From recovery to opportunity
A 10-year retrospective on the Luxembourg financial sector and propositions for exponential growth
A 10-year retrospective on the Luxembourg financial sector and its impact on the Luxembourg economy
Dear reader,

2017 marks the 10-year anniversary of the beginning of the financial crisis. In the summer of 2007, high yield credit markets started showing signs of tension in the US, and some banks including the former Bear Stearns incurred initial losses on subprime-related investments. The following year, Bear Stearns virtually failed before being acquired by J.P. Morgan at a deeply discounted value, and Lehman Brothers went bankrupt. A global financial crisis ensued as bank liquidity dried up and concerns over systemic failure of the global banking system brought many banks to fail or to seek emergency recapitalization.

Concerns over the financial sector propagated to the rest of the global economy, as reduced access to financing and liquidity posed their own challenges to non-financial players as well. Financial markets collapsed, and the world came to know its worst financial and economic crisis since the great depression. In several European countries, the financial crisis escalated into a government debt crisis, as some states were unable to reimburse or refinance their debt or to bail out over-indebted banks, requiring the assistance of other countries and international organizations.

Almost a decade later, global economies have recovered from these events, namely in terms of positive economic growth and decreasing unemployment levels. However, this recovery was promoted to a significant extent by accommodative central bank policies of ultra-low interest rates (e.g., quantitative easing)—the full side effects and consequences of which are yet to be seen.

What about Luxembourg? Beyond the crisis, and partly as a consequence of it, dramatic forces have affected the Luxembourg economy and financial sector in the past decade, causing substantial change and creating new opportunities for its players.

This paper aims to shed light on how the Luxembourg financial sector and its different sub-industries have evolved since the financial crisis. As we look at past challenges overcome, we also attempt to highlight the key disruptions faced today by the Luxembourg financial sector, and to draw key implications for the next decade.

It is often said that understanding history is important to apprehend current and future events. We hope you enjoy reading this paper and it will provide you with new insights and ideas for the coming years.

Yves Francis
Managing Partner
Deloitte Luxembourg

Benjamin Collette
Partner
Financial Services Industry Consulting Leader
Deloitte Luxembourg
Methodological note

In order to prepare this report, our team has compiled economic and financial sector data from multiple sources including Eurostat, STATEC, CSSF, ABBL, BCL, and the CAA.

In addition, we have relied on Deloitte’s proprietary database of financial market information, and analyzed the financial evolution in key sectors on a player-by-player basis where required, to produce a view of Luxembourg financial sector profit pools over time.

Finally, the perspective developed in this document builds on multiple research efforts conducted by Deloitte over the past 10 years.

We would like to thank all those who have contributed data and perspectives in support of this report.

Inputs

**Economic data**

- Variables:
  - National and European economic aggregates
  - Financial sector economic aggregates

- Sources:
  - Eurostat, STATEC

**Sector-level data**

- Sectors:
  - Funds
  - Banks
  - Wealth management
  - Insurance

- Variables:
  - Sector business volumes
  - Aggregate revenue and profitability metrics, where available
  - Mapping of revenue and profit for individual industry players

- Sources:
  - Sector statistics: CSSF, BCL, CAA
  - Company filings

**Deloitte database**

- Sources:
  - Deloitte financial sector database
  - Reports on the Luxembourg financial sector produced since 1999 for fédération PROFIL, comité CODEPLAFI and Haut Comité de la Place Financière

**Expert input**

- Sources:
  - Interviews with Deloitte industry experts
  - Validation with selected industry leaders

Questions & analyses

**Economic contribution of Luxembourg financial sector**

**Evolution of financial sector employment**

**Luxembourg financial sector profit pools**

**Review of key historical drivers and outlook**

A 10-year retrospective on the Luxembourg financial sector

Results

Note:
- Data used in this report has been mostly sourced from 2015 Annual Reports – some figures may have been revised at time of publishing and may not be fully reflected in the study
Key messages

General economic overview

Since 2007 and despite the crisis, the Luxembourg financial sector has grown almost 10 times faster than its European peers, with a compound average growth rate (CAGR) of nearly four percent per annum since 2007 in Luxembourg compared to 0.4 percent in Europe.

The Luxembourg financial sector remains the key strength and contributor of the Luxembourg economy with 27 percent of value produced.

Non-financial sectors (e.g., services sector, public sector, retail, and HORECA) have nevertheless grown at a faster rate than the financial sector (4.7 percent compared to 3.7 percent), reflecting the diversification of the economy.

Financial sector employment has grown by approximately 7,500 units since 2007, to reach a total of 46,000 FTEs in 2016, equivalent to nine percent of total Luxembourg employment growth in the period.

As such, the Luxembourg financial sector has contributed a lower than proportional share to employment growth compared to GVA growth, and this is explained by the outsourcing, automation, and digitalization of many operational processes, leading to an evolution from traditional operational jobs at the benefit of control and oversight as well as technology profiles.

Sub-sector highlights

Luxembourg’s financial sector remains anchored around a few key segments and has consolidated its strengths in funds, wealth management, and insurance, which are analyzed in detail in this paper.

In funds, UCITS assets domiciled in Luxembourg have more than doubled from €1.6 trillion in 2007 to €3.3 trillion to date in 2017, consolidating Luxembourg’s position as the top fund domicile center for international funds globally.

Alternative funds have also developed significantly with the introduction of AIFMD national law in 2013, with over 230 AIFMs now authorized in Luxembourg and €0.6 trillion in regulated alternative assets, supported by the development of relevant vehicles (e.g., RAIF), among other things.

In wealth management, in spite of client outflows due to repatriation following increased tax transparency, assets under management in Luxembourg have grown from €270 billion to over €350 billion in 2015.

The Luxembourg insurance sector has also grown significantly, with double-digit growth in premiums and reserves for the life, non-life and reinsurance activity branches.
Financial sector profit evolution

In spite of volume growth, Luxembourg financial sector profitability has declined, with overall sector net profit almost flat since 2007 at €8.4 billion, and net profit margin in the key sectors went down on average from 30 percent to 25 percent over the period.

Fund-related profits have increased by €0.7 billion, well below the sector’s volume growth rate as net profit margin declined from 40 percent to 29 percent since 2007 according to our estimates, in spite of increasing consolidation and concentration among the largest players.

Bank profits have declined by €0.7 billion, with net profit margin down from 43 percent to 37 percent, reflecting the challenges of low interest rates and cost pressures.

Wealth management profits have decreased by €0.2 billion in spite of AuM growth, due to deteriorating fee levels and cost increases; net profit margin is down from 28 percent to 22 percent.

Insurance profits have increased by €0.8 billion, but nevertheless the sector saw an increase in combined ratios in non-life and reinsurance to 93 percent and 87 percent in 2015, respectively.

Technology investments and regulatory requirements have brought about significant costs and complexity to the financial sector—annual operating expenses have increased by nearly four billion euro in the financial sector since 2007, of which one billion euro additional operating expenses are in the banking sector alone.

Direct income tax contribution of the financial sector increased from €1.4 billion in 2007 to €1.7 billion, not including indirect taxes, social security charges, and taxes paid by employees of the financial sector.

The cornerstones of Luxembourg’s financial sector success, in our view, include the following:

- A flexible open-architecture model, allowing Luxembourg frameworks and capabilities to be used in multiple value chains
- A skilled workforce supporting complex business needs, and a multilingual talent base supporting cross-border business development
- The accessibility of the local regulator and its ability to adapt to business needs to support product innovation and market evolution
- A diverse investment product framework and structuring solutions, supporting the investment and finance needs of a variety of actors internationally
From recovery to opportunity

Competition among sector participants will also continue to increase, requiring incumbents to push efficiency and transformation efforts further, namely through solutions such as smart sourcing of complex and costly activities, and robotic process automation for more basic operating processes.

Luxembourg’s wealth management sector will need to continue its transformation; two avenues should be explored:

• HNWI Banking should be promoted as a growth area, namely by maintaining the relevance of structuring and fund solutions available in Luxembourg and encouraging collaboration between the multiple players of the wealth management ecosystem.

• The development of operational service hubs should be encouraged in support of international player activities to make the best possible use of existing infrastructure and competences in Luxembourg (“hub and spoke” model).

Regulatory costs will continue to drag on financial sector profitability, and the sector should look for new ways of spending more efficiently, for example through RegTech and outsourcing.

Client needs and social behaviors will continue to change, bringing the need for commercial innovation and further digitization of client interfaces.

Challenges and prescriptions for the next decade

Luxembourg’s open-architecture model will need to deliver more value and efficiency, and the financial sector will need to increase its focus on providing services internationally.

Political uncertainty may remain a factor to live with, and Luxembourg’s stability will be key, namely to support financial activity of important international players across Europe.

Fiscal requirements and the international tax landscape are likely to evolve in the wake of BEPS, and Luxembourg should gear up to support players wishing to increase local substance in the most effective way.

The alternative fund industry, specifically the private equity and real estate (PERE) industry, has become a strategic strength, and efforts should be made to further develop Luxembourg’s position and offer to alternative players and financial sponsors, and encourage the development of new growth areas such as private debt funds.

Competition for business activity among jurisdictions will continue to increase, and while existing Luxembourg strengths (e.g., UCITS) should be defended, addressing known obstacles to the development of under-served segments, such as ETFs and Hedge Funds, is vital.

Technology and regulation are opening the way for new business models (e.g., PSD2 aggregator model), for which Luxembourg can be an effective breeding ground, and which should therefore be encouraged and supported.

Addressing these new challenges will require new competences, and pivotal talent gaps should be fixed, for example in the alternatives and technology spaces.
Chapter 1
The Luxembourg financial sector in the past decade
The Luxembourg financial sector has rebounded in the past decade and at a faster rate compared to the European financial sector.
The financial sector remains a pillar of the national economy much more than in other European countries.

The financial sector continues to represent a disproportionate share of the Luxembourg economy, with 27 percent of gross value added generated by financial players. This proportion is much higher than in Europe, where the percentage has remained stable at five percent, and other important European financial centers that represent no more than eight percent of their respective economies. Some diversification is nevertheless observed as growth outside of the financial sector at around five percent has exceeded the financial sector growth of around four percent.

Since the financial crisis, the Luxembourg economy has diversified and has experienced a higher growth rate than the financial sector.

The Luxembourg financial sector remains an important contributor to total GVA compared to the EU.

Financial sector GVA as a percent of total GVA

Source: Eurostat.

Notes:
- Gross Value Added (GVA) as calculated by Eurostat (output less intermediate consumption; GVA is calculated before consumption of fixed capital).
- Financial Sector (FS) includes section K (Financial and insurance activities) as per NACE Rev.2 classification of economic activities in the European Community.
- "EU" represents 28 countries.

Source: Eurostat.
The Luxembourg financial sector also contributes a significant share of the country’s fiscal revenue. Previous studies have established this contribution at around 20 percent, consisting mainly of corporate income taxes, specific taxes on financial products (e.g., fund subscription tax), VAT contributions, social contributions, as well as income taxes levied on employee salaries.

Within the scope of this report, we highlight the evolution of one component: direct taxes paid by the financial sector, which have increased by around €300 million in the past decade, from €1.4 billion to €1.7 billion.

Further, we also note that while representing almost 30 percent of value created and nearly one quarter of economic growth in the past decade, the Luxembourg financial sector has only contributed nine percent of employment growth.

**Financial sector employment shows steady growth, but national workforce has diversified**

<table>
<thead>
<tr>
<th>Thousand FTEs</th>
<th>Luxembourg economy</th>
<th>Luxembourg financial sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>00</td>
<td>264</td>
<td>30</td>
</tr>
<tr>
<td>01</td>
<td>279</td>
<td>33</td>
</tr>
<tr>
<td>02</td>
<td>287</td>
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<td>03</td>
<td>293</td>
<td>34</td>
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<td>04</td>
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<td>34</td>
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<tr>
<td>05</td>
<td>308</td>
<td>34</td>
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<tr>
<td>06</td>
<td>319</td>
<td>36</td>
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<td>07</td>
<td>334</td>
<td>39</td>
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<td>08</td>
<td>349</td>
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<td>09</td>
<td>353</td>
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<td>10</td>
<td>360</td>
<td>41</td>
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<td>11</td>
<td>370</td>
<td>42</td>
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<td>12</td>
<td>379</td>
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<td>13</td>
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<td>15</td>
<td>406</td>
<td>44</td>
</tr>
<tr>
<td>16</td>
<td>418</td>
<td>46</td>
</tr>
</tbody>
</table>

**Note:**
- Financial Sector (FS): Includes section K (Financial and insurance activities) as per NACE Rev.2 classification of economic activities in the European Community.
- Source: Eurostat.

**Direct taxes paid by Luxembourg financial sector**

<table>
<thead>
<tr>
<th>EUR billions</th>
<th>2007</th>
<th>2015</th>
<th>CAGR 07-15</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.4</td>
<td>1.7</td>
<td>+2.4%</td>
</tr>
</tbody>
</table>

**Note:**
- PSF 2015 tax contribution estimated
- Source: CSSF, CAA, Deloitte estimations.
This trend is partly explained by uncertainties lingering from the financial crisis, as well as challenging business fundamentals in certain sub-sectors (e.g., banking). In addition, we find that these pressures, combined with the complexity brought about by new regulation in the past decade, have encouraged financial sector players to “variabilize” their business models and outsource part of their activities to third party providers outside of the financial sector stricto sensu. In addition and as another reaction to financial pressures, financial players have sought to automate parts of their operations through technology.

This also means that value creation per employee in the Luxembourg financial sector has increased from €251,000 in 2007 to €291,000 in nominal terms. The same cannot be said of real productivity. Indeed, at constant prices (i.e., comparing volumes produced with the number of employees producing these volumes), productivity has actually declined in the past decade.

In spite of growth, the contribution of the financial sector to employment creation has lagged value creation, due to outsourcing and technology developments. This evolution of employment in the context of economic recovery also speaks to the changing profile of Luxembourg’s talent pool in the financial sector, and to the increased relevance of control and oversight capabilities at the expense of more basic operational competences. We will come back to the challenges that this raises for the future later in this publication.
Luxembourg’s financial sector remains anchored around a few core segments, and these strengths have consolidated further in the past decade.

Luxembourg remains an important European financial center with strengths in funds, wealth management, banking, and insurance. In spite of challenges, Luxembourg’s position in these segments has strengthened in the past decade. The funds sector has seen the consolidation of Luxembourg’s position as the leading domicile for cross-border UCITS, as well as the development of the alternative fund sector, following the entry into force of AIFMD in 2013. Net assets for Luxembourg UCITS have increased from €1.6 to €3.3 trillion since 2007 (seven percent CAGR) and Luxembourg’s share of European UCITS has increased from 26 percent to 36 percent in 2016.

In the alternative space, Luxembourg has established itself as a firm position as a leading hub for private equity and real estate fund managers, which is reflected in the authorization of over 230 AIFMs since the inception of the framework, with net assets related to AIFs of €0.6 trillion in 2015. It is important to note that these assets constitute only the visible, regulated portion of the alternative fund sector. In addition, there is also significant legacy or non-European business carried out by asset managers on an unregulated basis, which in fact represents the majority of the business in this sector. Also to note, over 600 entities whose AIFs’ assets qualify as “below-threshold” are registered as AIFMs in Luxembourg.

In wealth management (in which both traditional private banking and non-bank portfolio management activities, as well as life insurance activities are included), Luxembourg has seen a substantial transformation. Further to various tax law changes, many banks have seen some of their clients re-patriate assets to their respective countries. In spite of this, Luxembourg’s wealth managers have succeeded in growing the assets under management from €270 billion in 2007 to over €350 billion in 2015, thereby defending Luxembourg’s market share and position among leading international wealth management centers in Europe (with the UK and Switzerland). As evidenced later in this report, this has not been accompanied by improvements in economic performance for Luxembourg private banks. On the other hand, in life insurance, strong growth in premiums and life technical provisions has been recorded in the past decade, highlighting the continued relevance of these products to support the wealth management of international clients.

In banking, the evolution has been more nuanced with banking income recovering to 2007 levels. However, during that period, a number of players have exited the market for economic reasons, while others have disappeared through consolidation, leading to a fewer number of banks. While total banking assets under management have increased, we will see that economic performance is challenged and that the profile of banking players has changed substantially, in terms of business mix as well as geographic origin.

Insurance (non-life and reinsurance) has also grown significantly in the past decade in terms of written premiums and provisions. Particularly, an appealing legal and economic framework has helped establish Luxembourg as a European captive reinsurance hub.
In the past decade, Luxembourg has sustained and developed its niche strengths in the funds, wealth management, and insurance sub-sectors.

**Net assets**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR trillions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>1.6</td>
</tr>
<tr>
<td>2015</td>
<td>2.9</td>
</tr>
<tr>
<td>2017</td>
<td>3.3</td>
</tr>
</tbody>
</table>

- **UCITS**

**Net assets**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR trillions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>0.6</td>
</tr>
<tr>
<td>2015</td>
<td>0.6</td>
</tr>
<tr>
<td>2017</td>
<td>0.6</td>
</tr>
</tbody>
</table>

- **AIF**

**Share of EU UCITS net assets**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>26</td>
</tr>
<tr>
<td>2015</td>
<td>35</td>
</tr>
<tr>
<td>2016</td>
<td>36</td>
</tr>
</tbody>
</table>

- **Wealth Management**

**AuM**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>271</td>
</tr>
<tr>
<td>2015</td>
<td>351</td>
</tr>
</tbody>
</table>

**Non-life insurance written premiums**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>1.5</td>
</tr>
<tr>
<td>2015</td>
<td>3.4</td>
</tr>
</tbody>
</table>

**Life insurance written premiums**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>11</td>
</tr>
<tr>
<td>2015</td>
<td>21</td>
</tr>
</tbody>
</table>

**Non-regulated / below AIFMD threshold (not quantified)**

- **Top European WM centers share**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008 (#3)</td>
<td>8</td>
</tr>
<tr>
<td>2014 (#3)</td>
<td>7</td>
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**Authorized AIFMs number**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>0</td>
</tr>
<tr>
<td>2015</td>
<td>211</td>
</tr>
<tr>
<td>2017</td>
<td>235</td>
</tr>
</tbody>
</table>

**Reinsurance technical provisions**

<table>
<thead>
<tr>
<th>Year</th>
<th>EUR billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>15</td>
</tr>
<tr>
<td>2015</td>
<td>34</td>
</tr>
</tbody>
</table>

Notes:

- AIF net assets include Luxembourg regulated Part I, SIF and SICAR funds; non-regulated funds or those falling below AIFMD threshold are not quantified here.
- Non-life and reinsurance technical provisions as reported in aggregated balance sheets.

Sources: CSSF, CAA, BCL, ALFI, EFAMA.
Profit pools and the evolution of value mix

Methodological note to the reader:
The following analyses result from a mapping of financial sector performance across sectors of activity (funds, wealth management, banking, insurance, and other) and by type of entities active in the sector (banks, insurance companies, PSF, chapter 15 management companies).

For this purpose, it is important to note that:

- Bank activities are split across the different sectors; custody banking and central administration activities of banks are included in funds, based on a player-by-player analysis of their banking business mix.

- Activities of the Professionals of the Financial Sector (PSF) are included under funds, wealth management, or other activities, based on the business focus of key PSF types.

- Life insurance activities are included under wealth management.

The following pages outline an overall view of the Luxembourg financial sector and its sub-components, followed by a closer look at some of the main sectors of activity or segments.

While net profit generated by the financial sector has remained stable in nominal terms, the mix of profit generation has changed noticeably in the past decade, reflecting strengths in funds and insurance activities but also deteriorating profitability in banking activities.
Overall net profit generated by the financial sector, as defined by its participants including banks, PSF, insurance companies, and chapter 15 management companies, is relatively stable at around €8 billion (€8.2 billion in 2007 and €8.4 billion in 2015). These €8.4 billion in net income are split by type of participant as follows: banks representing €4 billion, PSF €0.5 billion, insurance companies €1.2 billion, and management companies €2.7 billion.

**2015 after tax net profits by actor**

<table>
<thead>
<tr>
<th>EUR billions</th>
<th>Banks</th>
<th>PSF</th>
<th>Insurance and reinsurance companies</th>
<th>Management Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- Totals may not add up due to rounding.
- Financial Sector (FS): includes banks, insurance and reinsurance companies, PSF, and Chapter 15 management companies.
- “Funds” includes: investment management banking activities, PSF active in UCI (primarily registrar agents, administrative agents, and client communication agents), and Chapter 15 management companies.
- “Wealth management” includes: private banking, life insurance companies, and PSF (primarily investment firms with private portfolio managers status).
- “Banks” includes: retail and corporate banking activities.
- “Insurance” includes: non-life and reinsurance companies.
- “Other activities” includes: other PSF (primarily support PSF), new banking models, as well as other banking activities.

Sources: CSSF, CAA, BCL, Deloitte financial sector profit pool analysis.
A number of important evolutions have been observed over the past decade. First and foremost, the largest profit growth contribution by far comes from the funds sector, with €0.7 billion in additional net income generated by fund servicing activities of banks and the activities of management companies.

The next largest contributor to financial sector profit is insurance (non-life and reinsurance), which was the largest contributor to profit growth in the last ten years, adding €0.8 billion in net profit (with life insurance flat and included under wealth management).

On the other hand, both banking profits (corporate and retail) and wealth management-related profits have declined. Net profits related to total wealth management activity, including bank and PSF players, have declined by €0.2 billion (attributable to private banking). Slight growth in life insurance activities has not been enough to compensate for total activity sector decline.

Looking at banks across all sectors of activity confirms the decline in net profits, with €0.7 billion taken out since 2007, which also reflects the exit of several large players (e.g., German savings banks) during the period.

The following pages will look into the main drivers of these changes and what has shaped the evolution of profits in the main sectors analyzed.

### Luxembourg financial sector net profits after tax by player type and by sector of activity

<table>
<thead>
<tr>
<th>Euro billions</th>
<th>Funds</th>
<th>Wealth Management</th>
<th>Banking (retail &amp; corporate)</th>
<th>Insurance (non-life &amp; reinsurance)</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-0.7</td>
<td>+0.2</td>
<td>-1.2</td>
<td>+0.8</td>
<td>+0.2</td>
<td>+0.7</td>
</tr>
<tr>
<td>2007</td>
<td>3.2</td>
<td>0.8</td>
<td>2.3</td>
<td>0.3</td>
<td>1.7</td>
<td>8.2</td>
</tr>
<tr>
<td>2015</td>
<td>3.9</td>
<td>0.6</td>
<td>2.2</td>
<td>1.0</td>
<td>0.8</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Note: *Totals may not add up due to rounding.

Sources: CSSF, CAA, Deloitte financial sector database and profit pool analysis.
Fund profit improvement is driven mainly by volume growth and scale effects, compensating for lower revenue margins and profitability.
From recovery to opportunity

That being said, the management company branch of activity remains largely fragmented, with a lower concentration of assets and the coexistence of different models (including AIFMs, UCITS management companies, and super management companies), undertaking activities for in-house or third party funds. The entry into force of AIFMD and other regulations have structured the sector in line with the UCITS industry. In light of increased regulatory pressure, management companies were forced to increase substance (reflected in an increase of experience FTEs) and re-evaluate their operating model in order to achieve efficiency.

Wealth management

As stated previously, Luxembourg wealth management AuM increased from €270 billion to over €350 billion in the past decade, in spite of unfavorable "onshoring" effects following tax law changes, and partially supported by favorable capital markets. In comparison to the evolution of global equity markets, we note Luxembourg wealth management AuM have been more resilient through the downturn, and to date have grown higher since the crisis (on an indexed basis) than global equity markets.

The wealth management sector has transformed but remains challenged for profit due to falling revenue margins and increasing costs.
With increased transparency on fees and increased competition between domestic players and international players such as those based in Luxembourg, revenue margins have come down substantially. In fact, the average RoA on assets under management (net profit after-tax over AuM) for Luxembourg private banks decreased to around 10bps today, compared to 20bps in 2007. Consequently and in spite of growing volumes, private banking revenue declined by €160 million (down nine percent from 2007 levels).

In addition, private banks and wealth managers have faced cost pressures associated with the modernization of their operating model, as well as the management of the many regulatory-related obligations that have been required in the past decade. As a result, private banking net profits have declined by about 200 million in that period.

Life insurance players have shown even more favorable volume trends, with strong growth in premiums reflecting the continued relevance of life insurance products for international wealth management purposes. In spite of this, due to similar cost pressures as the rest of the sector, life insurance net profits have remained flat at €0.2 billion.

Despite challenging profit margins, Luxembourg has maintained its position as an important international wealth management center in the Eurozone with many non-EU private banks (e.g., Swiss banks) managing their European operations from Luxembourg. The subsector continues to benefit from cross-border expertise and attractive vehicles that allow for tailored wealth structuring solutions.

Sources: CSSF, CAA, Deloitte financial sector database and profit pool analysis.
Banks

The Luxembourg banking sector experienced turbulence as a result of the financial crisis. In 2008, one in every four banks reported a net loss, with at least two banks winding-up and another two banks requiring cross-border government intervention.

In 2015, and for the first time since the crisis, banking revenues recovered to those of 2007, with commission revenues outgrowing net interest revenues during the period. This reflects the low interest rate conditions under which banks are operating, and the development on commission-based income as a partial offset.

Bank profits, on the other hand, have not yet recovered since 2007 (€4.0 billion in 2015 from €4.7 billion in 2007), and they have followed a volatile trend due to the financial crisis and the subsequent European sovereign debt crisis. Macro-economic volatility and low interest rates combined with increasing regulatory compliance and technology costs have dragged down sector profitability compared to historical levels.

New regulatory standards have also encouraged a downward trend in banks’ balance sheets in the past decade (from €915 billion in 2007 to €747 billion in 2015), as higher asset quality and lighter balance sheets have been encouraged in the wake of the financial crisis.

Net commissions have outgrown interest margin revenue as a result of economic conditions and shifting market forces
Banking revenue mix, EUR billions

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2015</th>
<th>Evol. CAGR 07-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest margin</td>
<td>4.6</td>
<td>4.3</td>
<td>-0.3 -0.9%</td>
</tr>
<tr>
<td>Net commissions</td>
<td>4.0</td>
<td>4.3</td>
<td>+0.3 +1%</td>
</tr>
<tr>
<td>Other net revenues</td>
<td>2.4</td>
<td>2.3</td>
<td>-0.1 -0.5%</td>
</tr>
</tbody>
</table>


Fund-related and corporate banks have capitalized on a growing fund industry and an influx of foreign corporations
Banking revenue mix, EUR billions

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2015</th>
<th>Evol. CAGR 07-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds</td>
<td>1.9</td>
<td>2.8</td>
<td>+0.9 +5.1%</td>
</tr>
<tr>
<td>Private banking</td>
<td>1.8</td>
<td>1.7</td>
<td>-0.2 -1.2%</td>
</tr>
<tr>
<td>Retail</td>
<td>0.8</td>
<td>0.9</td>
<td>+0.1 +1.4%</td>
</tr>
<tr>
<td>Corporate</td>
<td>4.0</td>
<td>4.1</td>
<td>+0.1 +0.3%</td>
</tr>
<tr>
<td>Other</td>
<td>2.5</td>
<td>1.4</td>
<td>-1.1 -6.7%</td>
</tr>
</tbody>
</table>

Overall, in Luxembourg we observe fewer banks (156 in 2007 to 143 in 2015 and to date), and we note substantial movement through new arrivals and exits or consolidation across the various sub-sectors of activity. The funds sector and new banking models are net beneficiaries while private banks and corporate or multi-line banks have seen more outflows than inflows.

We also note increasing geographical diversity with 34 percent of banks coming from outside the EU in 2017. Luxembourg, for instance, has been chosen as the primary European hub by six of the largest Chinese banks, making it a leading European center for Renminbi loans and deposits, fostered by the corporate banking activities carried out by these banks. Further, new models have entered the market, including institutions offering electronic payment platforms, online brokerage, and online direct banking.

An increase in average FTEs per entity (from 168 in 2007 to 181 in 2015) despite fewer banks, signals the establishment of larger players in the country and, as previously mentioned, the consolidation of existing banks.

Overview of banking sub-sector profit evolution

<table>
<thead>
<tr>
<th>Loans and deposits</th>
<th>2007</th>
<th>2015</th>
<th>Evol.</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR billions</td>
<td>0.7</td>
<td>0.7</td>
<td>1.4</td>
<td>1.2</td>
</tr>
<tr>
<td>Revenue</td>
<td>11.0</td>
<td>10.9</td>
<td>-0.1</td>
<td>-0.1%</td>
</tr>
<tr>
<td>EUR billions</td>
<td>4.7</td>
<td>4.0</td>
<td>-0.7</td>
<td>-2.1%</td>
</tr>
<tr>
<td>Net profit after tax</td>
<td>43%</td>
<td>37%</td>
<td>-6 p.p.</td>
<td></td>
</tr>
</tbody>
</table>

Notes:
- Loans and deposits include those from Luxembourg, other Eurozones, and the rest of the world; all counter parts are included.


Change in number of banks 2007-2015

- Private banks: +11, -15
- Fund-related banks: +9, -8
- Corporate banks, multi-business and international banking activities: +21, -33
- New banking models: +3, -2

Notes:
- "New banking models" include digital-only banking, and credit card and e-payment related models.
- "Fund-related banks" include banks with a share of their activities as banks and central administrators.

Sources: CSSF, Deloitte analysis.
Insurance

While life insurance remains the main contributor to the insurance sector in terms of written premiums and technical provisions, the sub-sector’s reinsurance and non-life activities have experienced significant growth since 2007.

Technical provisions in insurance companies’ balance sheets have grown from €8.6 billion to €40.7 billion in life insurance, from €2.8 billion to €8.6 billion in non-life insurance, and €14.7 billion to €34.2 billion in reinsurance. Written premiums in life insurance have grown from €10.9 billion to €21.3 billion, from €1.5 billion to €3.4 billion in non-life insurance and from €2.9 billion to €9.5 billion in reinsurance. In 2015, only eight percent of premiums across all three branches of activities were collected in Luxembourg, reflecting the importance of cross-border distribution to the development of this sub-sector.

In terms of net profits after tax, non-life insurance has remained stable at €0.1 billion, in spite of strong growth in premiums. Life insurance profits have also remained stable at €0.2 billion in the period. The reinsurance sub-sector, on the other hand, has grown from €0.2 billion in 2007 to €0.9 billion in 2015, becoming the main contributor to the sector. The reinsurance sub-sector’s growth since 2007 has been primarily driven by the entry of an important actor and the development of an attractive framework for captive reinsurance companies that has helped establish Luxembourg as a European hub for such activities, with 216 domiciled companies. Nonetheless, it should be noted that the number of reinsurance entities has been in decline since 2007 (251 entities), mainly due to M&A activities but also liquidation. This decline is in line with the other insurance activity branches and can be partially explained by heavy regulatory implementation costs brought by Solvency II.

As in other parts of the Luxembourg financial sector, net profit growth has been largely volume-driven, while average profitability has declined. For example combined ratios increased from 89 percent in 2007 to 93 percent in 2015 in non-life insurance and from 79 percent (2009) to 87 percent in 2015 in reinsurance.

Written premiums in life insurance have grown from €10.9 billion to €21.3 billion, from €1.5 billion to €3.4 billion in non-life insurance and from €2.9 billion to €9.5 billion in reinsurance. Written premiums in life insurance have grown from €10.9 billion to €21.3 billion, in non-life insurance from €1.5 billion to €3.4 billion, and in reinsurance from €2.9 billion to €9.5 billion. With the entry into force of Solvency II a year ago, continued growth in technical provisions is to be expected.

Sources: CAA.
From recovery to opportunity
Chapter 2
Key disruptions and proposed actions for Luxembourg
Where next for Luxembourg?
As evidenced in the previous chapter, the Luxembourg financial sector continues to show a number of fundamental strengths, and while certain sub-sectors are currently facing performance issues, the sector has generally recovered from the financial crisis a decade ago. However, we see a number of key disruptions emerging today that present more fundamental challenges and opportunities for financial players operating in Luxembourg, and for the sector as a whole.

In this section, we outline our view of these disruptions and the key questions they raise for the future of the Luxembourg “Place Financière”.

From recovery to opportunity
Proposition 1

Shift from product- to service- orientation and position Luxembourg as a service center of choice for the global financial industry

It is critical for Luxembourg to maintain a set of products and regulatory framework at the forefront of market practices and with maximum relevance for financial players.

However, we believe further success for Luxembourg will revolve around better leveraging local skills and capabilities to provide value-added services internationally. This means that we will move from servicing mainly Luxembourg products in Luxembourg, to servicing global products based on Luxembourg oversight and capabilities, with operational activities handled where most relevant from a value creation standpoint.

More practically, this means Luxembourg should encourage the development of Luxembourg as international service hub in existing value chains (e.g., fund servicing) and facilitate the creation of cross-border service platforms, or shared market infrastructure, anchored around key areas of Luxembourg expertise (e.g., KYC/AML, middle office support, risk management, and oversight functions).

From recovery to opportunity

Luxembourg’s successful open architecture model is under pressure to deliver more value and efficiency.

The segments of the financial sector where Luxembourg displays strength all have an “open architecture” in common, where the country is typically positioned as a facilitator of value creation in these respective industries, enabling cross-border distribution, structuring, or administration of multiple financial products and services.

Historically, the model has also been largely “product-driven,” i.e., with activities revolving around the management or administration of Luxembourg financial products, whether it be UCITS funds, legal vehicles, or insurance policies.

Fee pressures observed in the past decade are a sign that this open-architecture model, while successful in supporting the functioning of multiple financial industries internationally, needs to adapt its operating model to deliver quality service at increasingly competitive costs.
Recent political developments have questioned certain “basic assumptions.” Recent elections in continental Europe have been marked by uncertainty about their outcome, and the possibility (although sometimes remote) of non-traditional parties accessing power. Earlier in the UK, the vote in favor of Brexit arguably came as a surprise to many, and quite certainly underlined divisions on such fundamental concepts as EU membership and the existence of the euro.

The future will tell if this uncertainty will linger, or on the other hand, whether we will witness a return to a more conventional political context. In any case, this uncertainty is raising a number of questions for Luxembourg market participants. For example:

- Fund product innovation may be affected by visibility on future EU regulatory developments.
- The successful UCITS framework may be affected by the perception of political stability and risks in the EU.
- Potential changes in EU structure may affect international financial players by requiring changes in EU operating models, causing relocation and transfer of activities across countries, and a potential challenge to the “open architecture” model.

**Proposition 2**

**Facilitate the introduction of new entrants seeking a stable foothold into the European Union**

We are convinced that Luxembourg will continue to be among several locations in Europe to host the activities of players seeking to establish a presence on the continent, for example in the wake of the exit of the United Kingdom from the European Union. Asset managers, private equity, and life insurance players are among those players who may seek to establish or strengthen their presence in Luxembourg for those reasons.

In our view, Luxembourg should ensure that the local setup process is transparent and continues to be handled as pragmatically as possible. In addition, connecting with international players and informing them on the potential benefits and the process of setting up activities in Luxembourg will be important to ensure the Luxembourg value proposition and differentiation is well understood by these potential new players.
The fiscal outlook has become more uncertain, but is presenting the perspective of increased substance development in Luxembourg.

Proposition 3

Ensure the fiscal framework adapts to the international context, and support players seeking to develop substance in Luxembourg

It is our view that the Luxembourg fiscal framework should continue to adapt to maintain relevance in response to international market needs. Anticipating potential changes and exploring ways to adapt on a timely basis will be important in the next few years.

As substance requirements evolve, we expect a number of players will seek to increase their presence in Luxembourg to comply with these new potential requirements. This will mean new experienced positions, office space, and related support facilities. We believe Luxembourg should prepare for such a possibility and for example ensure that these players have the means to establish their activities and attract the talent they need to Luxembourg in a cost-effective way.

Initiatives like the OECD/G20 Base Erosion and Profit Shifting (BEPS) project are expected to affect the global tax landscape over time. As a possible side effect, certain countries have decided or may decide in the next few years to make their fiscal frameworks more competitive (e.g., through lower tax rates in the UK or the US), in a bid to encourage repatriation of business activity to their homeland. These evolutions may affect players active in the Luxembourg financial sector, either directly by changing their own tax obligations or causing them to re-think their operating model (e.g., increasing substance), or indirectly, by altering the relevance of specific fiscal framework elements. For example, the local wealth management industry could be affected if the rules pertaining to some of the structuring tools (e.g., structuring vehicles, life insurance policies) are modified.
Alternative asset markets are a key source of growth for the asset management industry globally, and in Luxembourg in particular.

The alternative asset industry is worth approximately €7 trillion globally and has grown at double digit rates in the past few years, much faster than the traditional asset management space. If this trend continues as we expect, alternative assets will exceed €10 trillion before the middle of the next decade.

In Luxembourg, a number of factors have combined as of late to support the development of the industry. These factors include the need to bring more business substance to support entities in the country (BEPS context) as well as the lack of visibility surrounding Brexit and its consequences. In addition, we also note uncertainty in the market on the timing and availability of third party country passporting, while many players are in the process of raising funds and will need to maintain optimal access to European countries for distribution purposes.
Proposition 4

Push momentum in the alternative space

We believe that the growth of the private equity and real estate industry and Luxembourg’s strong position as a hub for alternative fund managers is a strategic strength to be put in focus for the next decade.

Among key needs to support that development, we note the importance of maintaining a flexible and competitive legal structuring for promoters, allowing support for their investment needs efficiently across the breadth of their often global activities. In our view, recent initiatives such as the introduction of SCsp and RAIF are good examples of how to further support player activity and promote success in the alternative sector.

Ensuring effective support to alternative investment fund managers (AIFMs) to set up their activities is also key, in particular for flagship players that may contribute to generating further momentum for the sector.

For these players and the sector as a whole, it will be important to encourage the development of effective control and oversight models for their activities, creating value in an efficient way in support of their international operations.

Momentum in the private debt sub-sector should also be encouraged as much as possible. Given current trends for alternative sources of debt capital, there are reasons to believe that in the next decade, private debt funds will come to represent another key pillar of the alternative fund industry in Luxembourg. Regulatory and fiscal stability are seen as key enablers of this potential development.

Finally, we believe Luxembourg’s proposition for hedge funds should be revisited, and ways of attracting these funds and players locally should be explored.
Other jurisdictions are gaining scale and competing in key segments of the Luxembourg financial sector.

We note the continued development of Ireland as one of the main alternatives to Luxembourg to support the fund industry’s needs in terms of cross-border fund distribution and administration, or the needs of the international insurance industry.

Over the past decade (2007-2015), Ireland has grown by €0.8 trillion in UCITS net assets, reaching €1.4 trillion in 2015, and €1.6 trillion as of early 2017.

Ireland has also developed its own niche strengths, for example in the area of Exchange Traded Funds (ETF) administration, with €288 billion in net assets in 2016 (compared to €85 billion in Luxembourg, and representing over half of Europe’s net ETF assets) and UCITS ETF net sales of €41 billion in the same year.

In the alternatives space, Ireland has positioned itself as an administration hub for hedge funds, attracting substantial volumes (nearly half of global hedge funds are serviced in the country) and many fund managers, while Luxembourg has rather developed a leadership position in the private equity and real estate sectors.

Source: Irish Funds, EFAMA.

Proposition 5

**Defend strengths in traditional UCITS and further develop Luxembourg’s value proposition for ETF sponsors**

In the face of competition from other jurisdictions, Luxembourg should defend its leadership position in the traditional UCITS space, ensuring that the existing value proposition continues to evolve and improve, and is marketed as effectively as possible to key partner countries and sponsors. Among other elements, the international business competences available in Luxembourg are a key differentiator in our view to support cross-border distribution and business development. Another potential source of value creation in the sector lies in developments surrounding Environmental Social and Governance (ESG) concepts, for example through fund screening or certification activities, or the listing of specific products complying with these ethical guidelines.

With the growth of passive investment products and their growing share in new asset inflows, it is also more important than ever for Luxembourg to build on its leading footprint for traditional UCITS. Addressing the key known issues limiting
Luxembourg’s development in the ETF space is critical to encourage sponsors to domicile ETFs in Luxembourg on the most attractive terms.

Given this trend toward passive investing, we also note that the indexed fund segment (traditional UCITS with a passive strategy) should be encouraged, as they also represent a growing segment of the fund landscape.

Finally, with the development of “actively managed ETFs” in the US, and the increasing diversity of assets being packaged in ETFs, innovation on the product-side also represents a potential source of differentiation for Luxembourg.
A more international playing field and increased competition for Luxembourg players.

In today’s environment, players based in Luxembourg must increasingly cope with international competition in their respective area of operation. For example in wealth management, Luxembourg providers now increasingly compete against players from domestic locations across Europe, as well as key international jurisdictions such as Switzerland and the UK. We note that Luxembourg entities not only compete, but in multiple instances “complete” the wealth management service model of international players to enhance international coverage capabilities through hub-and-spoke models.

This trend is a result of the increased fiscal transparency brought about in the aftermath of the financial crisis, which has reduced the possibility of tax-driven arbitrage across countries. More recent regulatory developments such as MiFID II have amplified this by increasing transparency on commercial aspects of the business, such as disclosure on fees. Finally, technology and the age of information have made it easier for clients to access information, assess the relevance of multiple offerings, and switch providers much more easily.

Moreover, in the fund sector, similar trends toward transparency have contributed to the growth of passive products in the investment management space, putting pressure on traditional active management business models, and as a result on the Luxembourg fund servicing chain supporting these products.

We have seen that several parts of the Luxembourg financial sector are still undergoing substantial transformation as they adapt to market trends and seek to overcome profitability challenges. These transformations are costly and require substantial investments in talent, technology, and external resources, to improve not only service delivery and operational aspects, but also improve commercial competitiveness, client value propositions, and channels. We believe that those players who invest in these aspects today will stand the best chance of emerging as strong performers in the next decade.

Enjoying strong growth should not leave room for complacency either. In our view, digitalization and operational transformation should also be treated as key priorities in the PERE sector, where asset servicers will increasingly need to differentiate in terms of efficiency and digital maturity as the sector continues to evolve.
Proposition 6
Support efficiency and the transformation of existing business models
To achieve this, Luxembourg should encourage business model flexibility and so-called “smart sourcing.” With the constant focus on cost across key industries, the ability to source operational capacity from the most competitive provider internationally is key to maximize the value of Luxembourg’s open architecture model. As such, Luxembourg should strive to facilitate externalization of non-core competences to local or international providers, including by enabling the exchange of information under the right level of control and security. Activities that are costly, complex, or cyclical are also prime candidates for outsourcing, and their optimization should be encouraged, for example through the development of shared platforms or utilities.

To further support cost optimization, Luxembourg should promote the full use of Robotic Process Automation (RPA) as a means to accelerate basic, repetitive operational tasks. We see robots being introduced on a growing scale by leading players worldwide and believe Luxembourg should not fall behind on this opportunity.

Proposition 7
Promote Luxembourg wealth management value propositions for (U)HNWI through structuring and fund solutions, and encourage further development of local service hubs in support of international player wealth management activities
We believe that the Luxembourg wealth management sector should continue to focus on what we see as the key growing client segment globally: High and Ultra-High Net Worth Individuals, defined broadly as investors with at least €10 million in investable assets.

In doing so, wealth managers and private banks should further promote the key elements of the Luxembourg value proposition. From a product standpoint, the elements to be promoted include the multiple structuring solutions available to support international wealth management needs and the fund solutions available to support personalized investment requirements. In particular, the strength of the Luxembourg “ecosystem” combining wealth managers, technical experts, and service providers is a key advantage, which helps deliver quality and efficiency in service of clients. In our view, these structuring and fund solutions are a key differentiator and source of value for the more sophisticated investors seeking tailored investment solutions under a robust and trustworthy product framework.

In addition, we believe that privacy and discretion should also be promoted as another differentiator compared with domestic providers. Providing access to value-creating features (such as, in the wealth management space, tax reporting or tax reclaim services, bringing immediate tangible benefits to clients) is another element. Finally, offering digital service on par with the latest developments is also key in our view, in particular as clients will increasingly be served on a cross-border basis.

Next to this idea of a better value proposition for Luxembourg-based wealth managers, we note the opportunity to further position Luxembourg as a service hub for international groups. There are already a number of banks using Luxembourg as an operational hub for their international wealth management activities, and we believe there is a case to achieve better efficiency and service quality by leveraging Luxembourg-based competences on an even more international basis, for example in the areas of operations, finance, compliance, or control and oversight functions.
The depth and breadth of regulatory developments that have affected the financial sector are unprecedented. Across sub-industries, players have or have had to adapt to growing list of directives including AIFMD, CRD IV, MiFID II, EMIR, UCITS V, PRIIPS, AML, Solvency II, and the list goes on. The amount of resources and external support required is enough to justify a substantial share of the increase in operational expenses across the financial sector.

Considering the combination of staff allocated to regulatory work and of external spend required to support regulatory projects, we estimate the cost of compliance in the range of €0.5 billion to €1.1 billion annually across the different types of participants (banks, PSF, insurance undertakings, management companies) or about 5-10 percent of the total expense base of the sector.

Proposition 8
Promote RegTech and outsourcing to improve efficiency and regulatory activities

We believe technology will play a central role in the optimization of regulatory operations in the next decade. Automated compliance checks, document updates, and KYC/AML checks are already a reality in the industry, and more and more processes in the compliance and risk management space should be examined for potential automation.

For the most complex and time-consuming tasks, smart sourcing should also be encouraged. For example, activities such as regulatory watch, prudential reporting, tax reporting, transaction reporting, and KYC/AML, can now be outsourced seamlessly to third parties, typically at a lower cost versus an in-house solution, and with limited investment requirements over time compared to an in-house solution.
In part driven by technological change, in part by generation change, expectations and needs of younger generations are different and increasingly disruptive for traditional business models. Information and service are now expected anytime and anywhere, and at low, or sometimes no cost. Efficient digital interfaces have now become a basic requirement for most financial business models, from a mobile application to access basic banking services, to more sophisticated information systems allowing corporate or institutional users to monitor the performance and cost of the services they use.

Changing social expectations and needs are also at the heart of market shifts such as the shift to passive investment products and ETFs in the funds sector, or the emergence of digital-only robo-adviser offerings in wealth management.

We are now faced with permanent and increasingly fast change. In Luxembourg, the implication is that players whose business is affected by this shift in expectations, for example wealth managers, simply cannot move fast enough to adapt their value proposition, digitalize their front-end, and bring more speed and flexibility into their delivery model.

A side effect of this evolution is that some players, if they fail to adapt, may become trapped in a triangle of lower customer relevance, lower efficiency, and lower organizational capability, as falling behind on required change may have a negative impact on players’ ability to attract and retain the talent to affect it.

### Proposition 9

**Promote commercial innovation and end-to-end digitalization of client experience**

In our view, Luxembourg financial players, in particular banks and wealth managers, should assess their current level of digital maturity and identify the necessary steps in order to better meet their clients’ ever changing expectations.

Digitalization is already present in many cases on the most visible parts of the client experience, such as account consultation and transaction interfaces. However, it is typically less developed for many important aspects of the client relationship, such as client onboarding, loan requests, or structured product requests.

Where client interaction flows are already digitalized, financial players should assess the user-friendliness of their existing models, as best practices evolve continuously and end users tend to be quickly exposed to them, namely through daily exposure to mainstream digital products and services (e.g., online retail or social media).

Digitalization of the customer journey must come hand-in-hand with investment in data intelligence in order to capitalize on new data available to uncover customer insights. As players’ digital maturity evolves, rearranging the organizational structure will be key.

In terms of commercial innovation, we believe that much can be done to deliver more value to clients through an alignment of product and service competitiveness to international standards. For example, some of the largest banks globally have launched semi-automated, thematic investment platforms offering both digital convenience and access to investment advice to clients—these solutions should certainly be considered by Luxembourg private banks as potential next steps.
Technology and regulation are opening paths for new business models.

A number of new business models are emerging or are expected to emerge in the next few years. We note a number of examples.

In the banking and payments space, the Revised Payment Services Directive (PSD2) is expected to further open the payment architecture between processors and banks. By allowing new third party financial services providers to access banks’ payment infrastructure and customer data, PSD2 is clearing the way for new business models. For example, digital-only aggregators of transaction flows may emerge, offering a single point of contact for end users to oversee their banking relationships and perform their day-to-day banking needs. Given the intrinsic cross-border potential of such business models, Luxembourg is well-placed to serve as a base for these new entrants. At the same time, this represents a threat for incumbents, both retail banks and private banks, which may find themselves disintermediated from key client activities.

In the wealth management sector, a large number of digital-only platforms supported by asset allocation algorithms have emerged, labeled “robo-advisers.” Driven by technology, these new players present a more cost efficient delivery model, with the break-even point of a robo-adviser estimated to lie up to 50 percent below that of a traditional wealth manager. These players are also encouraged by changing dynamics in the fund distribution space (which have introduced limitations on fund distribution inducements) as well as increased investor sensitivity to wealth and fund management costs, and a growing appetite for simpler, passively-managed investment solutions.

**Proposition 10**

**Facilitate new scalable business models**

With substantial shifts and new business models emerging in the financial sector, and given Luxembourg’s strategic position as an international hub for many players, we believe it is critical to maintain and consolidate the country’s value proposition for new market entrants.

Promoting new banking and payment models by ensuring European directives are quickly translated into local law, and by supporting potential new players in their efforts to connect with the Luxembourg-based sector would help accelerate the development of new transaction aggregator business models.

Continuing to market Luxembourg’s value proposition internationally will help maintain visibility and awareness of Luxembourg’s relevance as a European hub for those players seeking access to the EU financial market.

Last but not least, initiatives aimed at supporting the development of financial technology startups (FinTechs) through financing, clustering, or creating communities, or support of go-to-market efforts would be welcome to encourage new company creations, and the related business development based in Luxembourg.

**Proposition 11**

**Address key talent gaps**

Most of the challenges outlined in this report share the need to mobilize resources and talents. In some areas or job functions, gaps are already clear.

For example in the alternatives industry, we note a continued need for control and oversight competences to support the development of the sector. We expect the development of outsourcing on a more international basis to add to this trend and to accentuate the need for regulatory and risk control profiles. BEPS and the possibility of increased substance requirements are also amplifying this need.

In technology, we also note the need for better access to developers, but also to IT project manager resources who can coordinate and translate the business needs of financial players into clear requirements for technology development teams.

As Luxembourg financial players further develop their focus on “service,” we believe client relationship management resources will also constitute an increasing share of talent pools in the next decade.

We believe Luxembourg should put measures in place to encourage training and attraction in these talent categories. Promoting dedicated programs in higher education, and encouraging international talent to train in Luxembourg, should be part of the answer. Maintaining the competitiveness of Luxembourg’s value proposition to key talent targets is also critical in our view.
Talent infrastructure aspects should also be part of a comprehensive plan to boost talent attractiveness. Examples of areas to be explored include mobility, flight accessibility to certain US destinations, availability of school and family services, and the balance between real estate prices and the country’s value proposition for international talent. Finally, communication is likely to remain an important lever to ensure the benefits of a life and a career in Luxembourg are properly understood by employers and candidates.

Conclusion

Ten years after the global financial crisis and the subsequent European debt crisis, the Luxembourg financial sector has recovered in terms of economic activity and volume growth.

While the financial sector contributed nearly a quarter of national value added growth in the past ten years, it has done so less profitably due to both revenue and cost pressures.

Financial players have faced substantial changes in the past few years, and today continue to operate under challenging economic fundamentals, due to factors ranging from low interest rates and revenue pressures to cost inflation and regulatory complexity. Beyond this, a number of disruptions are currently unfolding, demanding Luxembourg-based business models to generate more value in a more efficient manner.

The Luxembourg financial sector has succeeded in navigating through the crisis, namely by playing its strengths around stability, transparency and security, and by maintaining its proactive position towards legislation at both European and national levels. The country’s skilled workforce and the continued relevance of Luxembourg products have also helped the financial sector consolidate its strengths, in spite of substantial headwinds.

Today, the financial sector must look forward to the challenges and opportunities ahead. For example, efforts should be made to build on growth momentum (e.g., in PERE) and fill the spaces where Luxembourg is not yet at its fair share (e.g., in ETFs). Embracing new business models and more international competition (e.g., in Wealth Management) is also key. Across the industry, regaining profitability should be a key focus area, with solutions such as RPA and smart sourcing offering potential beyond what traditional cost reduction levers may have allowed historically. Last but not least, talent should remain a critical priority, to ensure the industry has the resources to effect the changes necessary to its future success.

This report has outlined the Luxembourg financial sector context and a number of propositions to improve its outlook in the next decade. It is now in the hands of financial sector players, both private and public, to take note of opportunities and decide on the optimal positioning of Luxembourg activities for the next decade.
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