance with the IFRS<sup>5</sup>.

## 6. SUPERVISION OF MARKETS AND MARKET OPERATORS

### 6.1. Reporting of transactions in financial instruments

#### 6.1.1. Obligation to report transactions in financial instruments

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

<sup>4</sup> <http://www.cssf.lu/en/supervision/securities-markets/enforcement/>.

<sup>5</sup> <http://www.cssf.lu/en/supervision/securities-markets/enforcement/>.



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

As at 31 December 2016, 243 entities (credit institutions and investment firms incorporated under Luxembourg law and Luxembourg branches of credit institutions and investment firms incorporated under foreign law) fell within the scope of Article 28 of the MiFID Law and were potentially concerned by the transaction reporting regime (244 entities in 2015), including 141 credit institutions (143 in 2015) and 102 investment firms (101 in 2015). Among the investment firms, only those authorised to carry out transactions in financial instruments, i.e. commission agents, private portfolio managers, professionals acting for their own account, market makers, underwriters of financial instruments and distributors of units/shares of UCIs, are subject to the reporting obligation.

As at 31 December 2016, 88 entities (90 in 2015), of which 77 credit institutions (80 in 2015) and 11 investment firms (10 in 2015), were required to send their transaction reports to the CSSF as their interventions are considered as "executions of transactions" within the meaning of the MiFID Law, as specified by Circular CSSF 07/302. The difference compared to the number of entities that are potentially concerned by the reporting regime results from the fact that, in practice, a certain number of entities, mainly investment firms, are not subject to the obligation to report transactions in financial instruments because they do not conclude immediate market facing transactions and do not execute transactions on own account.

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

In 2016, the number of transaction reports sent by the entities and accepted by the CSSF reached 672,524 (-13.20% compared to 2015).

#### Monthly breakdown of transactions by type of instrument in 2016

	Bonds	Shares	Futures	Options	Rights	Others	Monthly total
CFI Code	(Dxxxxx)	(Exxxxx)	(Fxxxxx)	(Oxxxxx)	(Rxxxxx)	(Mxxxxx)	
January	23,174	27,353	8,813	5,142	624	770	65,676
February	28,409	16,075	8,967	7,274	523	309	71,377
March	29,230	21,432	6,806	4,713	771	286	61,557
April	28,014	16,369	4,415	4,298	487	711	87,636
May	31,811	14,719	9,988	2,515	725	203	63,038
June	24,320	14,146	2,493	2,366	948	861	68,145
July	32,131	14,685	12,854	4,027	448	217	54,294
August	29,413	20,672	8,424	6,786	703	281	59,961
September	29,343	15,465	7,503	3,697	347	392	45,134
October	26,335	15,041	3,770	2,908	436	343	64,362
November	23,284	19,652	9,499	4,030	297	860	66,279
December	23,681	14,674	2,478	2,394	114	208	56,747
Annual total	314,759	234,911	63,334	47,713	6,116	5,691	672,524

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



## 7. INVESTIGATIONS AND COOPERATION

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

In the context of its supervision of securities markets, the CSSF either initiates inquiries itself or conducts them following a request for assistance from a foreign administrative authority within the framework of international cooperation.

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

### 7.1. Investigations initiated by the CSSF

In 2016, the CSSF opened one investigation into market manipulation. This investigation is still on-going as are eight other investigations into insider dealing and/or market manipulation which were opened previously and of which two are being finalised. One investigation was closed following administrative fines imposed by the CSSF for market manipulation (cf. Press release 17 / 10 of 1 March 2017).

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

In 2016, the CSSF received 74 cooperation requests from foreign authorities (70 in 2015) in relation to the following subjects<sup>6</sup>.

#### Cooperation requests by subject

Subject		2015	2016
Market abuse	Insider dealing	55	40
	Manipulation	8	23
MiFID (markets in financial instruments)		4	4
Takeover bids		2	2
Transparency		4	4
Others		5	8

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

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

### 7.3. Suspicious transaction and order reports

Based on Article 12 of the Law of 9 May 2006 on market abuse and, since 3 July 2016, based on Article 16 of Regulation (EU) No 596/2014 of 16 April 2014 on market abuse (MAR), the CSSF received 28 suspicious transaction reports in 2016 (20 in 2015), among which 22 suspicious transaction and order reports under MAR.

For underlying financial instruments admitted to trading on one or several foreign trading venues, the CSSF transmitted the reports received to the competent authorities of the trading venues concerned, in accordance with the cooperation obligations provided for by the regulations on market abuse and the relevant multilateral cooperation agreements. These reports can lead these authorities to open investigations.

In 2016, the CSSF also received 25 reports transmitted by foreign authorities (six in 2015).

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

<sup>6</sup> Please note that a request may concern one or several of these subjects.

## 8. INDICES USED AS BENCHMARKS

The benchmarks play an important role in capital markets and they also determine the interest rate of consumer loans and mortgage loans for many consumers.

Lack of reliability in the integrity of the indices used as benchmarks may have a negative impact on confidence in the markets and may, thus, lead to losses for consumers and investors as well as to distortions of the real economy.

Manipulation of some interest rates benchmarks and foreign exchange benchmarks revealed significant deficiencies in the current regulations. These deficiencies led the European Commission to propose a strong regulatory framework guaranteeing the accuracy and integrity of the benchmarks in order to make them reliable and to avoid that they become subject to conflicts of interest or manipulations. This proposal resulted in the publication of Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

This regulation imposes new requirements on three types of market participants, namely on entities which provide interest rate benchmarks, foreign exchange benchmarks, securities benchmarks, commodity benchmarks and other benchmarks or reference prices (administrators), on entities providing input data required for the provision of a benchmark (contributors) as well as on supervised entities using them (users).

In this context, it is important to know that:

- Benchmark administrators will have to be authorised or registered. They will be subject to supervision with respect to governance and conflicts of interest, the oversight function, the control framework, the accountability framework as well as the record keeping.
- The contributors to benchmarks will henceforth be obliged, among others, to adhere to a code of conduct specifying clearly their responsibilities.
- The users which are supervised entities will no longer be permitted to use a benchmark unless it is provided by an administrator authorised or registered in the EU or, where the benchmark is provided by an entity established outside the EU, by an administrator recognised or whose application to endorse a benchmark in accordance with the provisions of the above-mentioned regulation was authorised.

The regulation in its entirety will be applicable as from 1 January 2018, whereas some provisions, relating to critical benchmarks for example, have already been applicable since 30 June 2016.

In this context, the European Commission has already designated EURIBOR as being the first critical benchmark pursuant to the regulation.

In Luxembourg, a draft law which will soon be subject to approval by the Council of the Government, lays down that the CSSF will be designated as the competent authority responsible for carrying out the duties under Regulation (EU) 2016/1011. Thus, the CSSF is currently implementing a structure which will allow fulfilling its obligations and duties under the regulation. Moreover, in 2016, it actively contributed to the preparation of level 2 measures within ESMA's groups.

It should also be noted that the CSSF is represented in the EURIBOR College in its capacity as the authority supervising Banque et Caisse d'Épargne de l'État (BCEE), being contributor to EURIBOR.

Any questions in relation to the benchmark regulation may be submitted to the CSSF at the address [benchmark@cssf.lu](mailto:benchmark@cssf.lu).





## CHAPTER XIII

### SUPERVISION OF INFORMATION SYSTEMS

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

#### 1. ACTIVITIES IN 2016

##### 1.1. Major events

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

The CSSF's analysis shows that the main risk arising from a cloud computing solution is a potential lack of control of the cloud computing solution by the financial institutions wishing to use it. Due to the complexity of the cloud computing infrastructures, this risk may notably lead to an inappropriate configuration of the IT resources (and thus introduce security flaws), an inappropriate business continuity management and a control environment which is only partially compliant with the financial sector requirements.

Another consideration emerging from the CSSF's analysis is the breach with certain traditional IT outsourcing governance principles. The standardisation of cloud computing solutions changes the way to address the control environment: the latter can no longer be imposed on the service provider, as this would imply that the service provider would have to meet as many (even contradictory) requirements as clients. In this new context, the financial institution is supposed to analyse the control environment offered by the service provider to ensure that it meets its needs or, should this not be the case, to desist from the envisaged outsourcing.

In general, the identified risks have shown that outsourcing on a cloud computing infrastructure requires particular attention, as it differs from traditional IT outsourcing. An evolution of the regulatory framework and the awareness, by the service providers offering cloud computing solutions, of the specificities of the financial sector are thus necessary to take into account these particularities. The CSSF is drafting a circular clarifying the regulatory framework applicable to IT outsourcing relying on a cloud computing infrastructure.

### 1.2. National cooperation: working groups and conferences

In 2016, the CSSF participated in the committees, commissions, associations or working groups notably dealing with the following topics:

- security and evolution of means of payment, through its participation in the Commission de Paiement of the ABBL and ALMUS (Association Luxembourgeoise des Membres et Utilisateurs SWIFT);
- the new technologies used to deliver financial services (FinTech), through its participation in Luxembourg for Finance/FinTech.

The conferences and events on new technologies or new IT service provision offers represent interesting information and exchange platforms in order to stay abreast of the evolution of new technologies. In this respect, the CSSF participated in many events organised in Luxembourg on topics such as mobile payments, cybersecurity, robo advisors or blockchain.

### 1.3. International collaboration with other authorities

As technology is rapidly and constantly changing, bringing about new forms of financial services (mobile, contactless payments) or more complex operational models (mutualisation of equipment), which are exposed to new threats (e.g. cyberattacks), it is in the interest of any supervisory authority to take part in working groups to discuss these various subjects with its peers and benefit from each other's experience.

This is the reason for the CSSF's long-lasting membership in the ITSG (IT Supervisors Group), an international working group, composed of IT supervisors of different European, Asian, American and African countries.

In 2016, the annual meeting was held in Miami under the aegis of the three US financial sector authorities, i.e. the Federal Reserve Bank, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. Discussions concerned three major themes: (1) FinTech and innovation (notably blockchain, the regulators' approach and the new payment solutions), (2) cybersecurity (the regulators' approach on pentests and ethical hacking, the new vulnerabilities and attacks observed), and (3) outsourcing (notably public clouds). The exchange of views also allowed sharing information on the development of risk, regulation and supervisory practices.

In 2016, the CSSF also actively participated in the following working groups in charge of analysing issues relating to IT supervision within the European institutions:

- European Forum on the Security of Retail Payments (SecuRe Pay forum), co-chaired by the EBA and the ECB. The SecuRe Pay forum is composed of national EU/EEA supervisory authorities and central banks. The work of this forum focusses on the security of electronic payment instruments, services and schemes available in the EU/EEA Member States. Its aim is to facilitate common knowledge and understanding between the authorities of the challenges in this matter and to enhance their cooperation. It can submit its analyses and recommendations to the ECB and the EBA which adopt them, where appropriate, in the form of an oversight framework, guidelines or technical standards.
- Task Force on IT Risk Supervision (TFIT): the Standing Committee on Oversight and Practices (SCOP), which assists and advises the EBA with regard to the permanent risk assessment in the banking sector, the promotion of cooperation between authorities and the enhanced convergence of supervisory practices, created this new task force on IT risk supervision in June 2015, reflecting thus the growing importance of IT and of the ensuing operational risks for the financial sector.
- the Drafting Team on IT Risk Methodology (DTIT): in the framework of the Single Supervisory Mechanism (SSM) of the ECB, the DTIT was created at the end of 2015 comprising the members of the SSM's on-site inspection teams, with the purpose of reviewing the IT-related part of the existing methodology based on the feedback received and adapting it to address emerging IT risks.

In 2016, the three working groups mainly focussed on the following topics.



### 1.3.1 Security of retail payments (PSD2)

Published in December 2015, the revised Payment Services Directive (PSD2) entrusts the EBA, in close cooperation with the ECB, with the drafting of guidelines and technical standards on the security of retail payments. Under the aegis of these two European institutions, the SecuRe Pay forum dedicated the year 2016 to the preparation of the below regulatory texts.

#### • Regulatory Technical Standards (RTS) on authentication and communication

Upon a twofold market consultation (via the publication of a discussion paper at the beginning of 2016 and of draft technical standards in the summer of 2016), the EBA published the final version of these technical standards in February 2017, after having taken into consideration the largest number of market replies ever received for this type of consultation. The standards will enter into force 18 months after their adoption by the European Commission, i.e. at the end of 2018 at the earliest.

These standards define:

- the requirements which a strong customer authentication procedure must fulfil in order to be considered as such and to allow compliance with Article 97 of PSD2, as well as the authorised exemptions from these requirements according to the risk level associated with the action performed;
- the requirements aiming to protect confidentiality and integrity of the payment service users' personalised security credentials;
- the requirements for standards of communication between all the participants in a payment service (providers or users), notably between account servicing payment service providers and two new types of payment service providers from now on subject to PSD2, i.e. account information service providers and payment initiation service providers.

One of the main challenges in drafting these standards was to define balanced requirements which guarantee both an appropriate security level that does not inhibit the development of innovative and user-friendly means of payment, and fair competition between all payment service providers.

#### • Guidelines on the management of operational and security risks

In autumn 2016, the SecuRe Pay forum started working on Article 95-3 of PSD2, i.e. drawing-up the guidelines for establishing, implementing and monitoring the measures taken by payment service providers in order to manage operational and security risks associated with the services they provide. Considering the workload for finalising the authentication and communication standards, the EBA's deadline to publish these guidelines was extended. Market consultation on a draft text is planned for the summer of 2017. The final text is scheduled for publication by the end of 2017 at the latest.

#### • Guidelines on the information to be provided by applicants intending to obtain authorisation as payment and electronic money institutions as well as to register as account information service providers

The CSSF contributed to the drafting of these guidelines as regards the information on IT organisation, IT systems, payment and data security. In November 2016, the project has been submitted to market consultation until February 2017.

### 1.3.2. Cloud computing IT outsourcing

In 2015, a cloud computing workshop gathered financial institutions, regulators and providers of cloud computing services to exchange expectations and issues on this subject. These exchanges notably allowed identifying a need for clarification and harmonisation of the European regulators' expectations towards banks wishing to rely on a cloud computing IT outsourcing.

In 2016, the EBA TFIT worked on drafting recommendations with the purpose of meeting these needs and specifying and partially reviewing the "Guidelines on outsourcing" published in 2006 by the Committee of European Banking Supervisors (CEBS). These recommendations are scheduled for market consultation before the end of the second quarter of 2017.

### 1.3.3. Assessment of IT risks in the banking supervisory process

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

Consequently, in 2016, the EBA TFIT worked on the drafting of guidelines to the attention of competent authorities, aiming at promoting common procedures and methodologies for IT risk assessment in the context of the SREP. These guidelines have been submitted to market consultation from October 2016 to January 2017. The publication of the final version is expected for May 2017 and it will probably enter into force on 1 January 2018.

Upon the IT risk assessment in the context of the SREP, supervisors may activate different actions and, in particular, plan an IT on-site inspection at the supervised entity. In the context of the ECB's SSM, the DTIT works at continuously improving the methodology of on-site inspections based on the feedbacks received and on the evolution of IT risks. In 2016, this working group focussed its efforts, especially, on risks arising from cyberthreats, on data quality issues (within the meaning of the Basel Committee on Banking Supervision) and the IT risk management framework.

### 1.3.4. Reporting of security incidents

In order to allow supervisors to develop an improved appreciation of security risks and incidents, notably cyber risks and incidents, to which the financial sector is exposed, two incident reporting obligation processes were drawn up in 2016.

The first process concerns payment service providers and major operational and security incidents, including cyber incidents. In accordance with the mandate conferred upon it by Article 96 of PSD2, the EBA drafted, through the SecuRe Pay forum, guidelines on incident reporting addressed to each of the following recipients:

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

A market consultation on the draft guidelines published in December 2016 has been launched until March 2017, the final guidelines' publication being expected for the end of 2017.

The second incident reporting process emanates from the ECB in the context of the SSM. It concerns the significant banks (within the meaning of the SSM) and is related to cyber incidents. The reporting must be made to the ECB either directly or indirectly, i.e. via the competent national authority. The ECB, together with national authorities, drafted instructions intended for the authorities and banks concerned. The reporting requirement is expected to enter into force in the summer of 2017.

The authorities tried as much as possible to align the two reporting processes in order to limit the burden on the entities which will be subject to both reporting requirements. Grouping the reporting into one single procedure could not be considered, due to the differences in the nature of the incidents to be reported, the entities concerned and the competences allocated to the various players of the reporting chain.

In Luxembourg, the entry into force of these two processes will require a review of Circular CSSF 11/504 on frauds and incidents due to external computer attacks.

## 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 the view to maintaining or improving the services offered. This also takes into account the specific nature of the outsourcing of services to support PFS or third parties, within or outside the group.

In the context of this supervision, the CSSF processed 267 requests in 2016 (+13% as compared to 2015), among which:

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

It should be noted that most requests for advice or for authorisation originate from credit institutions.

The CSSF noted that the time needed for processing authorisation files for electronic money institutions and payment institutions is sometimes considerably extended as these entities repeatedly change their business model during the application process. This very often results in important changes at the IT level, requiring thus a new in-depth analysis of the project.



*Agents hired in 2016 and 2017: Departments "Information systems and supervision of support PFS", "Information systems of the CSSF" and "Personnel, administration and finance"*

Left to right: Jerry BECKER, Christophe MONNIER, Lauriane ADADAINÉ, Yannick SAUREN, Anna CURRIDORI, Miguel BUATU NSAKU, Marc COCQUEREAUMONT, Fabrizio TARELLO

Absent: James CHARTIER, André OTTAVINO, Jonas SCHMITT





## CHAPTER XIV

### SUPERVISION OF THE REMUNERATION POLICIES

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

In 2016, the CSSF carried out reviews in order to ensure compliance with the legal and regulatory requirements applicable to remuneration policies and practices. In this context, it conducted a review campaign of the remuneration policies on a sample of credit institutions and investment firms. Where appropriate, observations and recommendations were transmitted to the entities concerned in order to urge them to update their remuneration policies.

During these reviews, the CSSF noted that most of the entities implemented remuneration policies reflecting the last applicable legal and regulatory developments. The CSSF would like to remind that remuneration policies must be adapted to the nature, scale and complexity of the activities of the entities. The remuneration policy must, for example, present, in a practical manner, the governance mechanisms surrounding remuneration issues, the functions and the list of staff identified as having a significant impact on the risk profile of the entity and it must detail the process for the evaluation of the performance used to calculate the variable remuneration. The CSSF also draws the attention of the entities to the entry into force, since 1 January 2017, of new guidelines on sound remuneration policies issued by the EBA on 27 June 2016 and applicable to entities falling under the scope of Regulation (EU) No 575/2013 of 26 June 2013.

The CSSF also examined the remuneration practices of some entities and carried out, for the first time, a comparative evaluation exercise of the remuneration policies and practices at national level. In this context, the CSSF collected key data on remuneration practices of credit institutions for the financial year 2015. This exercise will be renewed annually and the results will allow the CSSF to monitor the development of the remuneration practices and to publish the trends. For this first year, the CSSF noted, in particular, that credit institutions distributed variable remunerations which amounted, on average, to 35% of the fixed component of the remuneration and that the proportion of the variable remuneration paid out in financial instruments amounted to 32%. The deferred component of variable remuneration amounted, on average, to 27% of the granted variable remuneration.



An annual control of identified material risk takers, which started in 2016, will continue to be carried out based on samples. The purpose is to verify that the entities comply with Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 and, particularly, with the qualitative and quantitative criteria during the identification of each material risk taker within the entity. The entities will have to list all the material risk takers and indicate for each one of them the criteria that led to his/her identification.

Among the tasks carried out by the CSSF in the area of remuneration, it is also worth mentioning the analysis of the notifications of higher remuneration ratios made by entities in order to pay out a variable remuneration exceeding 100% of the fixed component. These notifications are in line with the requirements of Article 38-6(g)(ii) of the Law of 5 April 1993 on the financial sector. In 2016, the CSSF received several notifications in this context and ensured that the procedure and requirements for paying out variable remuneration exceeding 100% of the fixed remuneration, without exceeding 200%, were complied with by the entities concerned.

The CSSF would like to remind that the shareholders, owners or partners of the entities concerned must act upon a detailed recommendation giving the reasons for, and the scope of, an approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base. In some cases, the CSSF observed that this recommendation was insufficiently detailed and required that the entities concerned provide further details as to the reasons for granting a higher ratio and its effects on the capital base. In 2016, the CSSF answered favourably to all notifications for a higher ratio payment, except for one.

Finally, it should be pointed out that the EBA guidelines on sound remuneration policies, applicable since 1 January 2017, specify that the proportionality principle does not exempt small institutions from the application of rules regulating the remuneration and no longer provide for an explicit possibility to neutralise some requirements as described in Circular CSSF 11/505. Given the ongoing discussion at European level and the uncertainty surrounding the topic, the CSSF decided to maintain the current application of Circular CSSF 11/505 so that all the requirements which could until now be neutralised will continue to remain as such until the European rules on this subject become clear.



## CHAPTER XV

### PUBLIC OVERSIGHT OF THE AUDIT PROFESSION

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

##### 1.1. Development of the legal and regulatory framework

2016 was the year the reform of the legal and regulatory audit framework initiated by the European Commission was implemented in Luxembourg law. Thus, two important texts for the audit profession, whose main objective consists in improving the quality of statutory audits, entered into force, namely:

- the Law of 23 July 2016 (hereinafter the Audit Law) which transposes into Luxembourg law Directive 2014/56/EU on statutory audits of annual accounts and consolidated accounts; and
- Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of public-interest entities.

The main measures of this new legal and regulatory framework concern the enhanced independence of *cabinets de révision agréés* (approved audit firms) and *réviseurs d'entreprises agréés* (approved statutory auditors), a more efficient scale of sanctions and a better harmonisation of the oversight of the audit profession throughout the EU with, among others, the creation of the Committee of European Auditing Oversight Bodies (CEAOB), a body for the coordination of national oversight authorities.

Stricter requirements apply now to public-interest entities and their auditors, like mandatory external rotation, limitation in the provision of non-audit services to these entities, an extended audit report content or an additional report to the audit committee.

The new Audit Law also includes specific amendments compared to the 2009 law, among which the broadening of the attributions of *réviseurs d'entreprises* (statutory auditors) who can now also carry out all the assignments which were previously entrusted exclusively to *réviseurs d'entreprises agréés* with the exception of statutory audits.

Irrespective of the European audit reform, some national regulatory provisions were amended in 2016 in order to simplify the administrative procedures. These amendments notably concern continuing education requirements for *réviseurs d'entreprises*, whether approved or not, and professional qualification conditions for *réviseurs d'entreprises*.

Finally, the regulatory framework was supplemented by a new CSSF regulation which describes the mechanisms and procedures relating to reporting of infringements of the Audit Law and Regulation (EU) No 537/2014.

### 1.2. Developments in audit standards

In 2016, the CSSF adopted the international auditing standards and the international standard on quality control in their version published in the "Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements - 2015 Edition" of the International Federation of Accountants (IFAC). It also adopted the code of ethics for the audit profession in Luxembourg which corresponds to the 2015 version of the code of ethics issued by the International Ethics Standards Board for Accountants (IESBA), as amended and published on 29 May 2015.

These standards and the code of ethics comprise henceforth Luxembourg supplements which include the provisions introduced by the Audit Law and Regulation (EU) No 537/2014 providing, thus, a unique standard framework of all the applicable rules in Luxembourg.

## 2. QUALITY ASSURANCE REVIEW

### 2.1. Scope

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

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

The population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* that carry out statutory audits and other assignments entrusted exclusively to them by law is as follows (as at 31 December 2016):

- Number of approved audit firms: 56, 12 of which are firms auditing public-interest entities (PIEs);
- Number of approved independent *réviseurs* (auditors): three, none of which audits PIEs.

Based on the data collected through the "Annual Annexes" for the year 2016, the audit engagements break down as follows between *cabinets de révision agréés* and independent *réviseurs d'entreprises agréés*:

- 84% of the audit engagements are carried out by the "Big 4"<sup>1</sup>;
- 10% of the audit engagements are carried out by medium-sized audit firms<sup>2</sup>; and
- 6% of the audit engagements are carried out by the other audit firms and independent *réviseurs*.

### 2.2. Activity programme for 2016

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

<sup>1</sup> PwC, KPMG, Deloitte, EY.

<sup>2</sup> Firms that carry out more than 100 audit engagements entrusted exclusively to *réviseurs d'entreprises agréés* and *cabinets de révision agréés* by law. As at 31 December 2016, four firms were concerned.

Under the 2016 programme, 12 firms were reviewed, seven of which audit PIEs and nine are members of an international network. The quality assurance reviews concerned:

- the understanding and documentation of the organisation, policies and procedures established by the reviewed audit firms in order to assess compliance with the International Standard on Quality Control (ISQC 1);
- the review of a sample of audit files relating to audit engagements of the financial year 2015 (or 2014 or even 2013, where applicable); and
- the setting-up of a specific follow-up for professionals for which material weaknesses were noted in the previous financial years.

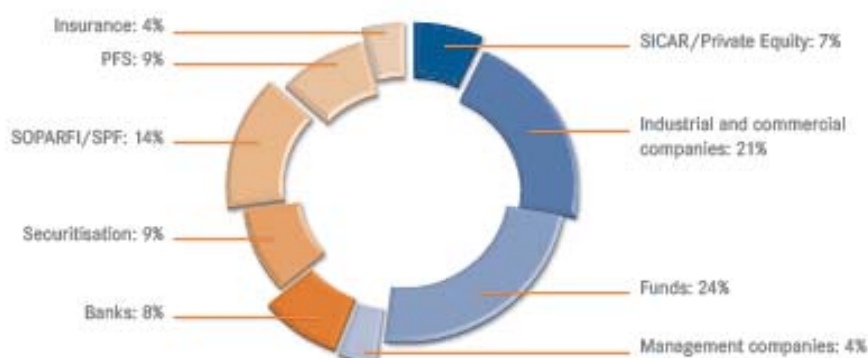
The 12 reviewed audit firms reported<sup>3</sup> a total of 9,952 mandates falling within the scope of public oversight of the CSSF, including 416 in relation to PIEs. These mandates include 8,896 statutory audits, of which 390 concern PIEs. Under the 2016 review programme, 127 mandates were reviewed, 33 of which concerned PIEs.

The quality assurance reviews started in January 2016 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 7,771 hours.

#### Breakdown of audit files reviewed by the CSSF in 2016 per entity type



#### Breakdown of audit files reviewed by the CSSF in 2016 per sector



### 2.3. Conclusions of the 2016 campaign of quality assurance reviews

Out of the 12 reviews carried out in 2016, 10 were subject to a report and two are in the finalisation process.

Following the 10 reviews which were finalised in 2016, the CSSF carried out a specific follow-up of one firm and six *réviseurs d'entreprises agréés* due to previous campaign conclusions. The measures were terminated during the 2016 review.

<sup>3</sup> Based on the statements of *cabinets de révision agréés* as at 31 December 2015.



For the 2016 campaign, the following specific conclusions were transmitted to the *réviseurs d'entreprises agréés*:

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

### 2.4. Major issues identified during the quality assurance reviews of 2016

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

Based on the work carried out in 2016, the CSSF did not observe significant findings concerning the quality assurance systems of the *cabinets de révision agréés*. However, it noted shortcomings in the controls implemented by the *cabinets de révision agréés* in order to ensure compliance by the *réviseurs d'entreprises agréés* and their personnel with their regulatory training obligations. This observation covers, on the one hand, the continuing education requirements of *réviseurs d'entreprises agréés* and, on the other hand, the compulsory training on independence to be provided for all the staff. The CSSF's review of the continuing education activities of *réviseurs d'entreprises agréés* carried out at the beginning of 2016 resulted in the identification of 24 *réviseurs d'entreprises agréés* who did not comply with the regulatory requirements on continuing education.

The CSSF also commented, on several occasions, on the compliance with the deadlines for archiving audit files. In light of this, the CSSF reminds that the final assembly of the audit files (electronic and in paper form) must not exceed 60 days following the date of the audit report.

In 2015, the CSSF noticed improvements in the involvement of the persons in charge of the Engagement Quality Control Reviews (EQCR). In 2016, the CSSF did not identify critical issues on this topic. However, it highlights that, pursuant to the new legislation in force, the *cabinets de révision agréés* must henceforth submit all audit engagements of PIEs to such reviews.

#### 2.4.2. Audit files

The results of the 2016 quality assurance reviews show the firms' implication and willingness to carry out audits of quality. Even if some issues that were noted the previous years remain, no new major problem occurred.

The main observations in 2016 concern:

- the identification and assessment of fraud risk;
- the audit of accounting estimates;
- the documentation of audit diligence; and
- the appropriateness of the presentation and information disclosed in the financial statements.

These observations were made in bigger and in smaller firms.

##### • Identification and assessment of fraud risk

The CSSF observed a trend of minimising or even ignoring fraud risks so as to avoid implementing the complementary audit procedures whose nature, timing and extent specifically address these risks at the level of the assertions concerned. Where the risk of fraud in the revenue recognition is not rebutted, the CSSF reminds that the auditor must clearly identify the nature of the income, transactions or assertions which may cause such risk and implement complementary audit procedures in order to take it into account.

Moreover, the CSSF underlines that, regardless of the assessment of the risk of management override of controls, the auditor cannot avoid to implement specific audit procedures in order to test the appropriateness of the accounting entries recorded in the general ledger and other adjustments made during the establishment



of the financial statements. The evidence gathered from the tests of controls or substantive procedures do not adequately fulfil the objective of the test.

• **Audit of accounting estimates**

The situation has changed little with respect to the audit of accounting estimates and the CSSF still notes deficiencies in this area. The main deficiency concerns the lack of professional scepticism in assessing the reasonableness of the assumptions retained by the management.

• **Documentation of audit diligence**

In many audit files, the CSSF noticed that the documentation of the audit diligence performed can be improved. It is not always clear for an experienced auditor, who has no previous relation with the audit engagement, to understand, on the one hand, the nature and extent of the audit procedures implemented and, on the other hand, the main conclusions of the audit team based on the gathered evidence.

One should also ensure that the evidence and final versions of the work carried out are centralised in the audit file.

• **Appropriateness of the presentation and information disclosed in the financial statements**

Several findings relating to incompleteness or inadequacy of the presentation and information disclosed in the financial statements led the CSSF to reiterate its recommendation to the audit firms to enhance the teams' due diligence during the implementation of such audit procedures. The use of checklists cannot replace professional scepticism.

### 3. OVERVIEW OF THE POPULATION OF *RÉVISEURS D'ENTREPRISES* IN LUXEMBOURG

#### 3.1. Access to the profession

##### 3.1.1. Activities of the Consultative Commission for the Access to the Audit Profession

The Consultative Commission's task is, among others, to verify the theoretical and professional qualification of the candidates for the access to the audit profession in Luxembourg, as well as that of the service providers from other Member States wishing to exercise by way of free provision of services.

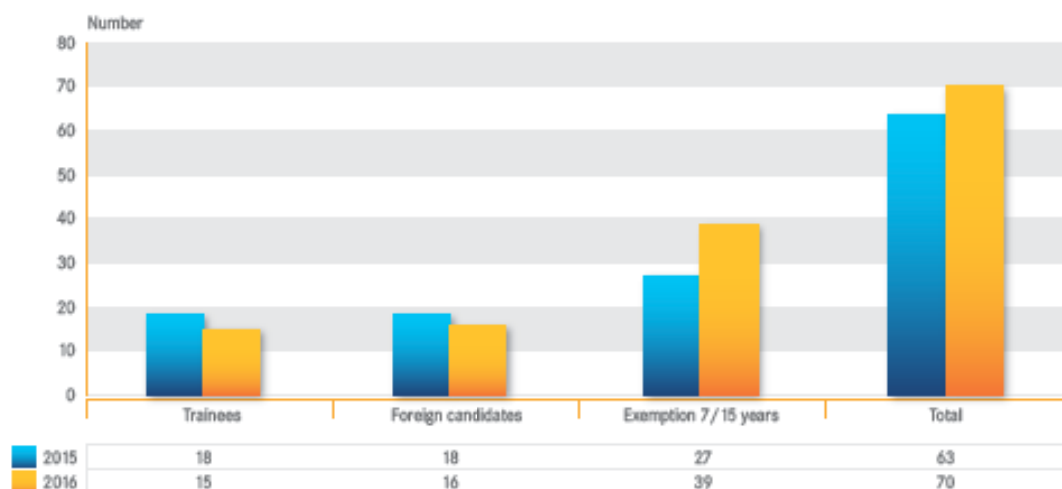
The Commission met six times in 2016 and analysed the files of 70 candidates, against 63 in 2015, representing an increase of 11%.

In 2016, the access to training was refused to six candidates (9%) as the number of subjects to be completed based on their administrative certificate was greater than five.

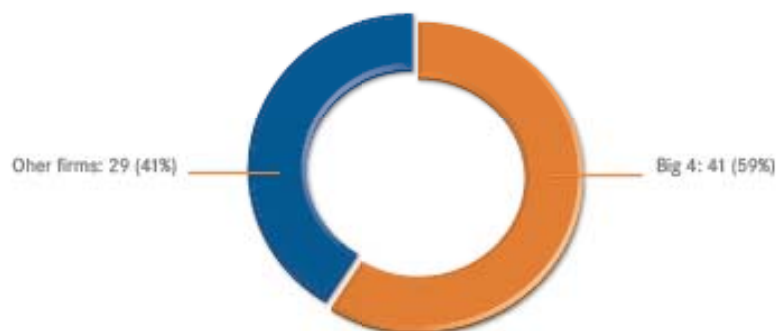
There are three categories of candidates:

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

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



## Breakdown of candidates per firm



## Breakdown of candidates per nationality



### 3.1.2. Examination of professional competence in 2016

The CSSF administrates the examination of professional competence in accordance with Articles 5 and 6 of the Grand-ducal Regulation of 9 July 2013 determining the requirements for the professional qualification of *réviseurs d'entreprises*.

In this context, the examination jury communicated the following results with respect to 43 candidates registered for the 2016 examination of professional competence to the CSSF:

- Ordinary session: 42 candidates took the written exam, 11 of whom were admitted to the oral exam. In total, 11 passed the exam and no one was subject to partial referral.
- No extraordinary session in 2016.

Thus, all sessions included, 11 candidates passed the examination of professional competence in 2016 successfully.

Having passed this examination, candidates may request the CSSF to be granted the title of "*réviseur d'entreprises*".

The graduation ceremony was held on 23 January 2017 in the presence of the Minister of Finance Mr Pierre Gramegna.

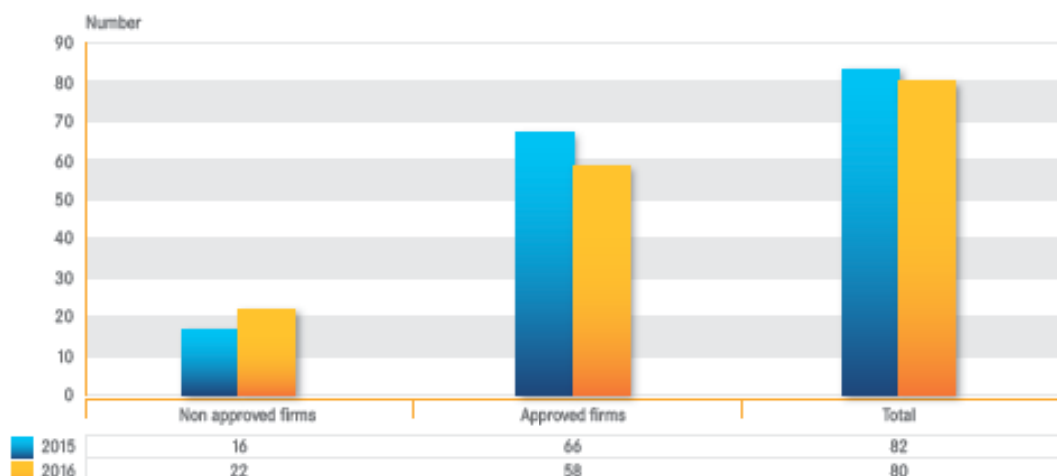
## 3.2. Public register

The public register of *réviseurs d'entreprises agréés*, *cabinets de révision agréés* and third-country auditors and audit entities is available on the CSSF's website (Supervision > Audit profession > Public register).

### 3.2.1. National population as at 31 December 2016

#### • 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 80 as at 31 December 2016, against 82 as at 31 December 2015.



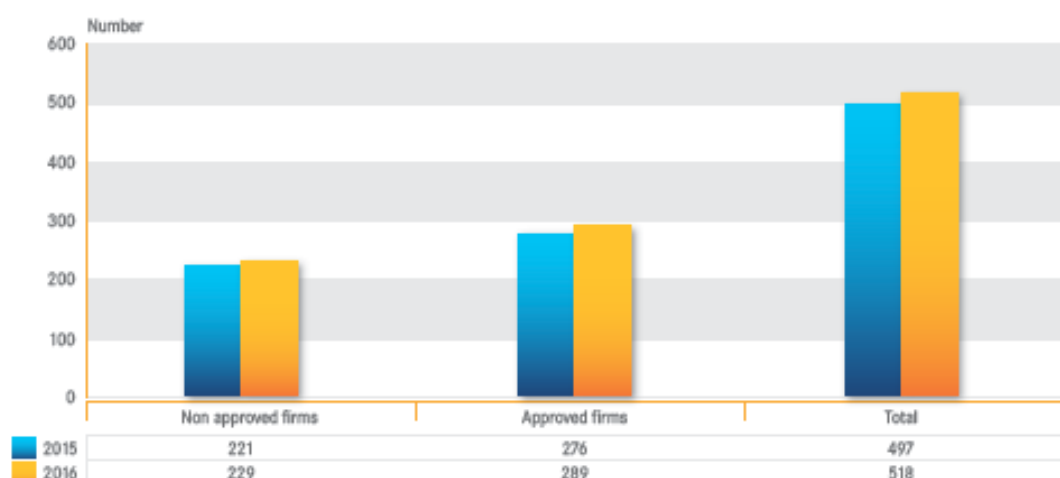
The following firms were approved in 2016:

- Akene Audit;
- Fiduciaire Alpha;
- IFG Audit.

In 2016, 11 firms gave up their approval, three of which have also abandoned the title of *"cabinet de révision"* and two firms have merged.

## • Development in the number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés*

The total number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés* amounted to 518 as at 31 December 2016, against 497 as at 31 December 2015, which is a 4.22% increase.



In 2016, the CSSF granted the title of *"réviseur d'entreprises"* to 28 persons and approved 24 *réviseurs d'entreprises*.

During the year under review, 11 *réviseurs d'entreprises* gave up their approval.

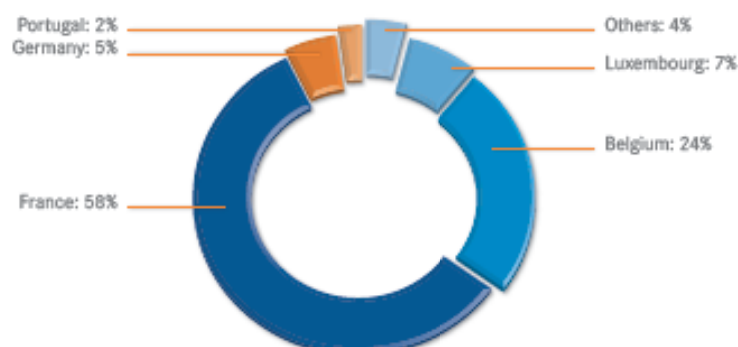
The population consists of 69% men and 31% women. The average age of the *réviseurs* is 41.7 years for women and 45.8 years for men.

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

The total number of trainee *réviseurs d'entreprises* amounted to 164 as at 31 December 2016, against 227 as at 31 December 2015, which represents a 27.75% decrease.

The population consists of 64% men and 36% women. The average age of trainees is 32.8 years for women and 32.02 years for men.

It should be pointed out that 84% of the population of trainees comes from the "Big 4" firms.

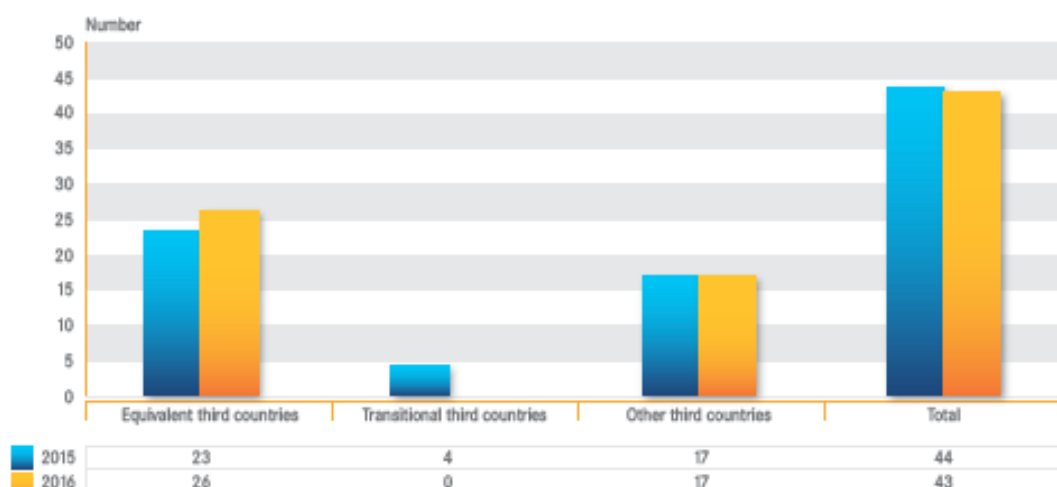
**Breakdown of trainees per nationality****3.2.2. Third-country auditors and audit firms**

The registration procedure for third-country auditors and audit entities that provide an auditor's report on the annual or consolidated accounts of a company incorporated outside EU Member States, whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange, continued in 2016.

Thus, the CSSF accepted three new applications for registration from audit entities located in third countries which have public oversight, quality assurance, investigation and penalty systems which are considered as equivalent to the systems in place in the EU.

Moreover, the CSSF reclassified four third-country audit entities following the decision of the European Commission of 25 July 2016 (2016/1223/EU).

Finally, except for the four third-country audit entities whose activities did not fall any more within the scope of the amended Directive 2006/43/EC, all the third-country audit entities previously registered have renewed their registration.

**Breakdown of registered third-country auditors**

The public register listing all registered third-country auditors is available on the CSSF's website.



### 4. COOPERATION AGREEMENTS

In addition to the cooperation agreements already signed with the Japanese and Swiss counterparts, the CSSF signed, on 30 November 2016 and 12 December 2016, two new memoranda of understanding with its counterparts from Jersey and Australia, respectively.

Moreover, on 22 July 2016, the CSSF renewed the statement of protocol signed on 17 September 2015 with its US counterpart, the Public Company Accounting Oversight Board.

These agreements are available on the CSSF's website.



# CHAPTER XVI

## INSTRUMENTS OF SUPERVISION

### 1. ON-SITE INSPECTIONS

The "On-site inspection" (OSI) department is in charge of coordinating all on-site inspections conducted by the CSSF with regard to banks<sup>1</sup>, payment institutions, electronic money institutions, UCIs as well as their management companies, investment firms, specialised PFS, support PFS, pension funds, securitisation undertakings and financial market participants. Moreover, the OSI department coordinates on-site inspections of Luxembourg significant banks with the Centralised On-site Inspection department of the ECB. It should be noted that, beside the OSI department, other CSSF departments also carry out targeted on-site inspections.

In addition to on-site inspections of professionals under Luxembourg law, the OSI department also participated, as part of the mixed teams implemented by the ECB, in on-site inspections of significant European banks abroad.

The OSI department's staff increased to 50 people as at 31 March 2017 in order to fulfil all its tasks. The OSI department's teams are expected to be strengthened in 2017 by way of the recruitment of 20 additional agents. The CSSF thus follows the general demand and trend existing at European and international levels.

On-site inspections are in-depth investigations which allow the evaluation of the various risks to which the supervised entities are exposed. In general, on-site inspections are proposed by the supervision departments on an annual basis and analysed subsequently with respect to their feasibility. On this basis, an annual planning is established and validated by the Executive Board of the CSSF. Any change, insertion or deletion in this annual planning must be subject to a formal validation.

The teams in charge of on-site inspections<sup>2</sup> are set up according to the nature, scale and scope of the missions and generally include agents from the OSI department and supervisory departments.

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

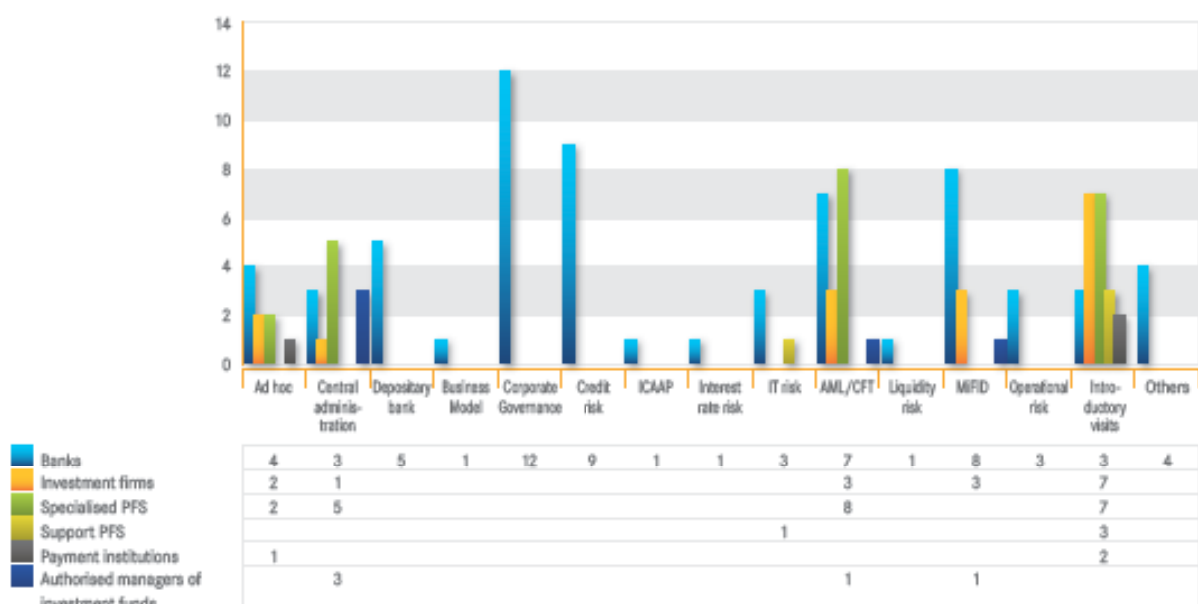
<sup>1</sup> This includes less significant banks which are not subject to the Single Supervisory Mechanism (SSM) as well as "AML/CFT", "MiFID", "Depository bank" and "Central administration function" on-site inspections of significant and less significant banks as these topics are not directly covered by the SSM.

<sup>2</sup> With the exception of the missions performed at significant banks which are organised according to the methodology of the ECB.

whether an injunction procedure or a non-litigious administrative procedure is required in order to impose an administrative sanction pursuant to Article 63 or 63-2 of the Law of 5 April 1993 on the financial sector. The sanctions and means of administrative police are described in detail in point 2. of this chapter.

In 2016, a total of 139 on-site inspections were conducted by the CSSF departments or with their participation. Twenty-four of these missions were performed by the UCI departments and are set out in point 5.5. of Chapter IX "Supervision of investment fund managers and UCIs". The other 115 missions concerned the following topics.

## Breakdown of the on-site inspections carried out in 2016 by topic and type of entity (excluding UCI departments)



### 1.1. Ad hoc on-site inspections

Ad hoc control missions are on-site inspections intended to investigate a specific or even worrying situation or a specific problem related to the professional. Often, this particular situation of the professional has already been observed in the context of the off-site prudential supervision. Such missions may either be planned in advance or occur unexpectedly. The nature and scale of ad hoc missions may vary significantly and, consequently, determine the composition of the on-site teams.

In 2016, the CSSF carried out 19 ad hoc missions. Ten of these ad hoc missions focused on corporate governance, anti-money laundering and counter-terrorist financing (hereinafter AML/CFT), MIFID and credit risk and are thus referred to in the points of this chapter relating to these topics. The nine other ad hoc missions covered, inter alia, internal governance and activity management issues.

### 1.2. "Interest rate risk" on-site inspections

"Interest rate risk" or "Interest rate risk in the banking book (IRRBB)" on-site inspections aim to assess the management of the interest rate risk arising from non-trading activities and the stress test results. They are performed based on the methodology covering the interest rate risk prepared by the ECB.

In 2016, the CSSF carried out one IRRBB mission. Deficiencies relating to the exhaustive identification, measurement and limitation of interest rate risks and as regards reporting processes were identified.

### 1.3. "Operational risk" on-site inspections

"Operational risk" on-site inspections, excluding internal models, aim to verify the manner in which operational risk is identified, controlled, managed and measured. They are performed based on the methodology covering the operational risk prepared by the ECB.

In 2016, the CSSF carried out this type of mission at three banks of the financial centre.

One of these missions started at the end of 2016 at a significant bank and is still underway in the first quarter of 2017. Performed upon the ECB's request, this mission, in particular, aims to verify the sound management of the operational risk in Luxembourg, but also of significant subsidiaries in Europe. A team of inspectors from several countries was set up to perform this mission.

Another mission aimed to check how the project of outsourcing to a group entity was managed during the preparation, implementation and monitoring phases.

The third mission performed at a significant bank was intended, in particular, to undertake IT business line controls and to verify the management of operational risks.

### 1.4. "Credits" on-site inspections

The purpose of "Credits" on-site inspections is to verify the sound and prudent credit risk management within the banks of the financial centre.

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

The "Credits" missions are performed based on the methodology covering the credit risk prepared by the ECB. At the beginning of 2016, the ECB put in place a working group to review the methodology, the will being to deepen this type of control by enlarging, in particular, the samples of credits controlled. A minimum number of files must now be reviewed. This methodology review resulted in a significant increase of the missions' duration.

For the purposes of optimising and rationalising processes, the OSI department developed a Loan Tape model allowing it to collect information linked to credit portfolios subject to an on-site inspection in a uniform manner.

In 2016, the CSSF carried out "Credits" missions at nine banks, including four missions at significant banks. One of these missions was entirely conducted by a mixed team at a European bank abroad.

These missions concerned various subjects such as mortgages, lombard loans and corporate banking loans.

The major weaknesses identified during "Credits" on-site inspections are, on the one hand, the weak documentation of credit files, at debtors' and potential connected debtors' level as well as at the level of the loan itself (lack of detailed critical analysis) and, on the other hand, the absence of adequate management of the collateral. Indeed, several controls relating to loans secured by securities brought in by clients showed that the risk analysis by the bank or the collateral weighting rules laid down by the bank did not allow meeting the diversification or liquidity requirements, thereby leading to a real loss given default risk. The classification of these loans within the systems thus generally differs from the real risk incurred, which may result in the communication of inaccurate information to the managing bodies. Moreover, the absence of a definition or adapted processes for the identification of credits in default and forborne credits remains a recurrent flaw.

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

"AML/CFT" on-site inspections are carried out at all players of the financial centre in order to assess whether the quality of the AML/CFT framework is in line with the legal and regulatory requirements. Inspections cover notably both private banking (portfolio management, domiciliation, etc.) and UCI activities.



In 2016, the CSSF conducted 19 "AML/CFT" on-site inspections<sup>3</sup>.

The major flaws identified in 2016 within the context of "AML/CFT" on-site inspections are notably linked to transaction monitoring, supervision of entities and shortfalls in the application of a risk-based approach.

Consequently, in respect of transaction monitoring, the CSSF observed important inefficiencies in the transaction monitoring system: the absence of a critical review of the transactions linked to the subscription/redemption of shares of investment funds in order to verify that the funds really originate from the account indicated by the investor in the subscription form or in order to avoid the payment of redemptions to third-party accounts, and the acceptance of cash deposits for which the documents in proof were insufficient or whose amounts were not plausible with regard to the information held by the professional.

Moreover, in some cases, the Compliance function of the parent company established in Luxembourg had poor knowledge of the activities carried out by its subsidiaries/branches, contributing to an incorrect identification of the AML/CFT risks to which these entities are exposed and lacks in terms of steering of the activities carried out by the local AML/CFT Compliance functions.

The CSSF also noted cases where the risk-based approach applied by the professional was inadequate, either because the classification of the business relationships according to their AML/CFT risk only based on risk criteria linked to the account holder without considering the beneficial owners and proxies, or because the country of residence of certain people intervening on the account was not included in the database of the professional so that the latter was unable to easily identify all the business relationships with countries on the official lists in order to apply adequate due diligence measures.

Finally, within the context of the publication of a series of documents referred to as "Panama Papers" by the International Consortium of Investigative Journalists, the CSSF decided to mandate different *cabinets de révision agréés* (approved audit firms) in order to carry out on-site inspections at about 30 banks of the financial centre in relation to account holders such as off-shore companies. The aim of these inspections was to allow the CSSF to assess whether potential cases of non-compliance with the legal and regulatory AML/CFT framework in force in Luxembourg were identified by the mandated *cabinets de révision agréés*. The inspections in question notably covered the procedural aspect of the due diligence measures applied by banks to off-shore companies, the quality of the Know Your Customer documentation and information based on a sample of off-shore client files, the quality of the Know Your Transactions documentation and information for this sample as well as the risk-based approach applied by the different banks. At the end of 2016, the CSSF was in the analysis phase of the results provided by the different *cabinets de révision agréés*. The final conclusions of this large-scale transversal mission are expected for the second quarter of 2017.

## 1.6. "Corporate governance" on-site inspections

"Corporate governance" on-site inspections aim to assess the quality of the governance arrangements set up by the professionals pursuant to the legal and regulatory requirements. The general governance arrangements of a Luxembourg entity, the "group head" function exercised by a Luxembourg entity on its subsidiaries and/or branches, the organisation and efficiency of one of the internal control functions of an entity may thus be subject to such an inspection. Since 2016, "Corporate governance" on-site inspections also cover remuneration policies implemented within Luxembourg entities.

In 2016, the CSSF carried out 12 "Corporate governance" on-site inspections<sup>4</sup> at credit institutions.

With six missions completed in 2016, special emphasis was placed on inspections relating to the "group head" function. In this context, important shortcomings in the control and the supervision of subsidiaries/branches by Luxembourg entities were identified at several credit institutions. The absence of a quality review of the internal control functions' work of the subsidiaries/branches by the internal control functions of the Luxembourg entities has, for example, been identified several times. In addition, the CSSF noted one case where the Compliance function was not aware of all the activities of the branches and where the Luxembourg entity had only limited access to the accounting systems of its branches.

<sup>3</sup> Including one follow-up mission carried out following a previous "AML/CFT" mission and four ad hoc missions.

<sup>4</sup> Including four ad hoc missions.



Moreover, one on-site inspection was conducted under the SSM. During this mission on governance, the remuneration issue was also analysed by the CSSF. The main flaws identified in this respect were as follows:

- quantitative criteria for determining the decision-makers of the entity not taken into account;
- insufficient involvement of the Board of Directors in the establishment and monitoring of the remuneration policy, in particular for the monitoring of the remuneration of the members of the authorised management;
- non-compliant composition of the Remuneration Committee and insufficient involvement of the latter in the preparation of remuneration-related decisions;
- insufficient involvement of the internal control functions in the development and the review of the remuneration policy.

The most significant flaws, in terms of frequency or seriousness, that were identified in 2016 during the "Corporate governance" on-site inspections, are similar to those identified in 2015.

### 1.7. "MiFID" on-site inspections

The purpose of "MiFID" on-site inspections is to assess whether the implemented MiFID framework is in line with the legal and regulatory requirements. In 2016, the CSSF carried out 12 "MiFID" on-site missions<sup>5</sup> at credit institutions, investment firms and management companies authorised under Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment.

The following most significant flaws, in terms of frequency or seriousness, were identified during the 2016 "MiFID" on-site inspections<sup>6</sup>:

- shortcomings identified in the controls relating to compliance with the investment profiles (in particular, excessive delays in the resolution of alerts detected during these controls);
- shortcomings identified in the inspections performed by the internal control functions (in particular, incompleteness of all the MiFID-related themes in the monitoring plan of the Compliance function and insufficient formalisation of the controls carried out by the Compliance function).

### 1.8. "Depository bank" on-site inspections

In 2016, the CSSF conducted five on-site inspections regarding the "Depository bank" function, including one at a significant bank.

The methodology used for carrying out these inspections was developed internally and is mainly modelled on the existing regulations. Indeed, during these inspections, the CSSF took account of the requirements arising from the AIFMD and the requirements of the UCITS V Directive that entered into force in 2016.

The purpose of these inspections was, notably, to identify the failures to comply with the delegated regulations (Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 and Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012), the national laws (the Law of 17 December 2010 relating to undertakings for collective investment and the Law of 12 July 2013 on alternative investment fund managers) and the CSSF circulars (Circular CSSF 14/587 replaced in October 2016 by Circular CSSF 16/448).

The procedures and controls in place to guarantee the custody of the different types of assets, the process of acceptance of new assignments, the follow-up of the delegated activities as well as the specific supervisory and monitoring duties are systematically reviewed during these inspections.

The CSSF noticed that the new UCITS V regulation did not represent a major challenge for banks, because most of them had already anticipated the issues, in particular, with the entry into force of the AIFMD. It was noted, however, that the aforementioned regulations, which largely contributed to the development of the depository function, are complex and difficult to put in place, in particular for smaller-sized players.

<sup>5</sup> Including one ad hoc mission.

<sup>6</sup> The flaws identified in the CSSF Annual report 2015 were also identified during the on-site inspections conducted in 2016.

The management of the sub-custodian network, either in relation to the selection or the follow-up, remains a major focus of attention within the banks. In addition, the specific supervisory missions applicable to a depositary are often not reflected by way of adequate and, especially, independent processes.

Finally, the issue relating to conflicts of interest management is a sensitive subject for a certain number of banks.

### 1.9. "UCI central administration" on-site inspections

In 2016, the CSSF conducted 12 "UCI central administration" on-site inspections at three banks, including one significant bank, and nine professionals of the financial sector.

This type of missions mainly cover the NAV calculation process and the transfer agent function. They were carried out at both large-sized players of the financial centre and small entities with the aim to control the general organisation of these providers. In this respect, the process of acceptance of new assignments, the procedures in place, the human and technical means available and the supervision of the delegated activities have been reviewed in further detail.

### 1.10. "Business Model" on-site inspections

In 2016, the CSSF carried out one "Business Model" targeted mission at a bank of the financial centre which operates in trade financing operations. The mission allowed verifying on-site the specificities of this subject as well as how the bank manages the related risks.

### 1.11. "ICAAP" on-site inspections

In 2016, one mission relating to the ICAAP reporting was realised at a European bank by CSSF inspectors. This inspection was requested by the ECB.

### 1.12. "IT risk" on-site inspections

The "Supervision of information systems and support PFS" department includes a specialised team in charge of conducting IT on-site inspections at the supervised entities. In 2016, this team carried out six on-site inspections, four of which were carried out upon the ECB's request in the framework of the SSM and two upon the CSSF's initiative.

Two out of four inspections in the framework of the SSM were carried out in Luxembourg under the CSSF's responsibility, and two in other EU Member States under the responsibility of the competent national authorities.

The two on-site inspections conducted at the CSSF's initiative concerned a bank and a support PFS.

The main shortcomings, in terms of frequency or seriousness, identified in 2016 during the "IT risk" on-site inspections concerned:

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

### 1.13. Introductory visits

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

In 2016, the CSSF undertook 22 introductory visits at new players of the financial centre.

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

## 2. DECISIONS AS REGARDS SANCTIONS AND ADMINISTRATIVE POLICE TAKEN IN 2016

The total amount of administrative fines imposed by the CSSF in 2016 reached EUR 1,330,950, against EUR 1,335,000 in 2015.

It should be noted that the amount of administrative fines is likely to grow in the following years due to the entry into force of certain amending laws transposing EU law. Indeed, the amending provisions of these laws have generally adapted the administrative pecuniary penalty regime in order to increase the maximum amount of administrative fines that the CSSF may impose. In the case of legal persons, they introduce, notably, a rule according to which the maximum amount of the administrative fine represents a determined percentage of the total annual turnover. Alternatively, the CSSF could impose administrative fines of up to twice the amount of the profits gained or losses avoided because of the breach of the law where those can be determined. Examples are the Law of 23 July 2015 transposing Directive 2013/36/EU (CRD IV) and amending the Law of 5 April 1993 on the financial sector (cf. Article 63-2), the Law of 10 May 2016 transposing Directive 2014/91/EU (UCITS V) and amending the Law of 17 December 2010 relating to undertakings for collective investment (cf. Article 148) and the Law of 10 May 2016 transposing Directive 2013/50/EU and amending the Law of 11 January 2008 on transparency requirements for the issuers (cf. Article 25).

Moreover, the entry into force of these amending laws changed the regime of publication of sanctions and administrative measures. Indeed, the publication shall henceforth be made on a name basis, except in certain limited circumstances in which the disclosure of names may be postponed or the publication be made anonymously.

In 2016, the CSSF took the following decisions with respect to sanctions and administrative police.

### 2.1. Credit institutions

In 2016, the CSSF imposed five administrative fines on credit institutions pursuant to Article 63 of the Law of 5 April 1993 on the financial sector. Two of these fines amounting to EUR 15,000 and EUR 30,000, respectively, were imposed due to non-compliance with the AML/CFT professional obligations. Two other fines amounting to EUR 25,000 and EUR 30,000, respectively, were imposed for non-compliance with the depositary bank function. A fine of EUR 140,000 was finally imposed for serious shortcomings as regards governance and the management of the interest rate risk relating to the banking book.

Moreover, in 2016, the CSSF filed three complaints with the State Prosecutor relating to illegal exercise of banking activities by unauthorised entities.

### 2.2. Investment firms

In 2016, the CSSF imposed four administrative fines pursuant to Article 63 of the Law of 5 April 1993 on the financial sector. All these fines were imposed on investment firms as legal persons.

A fine of EUR 10,000 was imposed on an investment firm for repeated shortcomings with respect to the legal obligations to publish annual accounts. Two other investment firms had to pay fines amounting to EUR 5,000 and EUR 12,000 for not submitting the closing documents within the time limits set. Furthermore, the CSSF imposed an administrative fine of EUR 52,500 on an investment firm for non-compliance with a certain number of professional obligations of the financial sector relating to the expenditure management, the activity of professional acting for its own account and the remuneration policy. In addition, the CSSF imposed an injunction based on Article 59 of the aforementioned law on the investment firm in question in order for it to comply with the regulations in force within a short period of time.

The CSSF used its right of injunction in accordance with Article 59 of the aforementioned law on seven other occasions for the following reasons:

- shortcomings identified at the level of communication to the CSSF and compliance with the remuneration policy;
- non-regularisation of the findings and recommendations issued by the external auditor with respect to the closing of the 2014 financial year;
- high number of deficiencies identified and recommendations issued in the closing documents relating to the 2015 financial year, a large number of which was recurrent;
- non-compliance with the conditions required for the composition of the authorised management and for compliance with the four eyes principle;
- capital adequacy ratio deficiency in accordance with Article 92 of Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012;
- lack of transparency vis-à-vis the CSSF: the information transmitted upon request to the CSSF often proved to be minimalist or even incomplete;
- non-compliance with certain legal obligations.

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

With respect to investment firms, the CSSF filed three reports with the State Prosecutor pursuant to Article 23(2) of the Code of Criminal Procedure in 2016.

In 2016, the CSSF filed 11 complaints with the State Prosecutor regarding entities which provided investment services without authorisation.

### 2.3. Specialised PFS

In 2016, the CSSF imposed five administrative fines pursuant to Article 63 of the Law of 5 April 1993 on the financial sector.

Three of these fines, two of which amounted to EUR 5,000 and one to EUR 10,000, concerned, in particular, non-compliance with the AML/CFT professional obligations. They were imposed on natural persons in their respective capacity as directors and managing directors of a legal person.

Another administrative fine of EUR 50,000 was imposed on a legal person, in particular for non-compliance with the AML/CFT obligations.

The CSSF, moreover, imposed an administrative fine of EUR 12,000 on a legal person for non-compliance with the professional obligations regarding the filing of the annual accounts of domiciled companies with the *Registre de Commerce et des Sociétés* (Luxembourg trade and companies register).



In 2016, the CSSF decided on three occasions to temporarily withdraw the professional repute of natural persons for having provided incomplete, inaccurate or false information to the CSSF. The professional repute was withdrawn for twelve months from two natural persons who intended to take a qualifying holding in a PFS. The other withdrawal of a duration of five years concerned a natural person in his capacities as chairman of the Board of Directors, day-to-day manager and majority shareholder of a legal person.

In 2016, the CSSF also issued four warnings against natural persons pursuant to Article 63(2) of the Law of 5 April 1993 on the financial sector, including one against a shareholder and director and another one against a director of a legal person for non-compliance with the AML/CFT professional obligations. The two other warnings concerned two natural persons that are shareholders and directors of a PFS due to recurrent non-compliance with their professional obligations as regards notifications pursuant to Article 18 of the aforementioned law.

In 2016, the CSSF imposed a penalty on a legal person on the basis of Article 63(3) of the Law of 5 April 1993 on the financial sector in relation to a failure in regularising the filing with the Registre de Commerce et des Sociétés of the annual accounts of domiciled companies with the legal person in question. The penalty reached a total amount of EUR 15,750.

The CSSF used its right of injunction twice in 2016 in accordance with Article 59 of the Law of 5 April 1993 on the financial sector. One injunction concerned non-compliance by a supervised entity with the AML/CFT obligations. Another injunction concerned non-compliance with the professional obligations by a legal person as regards filing with the Registre de Commerce et des Sociétés of annual accounts of domiciled companies.

## 2.4. Undertakings for collective investment

In accordance with Article 148(1) of the Law of 17 December 2010 relating to UCIs, the CSSF imposed administrative fines of EUR 2,000 each on the *dirigeant* (director) of a UCI for filing an incomplete declaration of honour and on the *dirigeants* of a UCI for non-filing of the UCI long form report.

In accordance with Article 51(1) of the Law of 13 February 2007 relating to specialised investment funds, the CSSF imposed administrative fines amounting to EUR 2,000 or EUR 4,000, as the case may be, on the *dirigeants* of 33 SIFs for non-filing of the management letter as well as on the *dirigeants* of 32 SIFs for non-filing of the annual financial report. The CSSF also imposed administrative fines of EUR 4,000 each on a *dirigeant* of a SIF for filing an incomplete declaration of honour and on the *dirigeants* of two SIFs for the transmission of incomplete documents.

In 2016, the CSSF decided to withdraw five SIFs from the official list for non-compliance with the legal provisions governing SIFs.

In accordance with the provisions of Article 17(1) of the Law of 15 June 2004 relating to the investment company in risk capital (SICAR), the CSSF imposed administrative fines amounting to EUR 500 each on the *dirigeants* of 11 SICARs for non-filing of the management letter and on the *dirigeants* of 11 SICARs for non-filing of the annual financial report. It also imposed an administrative fine of EUR 500 on the *dirigeant* of a SICAR for filing an incomplete declaration of honour.

Moreover, in the course of the year, the CSSF refused registration of one entity on the official list of SICARs.

## 2.5. Securitisation undertakings

In accordance with the provisions of Article 85 of the Law of 22 March 2004 on securitisation, the CSSF imposed administrative fines amounting to EUR 2,000 each on the *dirigeants* (managers) of a securitisation undertaking for non-filing of the management letter and on the *dirigeants* (managers) of a securitisation undertaking for non-filing of the annual financial report.



### 2.6. Securities markets

In the framework of the control of advertisements and documents accessible to the public following the approval of a prospectus by the CSSF, injunctions relating to requests for transmission of information and documents, prohibition to issue advertisements and cessation of practices infringing the Prospectus Law were imposed on one issuer following irregularities observed with respect to various provisions of the Prospectus Law. The issuer in question received, in this context, an administrative fine of EUR 10,000 for having published false information in a prospectus and an administrative fine of EUR 20,000 for having offered securities to the public in breach of the provisions of the Prospectus Law.

In the framework of a posteriori controls of final terms, several injunctions concerning requests for the transmission of information and documents to the CSSF were imposed on an issuer that subsequently received an administrative fine of EUR 10,000 for having disclosed false information in a prospectus and for having obtained an admission of securities to trading on a regulated market in breach of the provisions of the Prospectus Law.

The review of financial reports under the Transparency Law led the CSSF to issue 11 administrative fines, mainly due to delays in the disclosure and filing of annual and half-yearly financial reports. The total amount of these administrative fines imposed in accordance with Article 25 of the Transparency Law amounted to EUR 108,500. The CSSF imposed an administrative fine of EUR 2,200 as regards the control of major holdings under the Transparency Law and a fine of EUR 2,500 on an issuer which failed to act in response to an order of the CSSF concerning a request for information.

Within the framework of the monitoring of compliance with the injunctions imposed for the preparation of their 2015 annual accounts, the CSSF noted non-compliance with certain of these injunctions for two issuers belonging to the same group. The CSSF thus imposed an administrative fine of EUR 22,500 on each of these issuers.

As regards market abuse, the CSSF sanctioned, by way of decisions dated 6 April 2016 and 14 September 2016, one issuer of shares and three persons belonging or having belonged to its management for market manipulation over shares of the issuer admitted to trading on a regulated market in accordance with the provisions of the Law of 9 May 2006 on market abuse. In this respect, administrative fines amounting to a total of EUR 125,000 were imposed.

Moreover, in accordance with Article 33(3) of the Law of 9 May 2006 on market abuse, the CSSF imposed on an institution subject to its prudential supervision an administrative fine of EUR 10,000, for having failed to act in response to injunctions to provide complete and accurate information within the context of information requests in relation to market abuse international cooperation files. The CSSF will, during a period of 18 months, pay special attention to quality, clarity and comprehensiveness of the information received by this institution in relation to information requests pertaining to market abuse.

In 2016, the CSSF used once its right of injunction in accordance with Article 41 of the Law of 13 July 2007 on markets in financial instruments. The injunction concerned the non-comprehensiveness of the reports on transactions in financial instruments sent to the CSSF pursuant to Article 28 of the aforementioned law.

### 2.7. Audit profession

In accordance with Article 67 of the Law of 18 December 2009 concerning the audit profession, the CSSF imposed, in 2016, an administrative fine of EUR 40,000 on a *réviseur d'entreprises agréé* (approved statutory auditor) for breaching legal and regulatory provisions and an administrative fine of EUR 1,500 on four *réviseurs d'entreprises agréés* for breaching the legal and regulatory provisions on ongoing training.



*Agents hired in 2016 and 2017: Department "On-site inspection"*

Left to right: Aline EL AYARI, Kelly SWIETCZAK, Shamim FARID, Marjorie DEMAZY, Inès ESCAMILLA, Fouad AZZI, Arnaud BERVAS, Frédéric GNABRO, Frank DENZER, Pierre NIKES, Anne-Sophie GRASMUCK, Renaud MESTÉ, Emilie FAES





## CHAPTER XVII

### RESOLUTION

The Law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), which, notably, transposes Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD), designates the CSSF as the resolution authority in Luxembourg. The CSSF exercises the missions and powers assigned to it as resolution authority through the Resolution Board, whereas the "Resolution" department (RES department) performs the day-to-day tasks related to these missions. The Resolution Director, Mr Romain Strock, who chairs the Resolution Board, heads the RES department.

For a description of the functions and composition of the Resolution Board, please refer to Chapter I "Governance and functioning of the CSSF".

Set up on 1 March 2015 in order to carry out the tasks and obligations entrusted to the national resolution authority under the BRRD as well as under Regulation (EU) No 806/2014 (SRM Regulation), the RES department is composed of 11 persons as at 31 March 2017.

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

- adopting resolution plans and resolvability assessments;
- measures to address or remove impediments to resolvability;
- appointing a special manager;
- ensuring a fair, prudent and realistic valuation of the assets and liabilities;
- applying simplified obligations or granting waivers, among others, to the obligation to draft a resolution plan;
- setting the minimum requirement for own funds and eligible liabilities, in particular its level;
- adopting resolution decisions and applying resolution tools in accordance with the relevant procedures and safeguards;

- writing-down or converting relevant capital instruments;
- executing the instructions issued by the SRB.

Moreover, the RES department represents the CSSF as resolution authority within international fora. Thus, the agents of the RES department, notably, participate in the work of the SRB and the EBA.

As far as the EBA is concerned, the RES department is represented in the Resolution Committee (ResCo) which is a permanent internal committee of the EBA, set up in January 2015, for the purpose of taking decisions and fulfilling tasks conferred on the EBA and the national resolution authorities under the BRRD. The voting members are the directors of the national resolution authorities within the EU. In addition, the RES department participates in the work of the Subgroup on Crisis Management (SGCM), joint subgroup of the Standing Committee on Regulation and Policy (SCRePOL) and the Resolution Committee.

As regards the SRB, for a detailed description of its tasks, functions and composition, please refer to Chapter II "The European dimension of the supervision of the financial sector" of the CSSF Annual Report 2015. The Resolution Director participates in the plenary session of the SRB as well as in the extended executive session when topics concerning Luxembourg entities are being discussed. This was the case in 2016 during the adoption by the SRB, meeting in extended executive session, of the resolution plans of several banking groups which include Luxembourg banking subsidiaries and of the resolution plans of Luxembourg banking groups or systemic banks. Moreover, a reorganisation of the permanent working sub-committees of the SRB took place in 2016 and the agents of the RES department participate, henceforth, in the work of the SRB Resolution Committee, the SRB Fund Committee, the SRB Administrative and Budget Committee and the SRB Legal Network. The CSSF also participates in the SRB ICT Network.

The RES department continues its collaboration with the SRB for the drafting of resolution plans of Luxembourg significant banks under the competence of the SRB. In this context, frequent meetings, videoconferences and information exchanges will take place with the representatives of the SRB, the CSSF's department "Supervision of banks" and the relevant banks. The RES department also participates, within the Internal Resolution Teams coordinated by the SRB, in drafting resolution plans for significant banking groups in the Banking Union, which have Luxembourg subsidiaries.

The RES department prepared and held meetings of three colleges of resolution authorities relating to banks for which the CSSF is the group-level resolution authority and participated in meetings and teleconferences of colleges of resolution authorities chaired by the group-level resolution authorities from other EU countries.

Moreover, the RES department started drafting a certain number of resolution plans for less significant banks under the direct responsibility of the Resolution Board.

Two CSSF-CODERES circulars were published in 2016 concerning, on the one hand, the raising of 2016 contributions for the Single Resolution Fund and, on the other hand, the collection of information for the calculation by the SRB of the 2017 contributions to the same fund.





## CHAPTER XVIII

### PROTECTION OF DEPOSITORS AND INVESTORS

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

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

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

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

#### • Activities of the CPDI

In 2016, the CPDI met four times, allowing, among others, to validate the following circulars:

- Circular CSSF-CPDI 16/01 of 6 April 2016 providing information regarding the collection of the 2016 *ex ante* contributions pursuant to Article 166(2) of the BRRD Law;
- Circular CSSF-CPDI 16/02 of 18 October 2016 on the scope of the deposit guarantee and the investor compensation;
- Circular CSSF-CPDI 16/03 of 18 October 2016 on the survey on covered claims in connection with investment business; and
- Circular CSSF-CPDI 16/04 of 23 November 2016 on the quarterly survey on the amount of covered deposits held during 2016.

The CPDI ensures that the FGDL has adequate mechanisms in place to determine its potential commitments. To this end, the CPDI will carry out stress tests on the FGDL system from 2017 on. Moreover, the PDI department assists the CPDI in the calculation and collection of the contributions to be paid to the FGDL by the member institutions, ensures the sound functioning of the depositor and investor compensation scheme, performs ongoing checks at the participating institutions to ensure the sound functioning of the compensation scheme, carries out the cross-border compensation and, if necessary, the contribution transfer transactions between the deposit guarantee funds in the EU, contributes to the drawing-up of opinions and technical standards within the relevant working groups on deposit guarantee and investor compensation of the EBA, and, where applicable, of the European Forum of Deposit Insurers (EFDI).

In 2016, the CPDI validated the membership of the FGDL to the EFDI Multilateral Cooperation Agreement Model, as well as a guide on good practices and associated standards, based on EBA Guidelines (EBA/GL/2016/02) which include important specifications on the objectives and minimum content of cooperation agreements which have to be concluded between deposit guarantee schemes under Directive 2014/49/EU.

The CPDI also mandated the implementation of an IT software to automate, as far as possible, the compensation process. The main functions of this software are: reading the Single Customer View file and providing a quality report, calculating the amount to be paid out for each depositor and the total payment volume, extracting the mailing addresses, inputting a new bank account number for each depositor to ensure the payment of the compensation, and generating payment instructions.

Moreover, the CPDI elaborates the educational and informational content of the website [www.fgdl.lu](http://www.fgdl.lu). A strategy has been put in place to optimise the access to the website, to the information provided and to its services in order to facilitate the contact with depositors in accordance with Article 158 of the BRRD Law. To this end, the CPDI is also currently seeking the assistance of a service provider in order to put in place a dedicated call centre for wronged depositors. This service will be activated in the event of a bank failure and may be adapted according to the size of the institution concerned.

#### • Ex ante contribution collection for the FGDL

Pursuant to Articles 179(2) and 180 of the BRRD Law, the FGDL collects the contributions from credit institutions, including Luxembourg branches of credit institutions having their registered office in a third country, and from POST Luxembourg for its provision of postal financial services. The FGDL will receive these contributions over a period of three years to reach the target level of 0.8% of the covered deposits at the end of 2018. In accordance with Article 180(1) of the aforementioned law, the FGDL will continue to collect contributions during the period from 2019 to 2026 in order to provide the FGDL with a buffer of additional financial means representing another extra 0.8% of the covered deposits. The FGDL will thus reach a level of contributions which represents twice the minimum assets required for by Directive 2014/49/EU.

The methodology elaborated by the CPDI in accordance with Article 182 of the BRRD Law and with the EBA Guidelines on methods for calculating contributions to deposit guarantee schemes (EBA/GL/2015/10) has been presented and discussed with the industry. The contributions are calculated based on the amount of covered deposits and the degree of risk incurred by the respective participating member. In accordance with the requirements of Article 182(3) of the BRRD Law, the CSSF approved the calculation method published as an annex to Circular CSSF-CPDI 16/01. The entities concerned paid ex ante contributions totalling EUR 76.6 million to the FGDL for the financial year 2016.

#### • Interventions

In 2016, the FGDL did not perform any reimbursement of deposits, nor finance any resolution nor any measure to safeguard depositors' access to covered deposits in the context of winding-up or reorganisation procedures.



## CHAPTER XIX

### FINANCIAL CRIME

The following developments present the CSSF's involvement in determining anti-money laundering and combating the financing of terrorism (AML/CFT) policies at national and international level over the year 2016. The operational part of the CSSF's activities with respect to AML/CFT supervision is further detailed in the chapters regarding supervision and in Chapter XVI "Instruments of supervision" of this annual report.

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

##### 1.1. Amendments to the European framework on AML/CFT

###### 1.1.1. Proposal for a directive amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing and Directive 2009/101/EC

On 5 July 2016, the European Commission adopted a proposal for a directive aiming to further strengthen the EU AML/CFT rules in order to fight against terrorist financing and to increase transparency as regards beneficial owners of undertakings and trusts.

The proposal for a directive is designed, more specifically, to reinforce the powers of the EU financial intelligence units and to facilitate the cooperation between them, to tackle the terrorist financing risks related to virtual currencies, to apply stricter controls to third countries at risk and to reinforce the transparency rules to prevent tax evasion and money laundering via the establishment of central registers of beneficial owners (BO) accessible to the public and interconnected in the different Member States.

The adoption process at European level of the aforementioned proposal for a directive, whose entry into force was initially planned for 1 January 2017 together with Directive (EU) 2015/849 (IVth Directive), whose deadline for transposition remains set on 26 June 2017 at the latest, is still underway.

It should be noted that the work to transpose the IVth Directive into Luxembourg law continues and that the date of transposition of all provisions of the directive into national law remains unchanged, i.e. 26 June 2017.

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

In accordance with the mandate under Article 9 of the IVth Directive, the European Commission adopted Commission Delegated Regulation (EU) 2016/1675 identifying high-risk third countries with AML/CFT strategic deficiencies and whose poor standards for controlling money flows pose significant threats to the financial system of the EU.

The regulation which entered into force on 23 September 2016 is binding in its entirety and directly applicable in each Member State of the EU. It will be updated on a regular basis by the European Commission.

### 1.1.3. Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money laundering information by tax authorities

Adopted within the framework of the fight against tax fraud and tax evasion, the directive is to be considered in the context of the implementation of the global standard for automatic exchange of financial account information in tax matters within the EU.

### 1.1.4. Conclusions of the Council of the EU on the criteria for and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes

To enhance transparency, and more specifically following the revelations brought to light by the "Panama Papers", the Council of the EU agreed to establish an EU list of non-cooperative jurisdictions for tax purposes. To this end, it has adopted, by publication in the Official Journal of the EU of 10 December 2016, conclusions that provide for criteria for screening non-cooperative jurisdictions, as well as guidelines for the assessment procedure. The Council's intention is to approve the final version of this list before the end of 2017.

### 1.1.5. Regulation (EU) 2016/1686 of 20 September 2016 imposing additional restrictive measures directed against ISIL (Da'esh) and Al-Qaeda and natural and legal persons, entities or bodies associated with them

In response to the concrete threat caused by Al-Qaeda and ISIL (Da'esh) to international peace and security, the Council of the EU has adopted, by way of this regulation, additional restrictive measures against ISIL (Da'esh) and Al-Qaeda as well as natural and legal persons, entities or bodies associated with them. All the restrictive financial measures adopted in 2016 are available on the CSSF website under the section "Financial Crime".

## 1.2. Amendments to the Luxembourg regulatory framework

### 1.2.1 Penal Code

In Luxembourg law, the entry into force of the Law of 23 December 2016 on the implementation of the 2017 tax reform, which directly impacts the fight against money laundering, should be noted. This law provides for, inter alia, the offences of aggravated tax fraud (*fraude fiscale aggravée*) and evasion (*escroquerie fiscale*) related to direct or indirect taxes for predicate money-laundering offences by way of an amendment of Article 506-1(1) of the Penal Code, and thus already transposes the requirements of the IVth Directive and the FATF in this respect.

### 1.2.2. Ministerial regulations

In 2016, the Ministry of Finance issued six new ministerial regulations implementing UN Resolutions 1267 (1999) and 1989 (2011) (Al-Qaeda) and 1988 (2011) and 2082 (2012) (Taliban).



### 1.2.3. CSSF circulars and other information

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

Moreover, the CSSF published Circular CSSF 16/645 on 27 October 2016, following the statements of the FATF during its plenary meeting of October 2016, which lists in this respect:

- the jurisdictions whose anti-money laundering and combating the financing of terrorism regime has substantial and strategic deficiencies;
- the jurisdictions whose anti-money laundering and combating the financing of terrorism regime requires the application of enhanced due diligence measures proportionate to the risks arising from these jurisdictions; and
- the jurisdictions whose anti-money laundering and combating the financing of terrorism regime is not satisfactory.

The CSSF circulars relating to the FATF statements are published three times per year at the end of each of the three annual plenary meetings of the FATF and are replaced successively.

The AML/CFT FAQ published by the CSSF on its website were amended in July 2016.

It is also worth mentioning the publication, on 12 April 2016, of the EBA's opinion on the application of customer due diligence measures to customers who are asylum seekers from higher-risk third countries or territories<sup>1</sup>, which is an information that the CSSF released in its Newsletter of May 2016.

In its Newsletter of November 2016, the CSSF informed professionals of the publication of the FATF guidance on correspondent banking services in relation, notably, to the de-risking issue, i.e. situations where financial institutions terminate or restrict business relationships with entire countries or classes of customers in order to avoid, rather than manage, risks in line with the FATF's risk-based approach.

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

The CSSF participates in several international working groups dealing with AML/CFT topics, including the Financial Action Task Force (FATF), the Joint Committee's Sub-Committee on Anti-Money Laundering (AMLC) under the Joint Committee of the European Supervisory Authorities, the Expert Group on Money Laundering and Terrorist Financing (EGMLTF) of the European Commission, the Anti-Money Laundering Expert Group (AMLEG) of the Basel Committee on Banking Supervision and The Wolfsberg Group.

Among the FATF's work in 2016 that is of particular relevance for the financial sector, the following can be mentioned:

- adoption of the Guidance on criminalising terrorist financing;
- drafting of a handbook to assist practitioners in their implementation of United Nations Security Council Resolution 1373.

Of particular note among the key topics discussed within the FATF in 2016 are the decline in correspondent banking relationships, mainly due to de-risking, and the transparency in information exchange and knowledge of the beneficial owner.

<sup>1</sup> [http://www.cssf.lu/fileadmin/files/LBC\\_FT/tax/tas UE/EBA-Op-2016-07.pdf](http://www.cssf.lu/fileadmin/files/LBC_FT/tax/tas UE/EBA-Op-2016-07.pdf).



Other more specific work of the FATF led to the publication of two important guides for banks, but also for providers of services related to the money or value transfer services, i.e.:

- Guidance on correspondent banking services (October 2016);
- Guidance for a risk-based approach for money or value transfer services (February 2016).

Finally, the FATF, which holds true to its objective to further involve the private sector in its work, met representatives of the private sector to openly exchange on, inter alia, existing barriers to AML/CFT-related information exchange and on the situation of correspondent banking relationships, always with the aim to remedy de-risking where an AML/CFT risk is involved.

All the publications of the FATF are available on the website <http://www.fatf-gafi.org/>.

At national level, the CSSF held in 2016 formal meetings with representatives of the FIU and/or the State Prosecutor. The discussions concerned, in particular, certain suspicious reports of major importance for the Luxembourg financial centre, the implementation of a new predicate money-laundering offence in tax matters by reference to the IVth Directive and the preparation of a common circular in this respect.

Several coordination and consultation meetings of all the national authorities competent in AML/CFT were also held in 2016 under the chairmanship of the Ministry of Justice and the Ministry of Finance, respectively, depending on the topics of the corresponding working groups.

The purpose of the meetings was the transposition work of the IVth Directive (including the exchange of views as regards the implementation of a national register of beneficial owners), the guidelines as regards the application of different financial sanctions (CFT and non-CFT), the standard form for transaction reports in relation to countries subject to financial sanctions as well as the preparation of the plenary meetings of the FATF.

The CSSF, moreover, actively participated in the preparation of a National Risk Assessment, as provided for by the FATF in its Recommendation 1.



## CHAPTER XX

### FINANCIAL CONSUMER PROTECTION

#### 1. FINANCIAL CONSUMER PROTECTION AND FINANCIAL EDUCATION

Financial consumer protection is increasingly developing in the financial centre and the CSSF is contributing to this development.

In order to facilitate consumers' dispute resolution, the legislator adopted the Law of 17 February 2016 introducing the alternative dispute resolution for consumer disputes into the Consumer Code and amending certain other legal provisions of the Consumer Code. This law provides, inter alia, that the Minister of Economy draws up a list of the entities in charge of alternative dispute resolution for consumer disputes (qualified entities). The CSSF was registered on this list in November 2016. The official recognition as qualified entity notably allowed the CSSF to participate in the alternative consumer dispute resolution platform established at the beginning of 2016 by the European Commission.

Moreover, as supervisory authority of the financial centre and as part of the mission conferred upon it by its organic law, the CSSF pays particular attention to the protection of the interests of financial consumers that are often dependent on the last technological developments. This willingness to protect financial consumers' rights is shared by the European supervisory authorities and international organisations such as the OECD or FinCoNet.

At Luxembourg level, the Financial Consumer Protection Committee developed a national strategy regarding financial education in 2015. As soon as it reaches the government's approval, the efforts made in this respect will be intensified and coordinated. Article L.226-4 of the Law of 23 December 2016 on credit agreements relating to residential immovable property introduces financial education of consumers in this respect. This law designates the CSSF as the authority competent, in particular, to promote measures aiming to educate consumers on responsible borrowing and debt management.

In general, financial education is a key strategy to enhance consumer protection and to promote consumers' confidence in financial products and players. According to a definition of the OECD, financial education is defined as the process by which a person improves his/her understanding of products, concepts and financial risks and via instruction develops the skills and confidence to carry out effective interventions

to improve his/her financial position. A cultural dimension can be added to this definition as regards anyone's understanding of the economic and financial world s/he lives in.

Financial education is a long-term exercise which is complementary to other tools such as regulation or supervision.

In addition to its involvement at European level, the CSSF contributes to the work of several international groups, the purposes of which are financial consumer protection and the spread of financial education.

### • Task Force on consumer protection of the OECD Committee on Financial Markets

The Task Force's work focussed on the implementation of the operational action plan that it developed following the work regarding the 10 High-Level Principles of the G20 on financial consumer protection.

The interest of the members was particularly keen for High-Level Principle 9 on complaints handling and redress. A self-assessment questionnaire was drawn up to enable the members to assess how they implement this principle. In this context, the Task Force also expressed an interest for the processing and backup of the data collected in complaint handling and for the current and future risks to which the financial consumer is exposed (e.g. household indebtedness, ageing population, dependence on new technologies, etc.).

### • FinCoNet

FinCoNet is an international organisation which gathers supervisory authorities that are responsible for financial consumer protection from 22 countries. It aims at fostering information exchange and cooperation between supervisory authorities in order to encourage a proper conduct of the market and a strong consumer protection in banking and credit.

In 2016, FinCoNet published summary reports on responsible lending ("Sales Incentives and Responsible Lending") and supervisory measures to mitigate security risks linked to online and mobile payment ("Online and mobile payments: Supervisory challenges to mitigate security risk").

FinCoNet also issued the document "Guidance to Supervisors on the setting of Standards in the field of Sales Incentives and Responsible Lending".

Moreover, FinCoNet organised, in 2016, in cooperation with the Indonesia Financial Services Authority an international seminar entitled "Fast Innovation and Development of Fintech: Striking a Balance Between Financial Inclusion and Consumer Protection". At the end of this seminar, FinCoNet published a communiqué encouraging supervisory authorities to focus on emerging Fintech risks in order to safeguard consumer interests.

### • International Network on Financial Education (INFE) of the OECD

This international network serves as a platform to collect data on financial literacy and to develop analytical and comparative reports, research, as well as policy instruments. Over 118 countries and regions are members of the INFE and 81 public authorities, including the CSSF, have the status of fully fledged members.

The INFE also seeks to promote and facilitate international cooperation between the different participants (politicians, regulators, associations, etc.) concerned by the financial education issue at global level. One of the key topics of the INFE is the national strategy regarding financial education that each Member State is requested to put in place.

The INFE has recently defined two core competencies frameworks on financial literacy, one for adults and another for youth. It is a tool which highlights a range of knowledge in financial education which might be considered as highly important to support or improve the financial welfare of the citizens in their daily life.

The INFE has also developed a policy handbook on financial planning for retirement and worked on the role of financial education and consumer protection in the digital era.

#### • Committee 8 on Retail Investors of IOSCO

The Committee's mandate is to perform IOSCO's tasks in relation to financial education, to advise the IOSCO Board on issues relating to investor protection and to work on the policy to be adopted in this field.

In 2016, IOSCO published a report on the vulnerability of elderly people. Indeed, it has been noted that they are at higher risk of becoming victims of a fraud or subscribing for inappropriate investments in regard to their situation. The report contains good practices on the protection of this specific kind of investors.

Moreover, the Committee is considering the implications of new financial technologies on financial education and the possibilities of using methods of behavioural economics in financial education.

The IOSCO Board mandated the Committee to organise a global week of investors. The purpose is to launch a global campaign to raise awareness of financial education and investor protection.

## 2. OUT-OF-COURT RESOLUTION OF COMPLAINTS

Since its creation, the CSSF has assumed a role of intermediary in the out-of-court dispute settlement aiming at professionals subject to its supervision.

The CSSF handles complaints which are submitted to it by following the procedure provided for in the first section of CSSF Regulation N° 16-07 relating to the out-of-court resolution of complaints. The second section of the regulation aims to specify certain obligations incumbent upon professionals in relation to the internal handling of complaints or in their relationship with the CSSF.

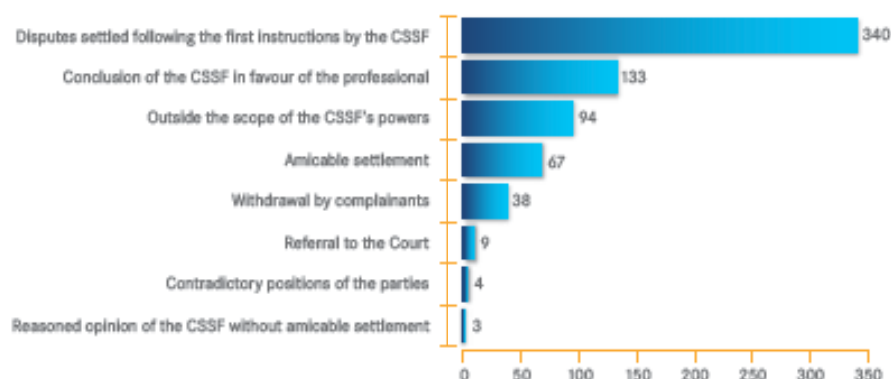
CSSF Regulation N° 16-07 takes into account the requirements of Regulation (EU) No 524/2013 of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC.

It should be noted that the CSSF was registered, on 11 November 2016, on the list of qualified entities for alternative dispute resolution, which was drawn up by the Minister of Economy and on the list of alternative dispute resolution entities drawn up and published by the European Commission.

### 2.1. Statistics regarding CSSF complaint handling in 2016

In 2016, the CSSF received 621 files from customers of entities subject to its supervision and closed 688 files (including files received in the preceding years which had not, so far, been closed).

#### Outcome of the CSSF's intervention/reasons for closing the files



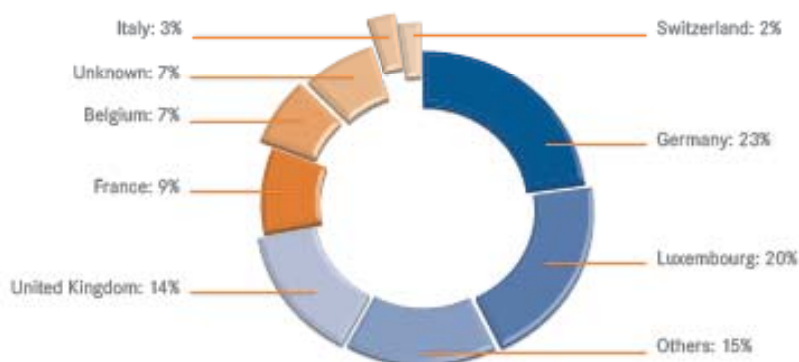
When the CSSF receives a financial consumer complaint, it sends an acknowledgement of receipt which includes all the useful instructions so that the claimant can resolve the dispute with the professional without additional intervention of the CSSF. This acknowledgement of receipt indicates, among others, the full name of the manager in charge of complaints whom the complainant should contact at the entity concerned in order to reach an amicable settlement and the link to the webpage where useful information on the out-of-court handling of complaints by the CSSF is available to the complainant.

Judging by the high number of disputes which were settled following these first instructions of the CSSF, the CSSF's approach consisting in favouring the dialogue between the parties to the dispute and not contacting immediately the supervised entity concerned by a complaint, is successful.

94 requests for the out-of-court resolution of complaints submitted to the CSSF were inadmissible for the following reasons:

- complaints involving entities<sup>1</sup> that are not subject to the CSSF's supervision (43%);
- complaints falling within the scope of the insurance sector (26%);
- complaints concerning a non-financial product (17%);
- complaints heard by a court (10%);
- complaints dealt with by another out-of-court dispute resolution body (3%);
- complaints concerning commercial policy (1%).

### Breakdown of the complaints according to the complainants' country of residence



The share of complaints from Germany is the most important with 23% of all the complaints received.

The country of residence of the complainants is not identified in 7% of the cases, which is, in general, due to the fact that these complainants contacted the CSSF by way of emails without indicating their country of residence and the CSSF's intervention stopped upon sending the first instructions. Finally, the category "Others" covers 37 different countries.

<sup>1</sup> Excluding the insurance sector.



**Breakdown of complaints according to their object**

The breakdown of complaints according to their object remained stable in 2016 compared to 2015.

With 48%, the major share of complaints registered concerned problems linked to the use of electronic payment services. The share of complaints relating to private banking (10%) is decreasing as compared to the previous financial year (13% in 2015). It should be noted that complaints relating to mortgages slightly increased.

The share of complaints in connection with UCIs remains low in comparison with the importance of the investment fund sector in Luxembourg.

## 2.2. Complaints handled in 2016

### 2.2.1. Money transmission services

The CSSF regularly deals with complaints relating to the execution of payment transactions.

In one case, the complainant blamed the bank for having debited, during several months and without his authorisation, his bank account in favour of a third party within the context of a direct debit.

After having been informed by the complainant, the bank blocked the contentious direct debit, but did not agree to return the funds that had been unduly debited from the complainant's account. Despite the complainant's protests, the bank did not grant his request to return the unduly debited funds, arguing that he had not introduced his refund application in written form within a period of 13 months from the date of the contentious debits. The bank justified its refusal to repay the funds also by the fact that the credited third party refused to return the funds debited from the complainant's account.

When examining the file, the CSSF noticed that the bank was unable to explain why the contentious direct debit was set up on the complainant's account, knowing that the complainant did not provide any instructions in this respect. The CSSF also noted from the internal emails of the bank that it had been informed, in due time, of the contentious debits by the complainant.

As regards the legal basis invoked by the bank to support its case, i.e. that the complainant did not file his complaint within a period of 13 months, the CSSF pointed out that Article 85 of the Law of 10 November 2009 on payment services which mentions this period, provides that the user of payment services must notify, without undue delay, his payment service provider that he noticed a non-authorised or defectively executed payment transaction on his account. As is clear from the provisions of this article, it is sufficient for the user of payment services to notify his service provider of the identified anomaly within a period of 13 months without any requirement for this notification to be in written form or a written refund application to be introduced with the payment service provider within a legal period of 13 months.

Based on the above, the CSSF concluded that the bank's refusal to reimburse the complainant for the unduly debited funds was not justified by the fact that the complainant did not introduce a written refund application with the bank within the legal period of 13 months. The argument of the bank that it should not transfer the

money back into the complainant's account because the third party credited during the payment transaction refused to return the contentious funds was not accepted by the CSSF either.

The bank eventually reimbursed the funds debited from the complainant's account without his authorisation.

In another case opposing parties as regards the execution of a payment order, the complainant blamed the bank for not having provided the support he required to recover the funds which had been fraudulently deducted from his account.

The complainant made a transfer to an account opened with a foreign bank in order to book a holiday home. After a certain period of time, the complainant understood that he had been the victim of a fraud and that the recipient of the transfer, made to book the holiday home, was not the owner of it. The complainant stated that the bank with which the fraudster's account was opened agreed to refund the contentious funds, provided that his bank issues a guarantee that would hold the foreign bank harmless of any consequences in case of a refund.

The complainant's bank asserted that, at the time it received the instruction to transfer the contentious amount to the account of the so-called owner of the holiday home for rent, it contacted the payer to confirm this order which did not correspond to the orders usually given by him. The bank then executed the transfer upon the complainant's express request.

As regards the bank guarantee required by the foreign bank, the complainant's bank did not issue it, because the foreign bank did not provide significant information requested in relation to the account to which the contentious transfer was made. The bank argued that, in the absence of such information, it has not been able to issue the guarantee in question.

The CSSF was of the opinion that the position of the bank was tenable and did not uphold any misconduct on its part.

### 2.2.2. Margin calls

In 2016, the CSSF dealt with some disputes in which the complainants challenged the rigorous application of margin call conditions.

Thus, in one case, the complainant blamed his bank for not having informed him of the contentious margin calls and for having, afterwards, been unaware that he had to credit his account or to liquidate the one or the other position on his account in order to respect the margin, failing which the bank would liquidate the positions on his securities account on its own initiative. The complainant requested compensation for the damage caused by the liquidation of his positions by the bank. He specified that instead of liquidating the positions and thereby causing him a damage, the bank could have used his current account on which he had some funds.

The bank argued that the complainant had been duly informed of the conditions of margin calls.

When examining the elements of the file, the CSSF noticed that the terms and conditions of the bank signed by the complainant clearly mentioned the rights and obligations of the parties relating to the provision of the margin, the functioning method of the margin calls and the liquidation of open positions which may take place in case of non-compliance with the required margin.

The bank also provided the CSSF with a statement of the warnings sent to the complainant to inform him that he no longer respected the margin and that he should fund his account in order to reduce his exposure. This statement also showed that the complainant actually received the information on the margin call and that he had acquainted himself with the warnings.

Moreover, the CSSF noticed that the terms and conditions of the bank clearly provide that, as far as the margin calculation is concerned, the bank only takes into account the assets booked on the securities account of the customer; the assets booked on any other accounts opened by the customer with the bank would not be taken into consideration.

The CSSF concluded that the complainant had been duly informed of the bank's conditions as regards margin.

In another case, the complainant blamed his bank for having automatically liquidated all the open positions on his account. The complainant stated that this liquidation should not have taken place because his account was sufficiently funded.

The bank defended itself by invoking its terms and conditions, which the complainant accepted, stressing that the contentious automatic liquidation took place in accordance with the terms and conditions.

Indeed, the terms and conditions of the bank provide for two methods of liquidation of the customer's positions in the event of non-compliance with the required margin. On the one hand, the terms and conditions provided for the liquidation of the positions where the balance of the account falls below the required margin without, however, falling below 50% of this margin. In this case, the bank can proceed with the liquidation of certain positions to reach the level of the required margin. On the other hand, the terms and conditions provide for a system of automatic liquidation of all the positions on the customer's account where the balance of his account falls below 50% of the required margin. In this event, the balance of the customer's account fell below 50% of the margin.

Consequently, the CSSF decided that the automatic liquidation was above reproach and closed the dispute without upholding the complainant's grievances.

Sometimes, banks that insist on compliance with the margins somewhat neglect the way in which the customers are warned of the necessity to take measures to respect the margin.

In one case, for example, the bank drew its customer's attention to the fact that, given the market fluctuations, he might soon no longer be able to comply with the requirements of the margin.

As the customer did not respond to this warning and his margin was not respected eventually, the bank sent him a margin call letter, giving him a time limit of three days as from the mailing of the letter to comply with the contractual obligations in respect of margin. In the absence of any additional guarantee provided by the customer, the bank sold the complainant's positions in order to ensure the respect of the margin level stipulated in the contract.

The complainant subsequently blamed the bank for having liquidated his positions without observing the notice period, so that he did not have enough time to fund his account in order to respect the margin.

The bank argued that the margin call took place in accordance with the contractual arrangements in force and that the notice period calculated as from the date of mailing of the margin call letter had been observed.

The CSSF noted that the terms and conditions did not explicitly provide for the date at which the notice period started running. Is it the date at which the margin call letter was sent as alleged by the bank or the date at which the margin call letter was received by the recipient as alleged by the complainant?

The CSSF finally held that the three-day period started running as from the day of receipt of the letter by its recipient, so that he had three days to make the necessary arrangements to avoid the "compulsory" liquidation of his positions by the bank.

### 2.2.3. Bank guarantees

The CSSF often receives complaints relating to bank guarantees given to banks within the framework of the financing they grant.

For example, the CSSF was contacted by a complainant who qualified as a company director. This company contracted from its bank loans that were backed by guarantee contracts signed by the company's directors and by mortgages on their real estate properties. After experiencing financial difficulties, the company was finally liquidated, placing the former directors before their responsibilities.

The complainant, with whom the bank exercised its guarantees, argued that he had not heard from the bank since his resignation as a director up until the day at which, a few years later, he received a letter from the bank informing him of its intention to enforce the bank guarantees provided to guarantee the loan granted to the company.

The complainant, who wanted to oppose the enforcement of the guarantees in question, reproached the bank for having unduly delayed in enforcing the guarantees, thereby wrongly accumulating the interest expense on the company's debt. The complainant was of the opinion that the contentious interests now claimed by the bank could have been cleared had the bank enforced the collateral in question earlier.

To justify its position, the bank provided several letters exchanged between it and the complainant. These letters showed that the complainant could not have been unaware of the existence and the evolution of the company's debt to the bank. Consequently, following his resignation as a director, the complainant had been, quite early on, in regular contact with the bank to negotiate the enforcement of the guarantees he provided and thus to envisage the repayment of the company's debt.

These documents enabled the CSSF to conclude that the complainant knew that the contentious debt existed even if he no longer held a position as director at the company and that he had been engaged in lengthy discussions with the bank to find a solution that would suit both parties.

#### 2.2.4. Asset management by the customer or the professional

A complaint was referred to the CSSF where the complainant complained that the shares of a fund held by him could not be sold. He claimed that he had been advised by the bank to purchase these shares within the framework of an advisory management contract. The complainant blamed the bank for not having duly informed him about the securities in question.

The bank denied having advised the complainant to invest in the contentious securities. The argument of the bank that the contentious securities were on the complainant's account following the transfer of the securities from a third-party account drew, in particular, the CSSF's attention. When examining the account statements of the complainant and the advisory management contract, the CSSF noticed that the contentious securities had actually been transferred to the complainant's account from a third-party account two months before the conclusion of the advisory management contract.

It follows therefrom that the contentious securities could not have been acquired by the complainant upon the bank's advice. The CSSF closed the file without upholding a misconduct by the bank.

### 2.3. FIN-NET

FIN-NET was launched by the European Commission in 2001 and is composed of bodies established in the EEA countries whose task is to resolve out-of-court disputes between consumers and financial services providers.

A new memorandum of understanding adopted by the members of FIN-NET entered into force on 16 March 2016. Since the CSSF is on the European Commission's list of qualified entities for alternative resolution of consumer disputes, the CSSF is again considered as a full member of FIN-NET.





## CHAPTER XXI

### BANKING AND FINANCIAL LAWS AND REGULATIONS

#### 1. DIRECTIVES AND REGULATIONS UNDER NEGOTIATION AT EU LEVEL

The CSSF participates in the groups examining the following proposals for directives or regulations.

##### 1.1. Proposal for a delegated regulation supplementing Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIP Regulation) 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

On 16 September 2016, the European Parliament rejected the regulatory technical standards under the PRIIP Regulation as established by the European Commission in a delegated regulation. These standards relate to the presentation, content, review and revision of key information documents (KIDs). Following this rejection, the Council adopted, on 8 December 2016, a regulation postponing the application date of the PRIIP Regulation by 12 months. It now will apply as of 1 January 2018.

##### 1.2. Proposal for a regulation on money market funds

On 7 December 2016, the Council of the EU confirmed its agreement on the final regulation on money market funds negotiated with the European Parliament and the European Commission. The publication of the regulation in the Official Journal of the EU is planned for the first half-year of 2017.



### 1.3. Proposal for a regulation amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds

On 16 December 2016, the Council of the EU adopted its negotiating position on the amendments of the EU rules aiming to increase venture capital investments and investments in social enterprises. Consequently, on behalf of the Council of the EU, the Permanent Representatives Committee requested the future Maltese Chairmanship to start discussions with the European Parliament once it has formed its position.

The proposed regulation is part of the EU plan to put in place a fully operational capital markets union, by diversifying the funding sources for European companies and long-term projects. The proposal aims to make European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF) available to both smaller and larger fund managers. By amending Regulations (EU) No 345/2013 and (EU) No 346/2013 of 17 April 2013, it widens the range of companies in which EuVECA and EuSEF may invest and also makes the cross-border marketing of these funds less expensive and easier.

### 1.4. Proposal for a regulation on the prospectuses to be published when securities are offered to the public or admitted to trading

The proposal for a new Prospectus Regulation was negotiated in trialogue between the European Commission, the Council of the EU and the European Parliament and led to the approval by the Council of the EU of a draft regulation on 20 December 2016. The interim agreement must be approved by the European Parliament in first reading in 2017, prior to the final adoption by the Council of the EU. The purpose of this draft regulation, which aims to replace Directive 2003/71/EC, is to simplify the administrative obligations related to the prospectus publication while ensuring that investors are well informed.

### 1.5. Proposal for a regulation on structural measures improving the resilience of EU credit institutions (BSR)

The proposal for a regulation was discussed in detail in the CSSF Annual Report 2015.

### 1.6. Proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

#### Proposal for a regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

Both draft regulations were published by the European Commission on 30 September 2015.

The first regulation aims to merge the securitisation-related provisions of diverse sectoral directives and regulations (CRR, AIFMD, EMIR, UCITS Directive and Regulation (EU) on credit rating agencies) in one single text, thereby creating a framework for simple, transparent and standardised (STS) securitisation.

The second regulation aims to amend the CRR in order to implement into European law the Basel rules on securitisation, while creating a preferential treatment for STS securitisation. The purpose of the proposal is to promote simply structured securitisations in Europe, allowing restoring confidence in order to reboot the securitisation market and, in fine, to finance the real economy with a view to fostering job creation and growth.

Following the compromise agreement that the members of the Council of the EU reached in December 2015 on both texts, the trialogue between the European Commission, the Council of the EU and the European Parliament on the two regulations started in January 2017.

### 1.7. Proposal for a regulation in order to establish a European Deposit Insurance Scheme

The text, which is still subject to discussions in 2016, was dealt with in detail in the CSSF Annual Report 2015.

### 1.8. Proposal for a directive amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures

**Proposal for a regulation amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and amending Regulation (EU) No 648/2012**

**Proposal for a directive amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy**

**Proposal for a directive amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms**

On 23 November 2016, the European Commission proposed a set of reforms of the EU banking sector, referred to as "CRR II package" with the objective to supplement the regulatory programme established by the EU after the crisis, so that the regulatory framework addresses all the risks that would threaten the financial stability, while ensuring that banks continue to support growth, thereby restoring confidence.

The CRR II package proposes to amend several existing legislative texts, i.e.:

- Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV);
- Regulation (EU) No 806/2014 establishing the Single Resolution Mechanism and the Single Resolution Fund (SRM Regulation);
- Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD).

The European Commission has developed these legislative proposals by taking European particularities into account, and by integrating the international standards recently adopted by the Basel Committee, including those relating to the requirement of compliance with the TLAC (Total Loss Absorbing Capacity) in the resolution context.

In order to facilitate the establishment of the Banking Union, the European Commission proposes an extension of the existing rules as regards exemption from own funds and liquidity requirements. In this regard, authorisation should be granted to the competent authorities that supervise, on a consolidating basis, a parent undertaking and its subsidiaries established in different Member States to exempt certain subsidiaries included in the consolidated supervision of the parent company from compliance with these requirements. These exemptions may be applied solely when one/several guarantee(s) of the parent undertaking are issued in favour of cross-border subsidiaries.

In respect of the supervisory review and evaluation process (SREP) and decisions on additional capital requirements taken subsequently, the proposal aims to now distinguish between a mandatory additional capital requirement (Pillar 2 Requirement - P2R) and a desired additional capital requirement (Pillar 2 Guidance - P2G). As regards P2R, the proposal is intended to clarify the circumstances in which the risk elements may be subject to an additional capital requirement, to specify the qualitative criteria in terms of eligible own funds instruments for reaching compliance therewith and to develop principles of transparency to be met by the competent authorities and of disclosure to be met by the institutions.

For the purpose of fostering greater harmonisation of the principle of proportionality, detailed proposals are put forward, in particular, in the fields of remuneration and prudential reporting.

Moreover, the European Commission intends to provide some clarification on the consolidated supervision of groups held by or using financial holding companies and mixed financial holding companies. This clarification aims to entitle a competent authority to directly address the supervisory decisions to these holding companies, where they represent the effective decision-making centre of a group composed of several supervised institutions, whereas they are not required to comply with the CRD IV/CRR provisions on an individual basis. In this regard, the proposal introduces an authorisation process granting the consolidating supervisor a direct supervisory power over these holding companies.

The other main objective of the proposal concerns the bank resolution framework put in place at EU level under the BRRD in order to allow loss absorption by shareholders and investors (in order to avoid burdening taxpayers) in case of failure of a credit institution. Thus, any EU institution is required to meet a minimum requirement for own funds and eligible liabilities (referred to as MREL). This requirement shall provide it with sufficient financial resources, which might be written down or converted into equity, in order to absorb its losses and/or recapitalise in case of failure. In addition, the proposal of the European Commission aims to integrate the international TLAC requirement within the MREL European framework. It is an additional requirement applicable as from 2019 solely to global systemically important institutions (G-SIIs). Therefore, the proposal amends the CRR provisions relating to own funds, in particular by introducing new minimum capital requirements as regards the solvency ratio for G-SIIs and by defining eligibility criteria of instruments that might be considered as TLAC/MREL, in particular their subordination to excluded liabilities. It should be noted that under the BRRD, the resolution authorities may decide, on a case-by-case basis, that other credit institutions partially comply with the MREL through subordinated instruments. The proposals envisage a harmonised European approach to subordination by providing for a harmonised national ranking of uncovered debt instruments in respect of insolvency in order to facilitate the issue by banks of such debt instruments likely to absorb losses in case of resolution.

In order to make the European resolution framework more operational, it is also proposed to extend the powers of the competent authorities and the resolution authorities and to introduce a tool in the form of a moratorium allowing them to suspend certain contractual obligations for a defined period, both during early intervention and resolution phases.

Finally, in order to facilitate the implementation of the aforementioned TLAC/MREL standards for non-European global systemically important institutions (non-EU G-SIIs) and, from a wider perspective, to simplify and strengthen their resolution process, the proposal requires that an intermediate parent undertaking (IPU) is established in the EU, where at least two institutions belonging to the same non-EU group are established in the EU and whose European activities have a systemic nature on an aggregated basis.

### **1.9. Proposal for a directive amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing and Directive 2009/101/EC**

The proposal for a directive is further detailed in point 1.1.1. of Chapter XIX "Financial crime".



## 2. DIRECTIVES TO BE TRANSPOSED INTO NATIONAL LAW

### 2.1. Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II)

**Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MiFIR)**

MiFID II and MiFIR will enter into force on 3 January 2018.

For further details on the main amendments introduced by MiFID II and MiFIR into MiFID (2004/39/EC), please refer to point 1.9. of Chapter XV "Banking and financial legislation and regulations" of the CSSF Annual Report 2011.

### 2.2. Directive 2014/92/EU of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features

The directive was discussed in detail in the CSSF Annual Report 2015.

### 2.3. Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012, and repealing Directive 2005/60/EC and Directive 2006/70/EC

The directive was discussed in detail in the CSSF Annual Report 2015.

### 2.4. Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds

The regulation was discussed in detail in the CSSF Annual Report 2015.

### 2.5. Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU, and repealing Directive 2007/64/EC (PSD2)

PSD2, which was published in the Official Journal of the EU on 23 December 2015, aims at developing the European internal market of electronic payments in a technologically neutral way and at adopting the existing legal framework to innovating payment services and, among others, to payment initiation service providers and account information service providers. It renders the use of internet payment services more secure, mainly by introducing strong customer authentication at the payment service providers' charge. Finally, PSD2 introduces a new balance, as compared to the current situation, between the home Member State and the host Member State for cross-border supervision within the context of the European passport, i.e. the right of establishment and freedom to provide services.

PSD2 must be transposed into national law by 13 January 2018.

### 2.6. Directive (EU) 2016/2341 of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision

On 24 November 2016, the European Parliament, the Council of the EU and the European Commission reached an agreement on the proposal for a review of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP II Directive), so that Directive (EU) 2016/2341 was published in the Official Journal of the EU on 23 December 2016. The Member States must transpose the directive into national law within a period of 24 months following its entry into force, i.e. no later than 13 January 2019.

### 3. LAWS AND REGULATIONS ADOPTED IN 2016

#### 3.1. Law of 15 March 2016 on OTC derivatives, central counterparties and trade repositories

The law implements certain provisions of Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR). It designates more specifically the CSSF as the competent authority for the authorisation and supervision of central counterparties established in Luxembourg and for ensuring compliance with the EMIR obligations by financial counterparties subject to its supervision and by non-financial counterparties.

Moreover, the law provides for a regime of sanctions and administrative measures applicable in case of non-compliance with the EMIR provisions.

#### 3.2. Law of 10 May 2016 transposing Directive 2014/91/EU of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

This law, which entered into force on 1 June 2016, transposes into Luxembourg law Directive 2014/91/EU (UCITS V Directive) by amending the Law of 17 December 2010 relating to undertakings for collective investment and the Law of 12 July 2013 on alternative investment fund managers. The transposed provisions of Directive 2014/91/EU mainly concern three parts:

- a new regime regarding the missions and responsibilities of UCITS depositaries;
- rules relating to the remuneration of UCITS managers aiming to avoid excessive risk-taking;
- rules concerning administrative penalties in case of non-compliance with the obligations incumbent upon the UCITS and their managers.

Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 with regard to obligations of depositaries, which entered into force on 13 October 2016, supplements the legislative arsenal with enforcement measures.

The law also brought some amendments to the aforementioned Laws of 17 December 2010 and 12 July 2013, which are unrelated to the transposition of the UCITS V Directive. Thus, under this law, a stricter UCITS depositary regime applies to UCIs governed by Part II of the Law of 17 December 2010 (UCIs that automatically qualify as alternative investment funds under the Law of 12 July 2013, but that are products intended to be placed with the public). Furthermore, the law introduces the obligation for alternative investment fund managers to use the services of a *réviseur d'entreprises agréé* (approved statutory auditor) for the audit of their accounts. By transposing the relevant provisions of Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II), this law enables alternative investment fund managers to offer their investment services, such as portfolio management on a discretionary or client-by-client basis, on a cross-border basis.

#### 3.3. Law of 10 May 2016 on transparency requirements for issuers of securities

##### Grand-ducal Regulation of 10 May 2016 on transparency requirements for issuers of securities

The Law of 10 May 2016 amending the Law of 11 January 2008 on transparency requirements for issuers (Transparency Law) and the Grand-ducal Regulation of 10 May 2016 amending the Grand-ducal Regulation of 11 January 2008 on transparency requirements for issuers of securities (Transparency Regulation) entered into force on 15 May 2016. The consolidated versions of the Transparency Law and the Transparency Regulation, as amended, as well as the updated versions of the relevant circulars and FAQs have been published on the CSSF's website.



For further details on the main amendments introduced, and in particular the determination of the home Member State and the notifications of major holdings, please refer to Press Releases 15/49 of 27 November 2015 and 16/23 of 17 May 2016 as well as to the CSSF Annual Report 2015 (cf. point 4. of Chapter XI "Supervision of securities markets").

### **3.4. Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014**

The regulation is further detailed under point 8. of Chapter XII "Supervision of securities markets".

### **3.5. Commission Delegated Regulation (EU) 2016/1675 of 14 July 2016 supplementing Directive (EU) 2015/849 by identifying high-risk third countries with strategic deficiencies**

The delegated regulation is further detailed in point 1.2. of Chapter XIX "Financial crime".

### **3.6. Law of 23 July 2016 concerning the audit profession**

The law is further detailed in point 1.1. of Chapter XV "Public oversight of the audit profession".

### **3.7. Law of 23 July 2016 on reserved alternative investment funds (RAIFs)**

The law, which entered into force on 1 August 2016, aims to create, under the name of "reserved alternative investment fund" (RAIF), a new status of alternative investment funds which, contrary to investment funds "regulated" by the Law of 17 December 2010 relating to UCIs, the Law of 13 February 2007 relating to SIFs or the Law of 15 June 2004 relating to SICARs, are not subject to authorisation or supervision by the CSSF, but enjoy the structuring flexibility of UCIs, SIFs and SICARs.

However, even if RAIFs are not subject to authorisation or supervision by the CSSF, they are defined by a regulated framework. Indeed, to be able to benefit from this new regime, an investment vehicle must qualify as alternative investment fund (AIF) within the meaning of Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers (AIFMD) and must be managed by a fully authorised AIF manager (AIFM) that is subject to the CSSF's supervision when established in Luxembourg. Although the AIFMD mainly aims to regulate managers, it also includes provisions which apply to AIFs managed by these managers (product rules). These provisions notably include the requirements to appoint a depositary and a *réviseur d'entreprises agréé*, to provide investors with information, to make available an annual report and to comply with the investment and leverage rules in relation to certain asset classes. The requirement that RAIFs must be managed by an AIFM means that they will be subject to these product rules and indirectly subject to a supervision through that exercised by the competent supervisory authority over their AIFM. This same requirement, moreover, means that RAIFs will benefit from the passport provided for in the AIFM regulation for the marketing to professional investors in the EU.

### **3.8. Law of 23 July 2016 concerning the disclosure of non-financial information and diversity information by certain large undertakings and groups and amending various provisions relating to accounting and annual accounts of undertakings as well as to the consolidated accounts of certain forms of companies**

The Law of 23 July 2016 transposes 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. Its provisions shall apply as from the financial year starting on 1 January 2017 or after that date.

The new rules apply to large public-interest entities with more than 500 employees and with a total balance sheet exceeding EUR 20 million and/or a turnover of more than EUR 40 million.

In accordance with the provisions of the Law of 23 July 2016, the companies concerned are required to disclose in their management reports information on policies, related risks and results as regards environmental, social and employee-related matters, respect for human rights, anti-corruption and bribery issues, and diversity in the composition of their boards.

Directive 2014/95/EU leaves great flexibility to companies as regards the form in which such disclosure should take place. Pursuant to the provisions of Article 2 of the aforementioned directive, the European Commission is in charge of issuing non-binding guidelines on the methodology applicable to non-financial information. These guidelines are expected to be published in the second quarter of 2017.

### **3.9. CSSF Regulation N° 16-07 of 26 October 2016 relating to the out-of-court resolution of complaints**

CSSF Regulation N° 16-07 relating to the out-of-court resolution of complaints repeals and replaces CSSF Regulation N° 13-02 of 15 October 2013. It notably takes into account the amendments introduced by the Law of 17 February 2016 introducing alternative dispute resolution for consumer disputes and amending certain other provisions of the Consumer Code, which transposes into Luxembourg law Directive 2013/11/EU of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC.

### **3.10. Grand-ducal Regulation of 15 December 2016 introducing certain derogations to standardised layouts of the balance sheet and profit and loss account pursuant to Article 27 of the Law of 19 December 2002 concerning the trade and companies register, as well as the accounting and annual accounts of companies, as amended, and repealing the Grand-ducal Regulation of 29 June 1984 determining the layouts according to which financial holding companies must draw up their annual accounts**

The grand-ducal regulation aims, notably, to reintroduce, for certain categories of undertakings, the derogations to the standardised layouts of the balance sheet and profit and loss account laid down in the Law of 19 December 2002 and which were repealed by the Law of 30 July 2013 reforming the Commission des normes comptables. The undertakings concerned are those which are not subject to the standardised collection of financial data (via the eCDF platform) and which are also exempted from depositing account balances of the Standard Chart of Accounts (SCA). In particular, the categories of undertakings concerned are those subject to the layouts of annual accounts, laid down in the Law of 19 December 2002, and which fall under the prudential supervision of the CSSF, except for the support PFS (which are subject to the eCDF and the SCA).

Consequently, the undertakings concerned are now at liberty to benefit from the adaptation measures for their balance sheet and profit and loss account layouts as from the financial year closing on 31 December 2016.

### **3.11. Law of 23 December 2016 on market abuse**

On 23 December 2016, the Luxembourg legislator adopted a new law on market abuse which repeals and replaces the Law of 9 May 2006 on market abuse.

The new law includes a repressive part and an administrative part. In the repressive part, it transposes Directive 2014/57/EU of 16 April 2014 on criminal sanctions for market abuse.

The subjects dealt with in the administrative part may be grouped into three categories. Thus, the administrative part specifies and supplements the investigation and enquiry powers of the CSSF as regards market abuse in accordance with the requirements of Regulation (EU) No 596/2014 of 16 April 2014 on market abuse (MAR). The administrative part also adapts the nature and amounts of the administrative sanctions to the MAR requirements. Finally, the administrative part transposes Commission Implementing Directive (EU) 2015/2392

of 17 December 2015 on Regulation (EU) No 596/2014 as regards reporting to competent authorities of actual or potential infringements of that Regulation. As regards reports of market abuse infringements, the Law of 23 December 2016 closely follows the provisions of the implementing directive. The transposition provisions of the implementing directive are grouped in one annex attached to the law which is part of it.

### **3.12. Law of 23 December 2016 transposing Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and amending the Consumer Code**

The Law of 23 December 2016 entered into force at the beginning of January 2017 and aims, inter alia, to regulate mortgage loan agreements and to strengthen consumer protection by the establishment of a harmonised legal framework. Moreover, the law introduces the status of mortgage intermediaries into Luxembourg law. The activity of mortgage intermediaries requires, henceforth, an authorisation from the Minister of Finance and the supervision of these intermediaries lies with the CSSF.

### **3.13. Regulation CSSF N° 16-06 on ex ante contributions to be paid to the Fonds de Résolution Luxembourg**

Pursuant to Article 107(2) of the Law of 18 December 2015, the Resolution Board shall set the annual contributions to be collected from the relevant institutions for the Fonds de Résolution Luxembourg (FRL) and to develop in this respect a methodology to set those contributions. The Resolution Board sought an opinion from the Consultative Committee for Resolution on a draft CSSF regulation in this regard and, on the basis of CSSF Regulation N° 16-06, subsequently set the ex ante contributions to the FRL for 2015 and 2016, which have been duly paid by all relevant institutions.

## LIST OF ABBREVIATIONS

2010 Law	Law of 17 December 2010 relating to undertakings for collective investment
2013 Law	Law of 12 July 2013 on alternative investment fund managers
AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AML/CFT	Anti-Money Laundering and Counter-Terrorist Financing
ASSEP	Pension savings association
BCL	Banque centrale du Luxembourg - Luxembourg Central Bank
BRRD	Bank Recovery and Resolution Directive - Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms
COREP	Common Reporting
CPDI	Council for the Protection of Depositors and Investors
CRD IV	Capital Requirements Directive - Directive 2013/36/EU of 26 June 2013 on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms
CRR	Capital Requirements Regulation - Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms
CSDR	Central Securities Depositories Regulation - Regulation (EU) No 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories
CSSF	Commission de Surveillance du Secteur Financier - Financial sector supervisory commission
EBA	European Banking Authority
EC	European Community
ECB	European Central Bank
EEA	European Economic Area
EFDI	European Forum of Deposit Insurers
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European Long Term Investment Fund
EMIR	European Market Infrastructure Regulation - Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	Euro
FATF	Financial Action Task Force
FGDL	Fonds de garantie des dépôts Luxembourg - Deposit guarantee fund Luxembourg
FINREP	Financial Reporting
FSB	Financial Stability Board
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process



IFM	Investment Fund Manager
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IML	Institut Monétaire Luxembourgeois - Luxembourg monetary institute (1983-1998)
IOSCO	International Organization of Securities Commissions
IRE	Institut des réviseurs d'entreprises - Luxembourg institute of registered auditors
ISQC	International Standard on Quality Control
JST	Joint Supervisory Team
LCR	Liquidity Coverage Requirement
LPS	Law of 10 November 2009 on payment services
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
NAV	Net Asset Value
NSFR	Net Stable Funding Requirement
OECD	Organisation for Economic Co-operation and Development
PFS	Professional of the Financial Sector
PIE	Public Interest Entity
PSD2	Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market
SEPCAV	Pension savings company with variable capital
SIAG	Self-managed investment company
SICAR	Investment company in risk capital
SIF	Specialised Investment Fund
SIIL	Système d'indemnisation des investisseurs Luxembourg - Investor compensation scheme Luxembourg
SME	Small and Medium-sized Enterprises
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
UCI	Undertaking for Collective Investment
UCITS	Undertaking for Collective Investment in Transferable Securities
VaR	Value-at-Risk



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