Luxembourg financial watchdog sharpens its teeth

Regulator Marco Zwick on efforts to strengthen supervision after years of criticism

‘Fund managers prefer being told by us when they did something wrong, rather than by investors,’ says Marco Zwick

Robert Van Egghen September 14 2020

As low interest rates drive investors to look for new, often riskier ways to make their money grow, EU regulators’ attention has focused on Luxembourg, Europe’s leading fund domicile.

The Grand Duchy has about €4.5tn under management — €1.5tn more than Ireland, its closest competitor — and is often depicted by transparency campaigners as a shadowy tax haven. Investment funds and other financial intermediaries that channel money from markets into companies are facing increasing scrutiny as rival EU centres vie to take on more business from London, Europe’s largest financial centre, now the UK has left the EU.

Some investors have accused Luxembourg of skimping on investor protection in the race to build its financial hub. The directors of three collapsed Luxembourg funds this year complained to the European Securities and Markets Authority (Esma) about what they alleged was the Luxembourg financial regulator’s obstruction of their efforts to investigate wrongdoing and recover losses. The Commission de Surveillance du Secteur Financier (CSSF), the Luxembourg regulator, denies any wrongdoing.

Marco Zwick, its director, argues that the criticism was “unfounded”, as the country’s financial sector “could not prosper” if the CSSF did not focus on investor protection.

“The CSSF does not market or advertise,” he says. “But we work hard to contribute actively to making the Luxembourg fund sector a secure and therefore attractive place.”

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Mr Zwick says fund managers look for a financial centre with strong supervision by an independent authority. This is because fund managers “are averse to reputational risk issues arising when rules are not respected. They prefer being told by us when they did something wrong rather than by their investors.”

The CSSF has introduced changes to its processes and operations since the UK Brexit vote in 2016, accelerated since Mr Zwick joined in 2018 — reforms Mr Zwick calls “CSSF 4.0”. These include

enhanced training in new technology for its 900-strong workforce, including a new online portal to ease file-sharing and improve communication between the regulator and companies it supervises.

The CSSF is working with the University of Luxembourg to automate the processing of fund documentation. This includes the use of artificial intelligence to extract data from documents. The regulator has also become more open and communicative with the financial sector. Legal and financial services professionals working in the Grand Duchy regard this as a welcome change of approach.

Within the past three years, the CSSF, for instance, has issued detailed guidance to the industry on matters such as investment breaches of rules restricting portfolio holdings, liquidity management and regulatory reporting.

Similar advice has been given on cyber security, urging investment firms to iron out system vulnerabilities to hackers. One Luxembourg-based fund lawyer, who asked not to be named, says this contrasts with former times when rules and requirements were not always codified.

"I would not consider the Brexit referendum as the event that [led] the CSSF to change its supervisory approach" Marco Zwick

The international reputation of the Grand Duchy took a blow following the publication of the Panama Papers in 2016.

This revealed that thousands of offshore companies created by the Panamanian former law firm Mossack Fonseca, to facilitate tax avoidance and money laundering, had links to Luxembourg.

In 2014 the International Consortium of Investigative Journalists published documents that suggested some leading investment firms had obtained secret deals from the Luxembourg government to lower taxes on funds launched in the Grand Duchy.

A surge in applications from London-based asset managers to set up Luxembourg funds to target European investors followed the Brexit referendum, given the likely loss of passporting rights that enable fund houses to service investors from the UK.

Companies bolstering their presence in Luxembourg have had to contend with demands from the regulator to hire more staff, and for senior managers to be based in Luxembourg, or to travel there on a very regular basis.

The CSSF says these are necessary safeguards to avoid "letterbox entities", where a company sets up an office in Luxembourg but works from another jurisdiction. Mr Zwick says this push for greater transparency was already in motion before the UK vote to leave the EU. "I would not consider the Brexit referendum as the event that [led] the CSSF to change its supervisory approach," he says.

The amount of documentation demanded by the regulator for due diligence purposes has increased sharply over the past few years. Anti-money laundering is a focus following the transparency scandals.

Mr Zwick attributes these changes to "stricter" expectations of financial regulators, with politicians and the public wanting authorities to prevent problems from occurring in the first place, rather than seeking to mitigate their effects. "Investor protection has been and continues to be our key objective," he says.