

The Financial Center Luxembourg

The calm before the storm?

Facing the cyclical downturn

Thomas Feld

15 November 2018



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BREXIT countdown
Outlook

NOTE: The views expressed in this presentation are those of the presenter and not the opinion of KPMG.



Introduction

Key Topics & Developments in 2018



Global & Political

- Geopolitical risks cause turmoil
- Change of US policy - unilateral vs. multilateral agreements
- US trade war against the world
- BREXIT countdown
- EURO-zone issues



Luxembourg

- New Government
- Strategy for the country
 - manage the growth
 - dependency on finance industry
 - attract businesses
- Integration into new world order
 - financial services regulation
 - tax harmonisation



Financial Markets

- Stock markets volatility
- ECB policy re QE, interest
- BREXIT Implications
- Non-performing loans (NPL)
- Consolidation process
- Regulatory landscape
- Digitalisation Fin Tech



Facing a Cyclical Downturn



Global weather change ahead

10 years after the crisis: The unrest is increasing after 120 months of recovery



The Raging Bull: Goldman Sachs “Bull/Bear” Index

Highest level since 1969

**“Reasonable
signal for bear
market risk”**

Basis:
Equity valuation,
Growth
momentum,
Unemployment,
Inflation, Yield
curve



Source: Goldman Sachs, Bloomberg, September 2018

Warning signals

Less than 5% of past national economic slumps have been predicted in advance

There is no natural law for the length of cycles

Periods of economic growth are often extinguished by flawed politics

- Erroneous central bank action
- Protectionism & Trade wars

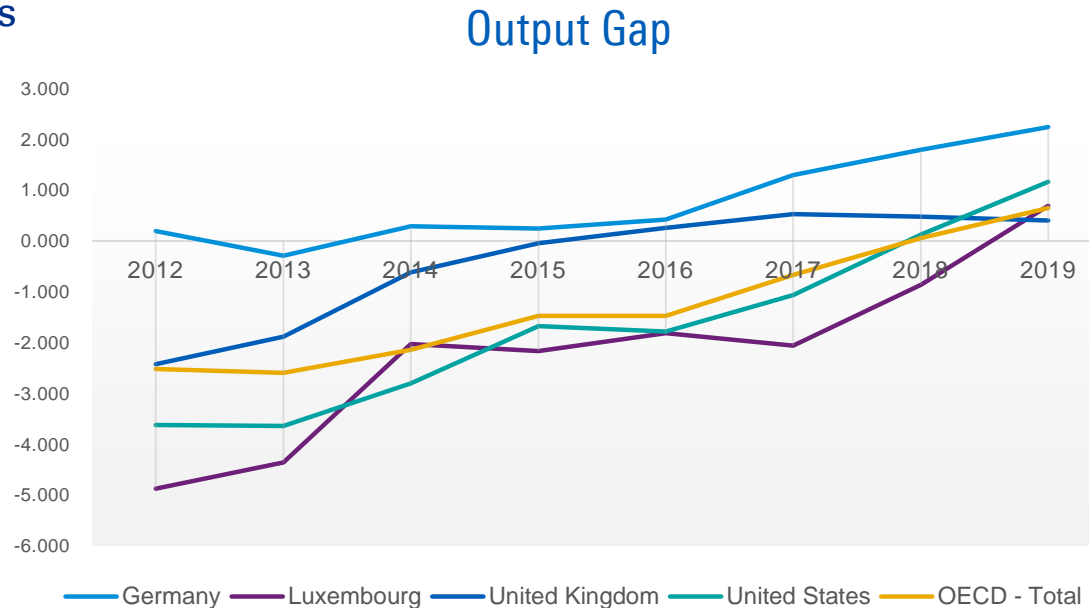
Resulting in Investor uncertainties

Positive output gap:

Actual minus potential output

Overheating job markets

High private sector debts



Source: OECD, November 2018

Manage the next crisis ?

The next crisis will emerge in unexpected ways

Productivity is key!

- Continuous investment in technology, modern equipment and higher wages
- The ongoing digitalisation is stimulating the economy

Major legal tools have already been established after 2008:

- US: Dodd-Frank Wall Street Reform & Consumer Protection Act
- Europe: Single Resolution Mechanism & Single Resolution Fund, BRRD
- UK: Banking Act 2009 & Financial Services Act 2012

Establish a level of trust and institutionalized cooperation among authorities

Closely monitor the shadow banking system

Strengthen the emergency tools: Lending, guarantees, capital



Source: Group of 30, 2018

Luxembourg's credit profile by



- Luxembourg's credit rating strengths include its **high wealth, strong economic growth** and **solid budgets**
- Moody's expects **GDP** growth of **3.7% (2018)** and **3% (2019)** while STATEC predicts **3,9% (2018)** and **4% (2019)**
- Luxembourg's very high institutional strength reflects **the regulatory authorities' prudential supervision and rigorous controls of credit institutions and other financial entities**
- Luxembourg has a **well-defined fiscal framework, transparent finances and inflation that is low and stable**
- **Healthy budget indicators and low public debt**
- **Credit risk is weak and relies on authorities to respond to economic challenges and long term public finances**

- **Risks** to the growth outlook for the Grand Duchy are mainly **external** and relate to the **potential negative effects of: BREXIT, global trade protectionism, the risk of weak trade within the EU and challenges to Luxembourg's business model from international and EU scrutiny on tax avoidance**
- Key credit challenges relate to uncertainties over its medium- to long-term **growth prospects**, in light of significant **shifts in the financial sector's regulatory and supervisory frameworks**



Luxembourg has a strong growth performance over a long period, similar to other economies like

Denmark (Aaa – stable)

France (Aa2)

Hong Kong (Aa2)

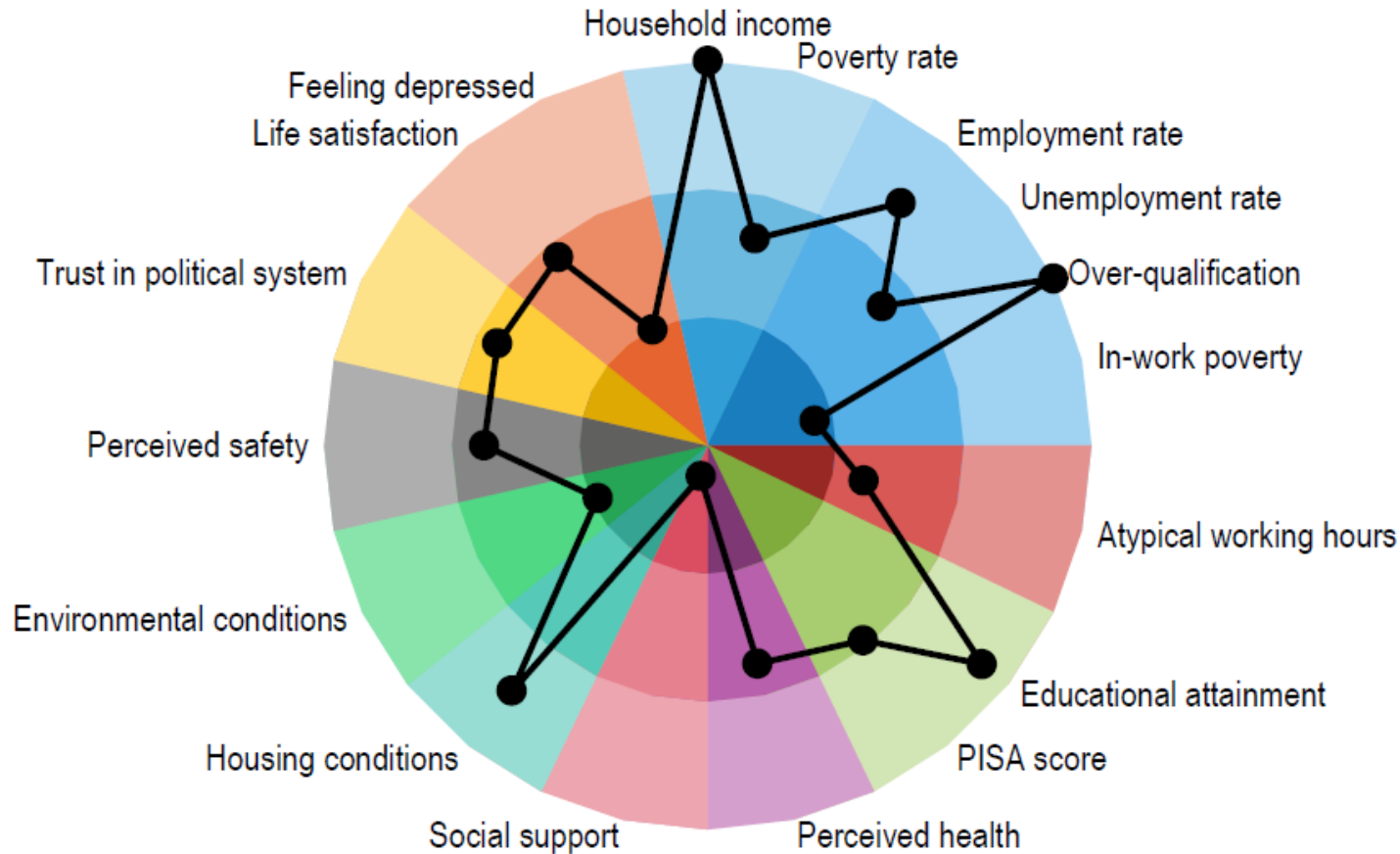
New Zealand (Aaa – stable)

Norway (Aaa - stable)

Switzerland (Aaa – stable)

Source: Moodys,
Le Quotidien 7 November 2018

How is Life in Luxembourg?



Main messages

- Household net wealth and average earnings highest in the OECD
- Good situation for migrants
- Life satisfaction close to OECD average
- Improved housing conditions
- Percentage of employees working 50 hours or more per week has increased
- Share of the population who declare that they feel safe when walking alone at night decreased slightly
- Education system supported by financial sector
- Percentage of adults reporting to be in “good” or “very good” health has remained stable

Source: OECD (2017): OECD Better Life Initiative 2017

Current STATEC figures

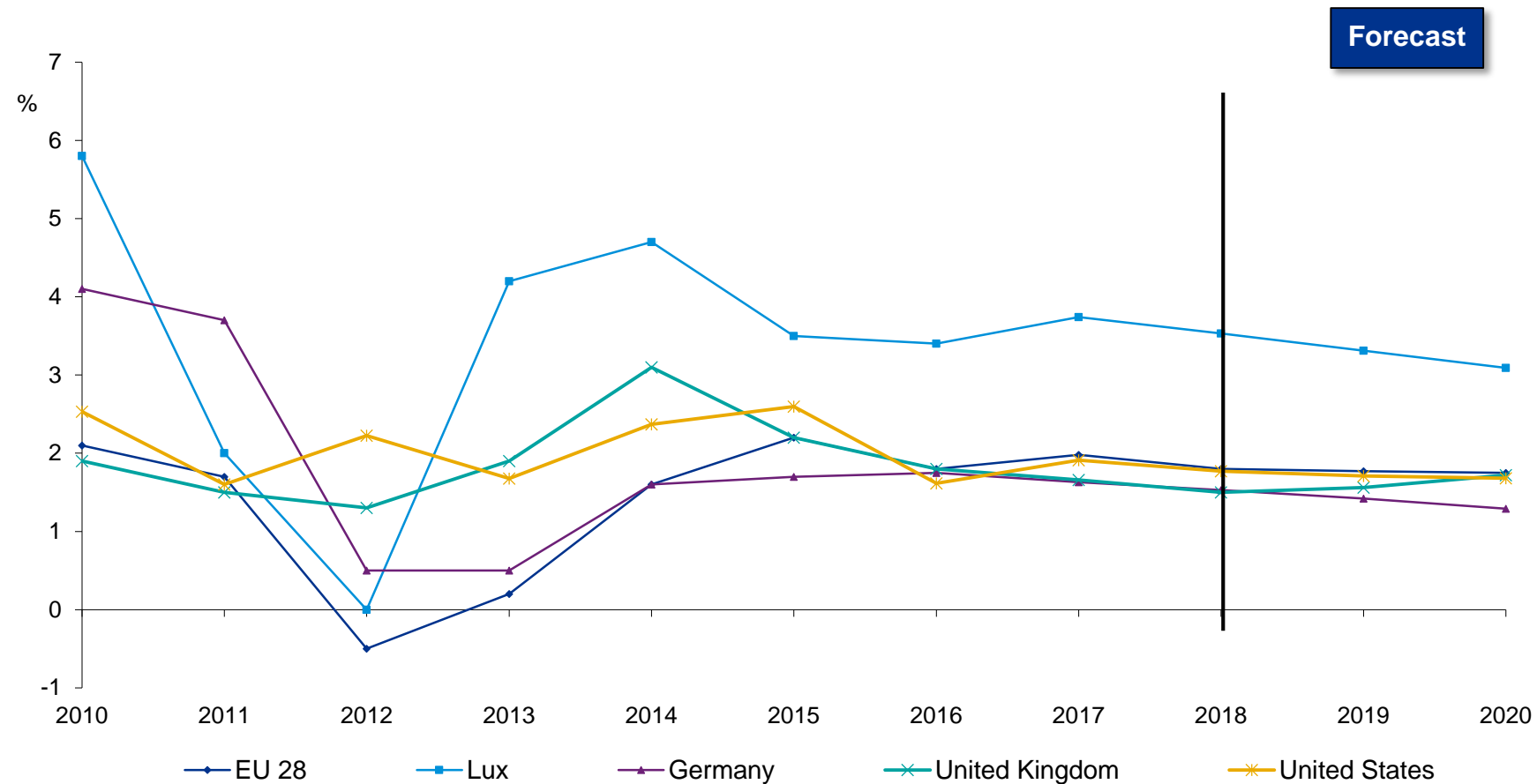
Population by sex and nationality on 1st January
(x 1 000) of years table by STATEC / CTIE



Year	1981	1991	2001	2010	2011	2012	2013	2014	2015	2016	2017	2018
Population												
Total population (x1000)	364	384	439	502	512	524	537	549	563	576	590	602
of which: Women	186	196	223	252	257	263	268	274	281	287	294	299
Luxembourgers	268	271	277	285	291	295	298	300	304	307	309	313
Foreigners	95	113	162	216	220	229	238	248	258	269	281	288
of which: Portugal	29	39	58	79	82	85	88	90	92	93	96	96
France	11	13	20	29	31	33	35	37	39	41	44	45
Italy	22	19	19	18	18	18	18	18	19	20	21	21
Belgium	7	10	14	16	16	17	17	18	18	19	20	20
Germany	8	8	10	12	12	12	12	12	12	12	13	13
Britain	2	3	4	5	5	5	5	5	6	6	6	5
Netherlands	2	3	3	3	3	3	3	4	4	4	4	5
Other EU	10	6	9	20	21	23	24	27	29	32	34	36
Other	...	9	22	30	28	31	32	34	36	39	41	43
Foreigners in %	26	29	36	43	43	48	44	45	45	46	47	47

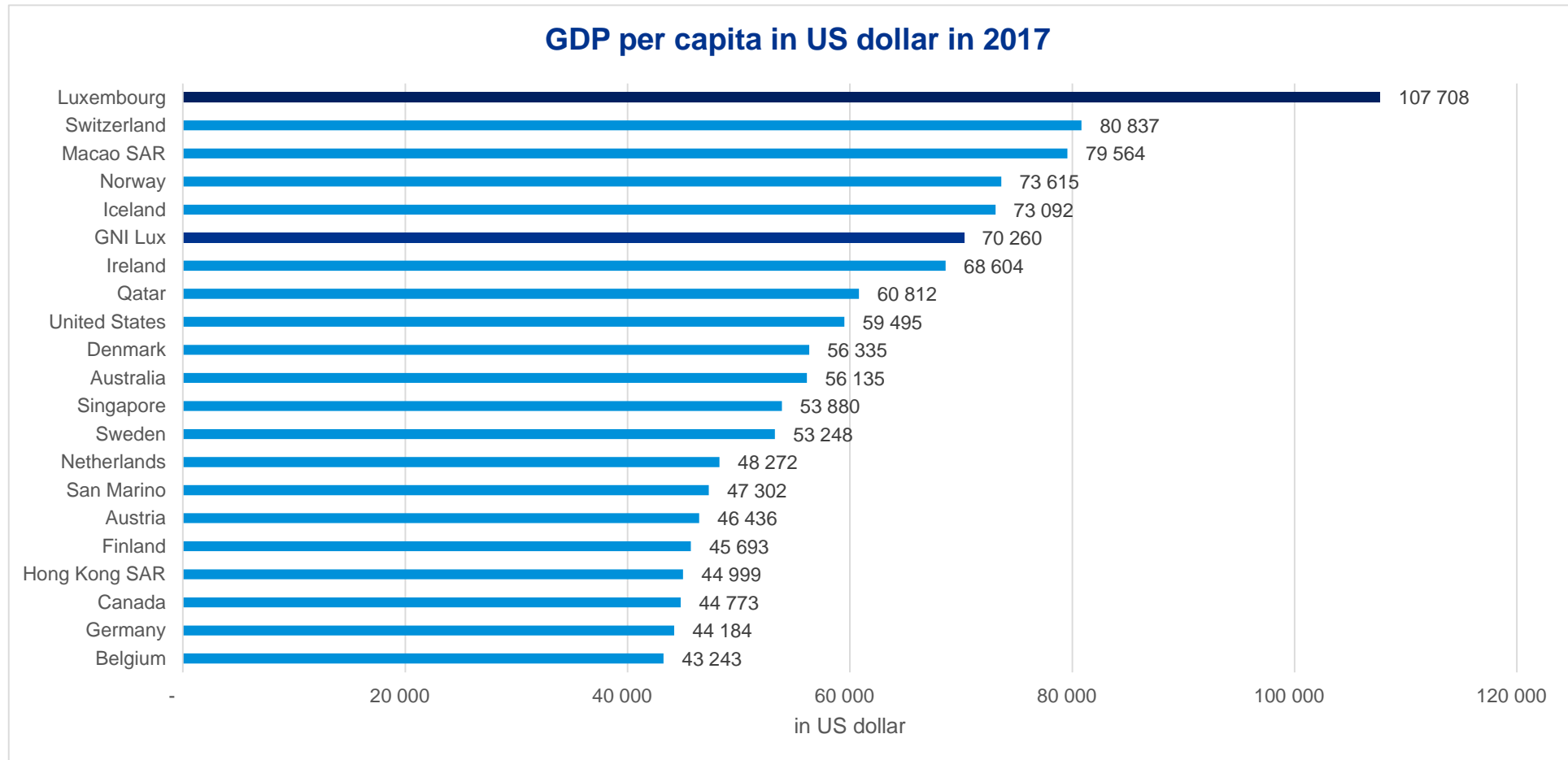
Source: STATEC

GDP growth rates



Source EU data: Eurostat
Source US data: Worldbank.org
2018-2021: Forecast statista.com

GDP per capita 2017



Source: [statista.com](https://www.statista.com)

GNI LUX: databank.worldbank.org



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Insights into the financial sector

Top 15 Western Europe Centers

GFCI: Global Financial Centres Index

Center	GFCI 24		GFCI 23		Change		Change	
	Rank	Rating	Rank	Rating	in Rank		in Rating	
London	2	786	1	794	-1	▼	-8	▼
Zurich	9	732	16	713	+7	▲	+19	▲
Frankfurt	10	730	20	703	+10	▲	+22	▲
Luxembourg	21	694	21	701	0	-	-7	▼
Paris	23	691	24	687	+1	▲	+4	▲
Geneva	27	685	26	682	-1	▼	+3	▲
Amsterdam	35	657	50	613	+15	▲	+44	▲
Dublin	37	652	31	666	-6	▼	-14	▼
Munich	39	639	35	660	-4	▼	-21	▼
Hamburg	41	636	29	676	-12	▼	-40	▼
Edinburgh	43	634	43	628	0	-	+6	▲
Monaco	46	629	54	604	+8	▲	+25	▲
Jersey	47	628	39	637	-8	▼	-9	▼
Glasgow	50	622	49	614	-1	▼	+8	▲
Vienna	51	621	64	583	+13	▲	+38	▲

Source: [longfinance.net](https://www.longfinance.net)



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Employment in the financial sector

**2017 saw an increase in staff numbers across all areas of the financial sector:
Total: more than 46,000 employees**

Type of financial sector entity	Number of staff	Change in number and %	
Banks	26,149	▲ 89	0%
Professionals of the financial sector	15,935	▲ 442	▲ 3%
Management companies	4,039	▲ 305	▲ 7%

Source: CSSF, KPMG Banking Insights 2018



Banks



The International nature of Luxembourg banks



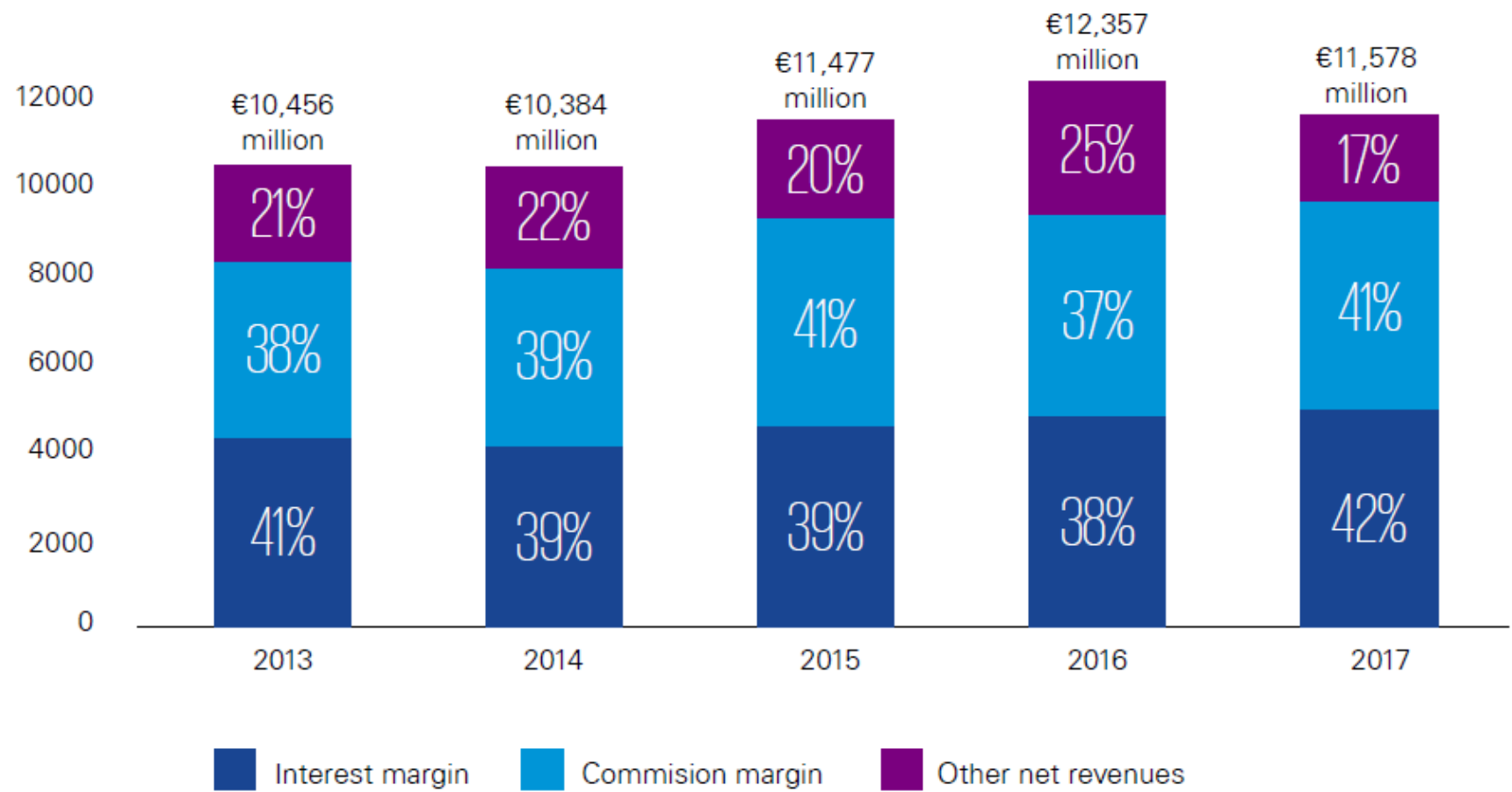
Source: CSSF, KPMG Banking Insights 2018

Size of the Luxembourg Banking Industry



Source: CSSF, KPMG Banking Insights 2018

Banking Income

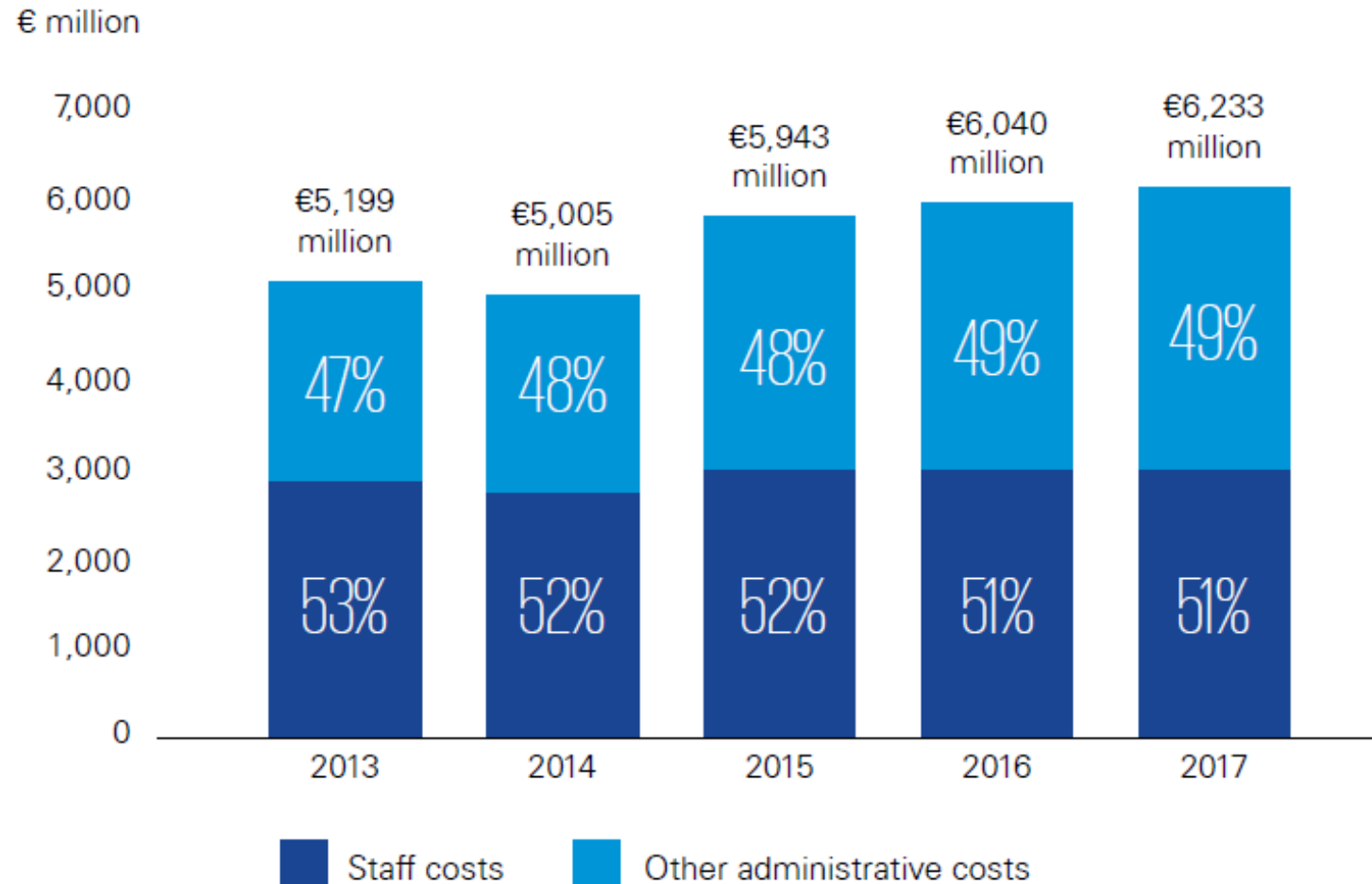


Source: CSSF, KPMG Banking Insights 2018



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Banking expenses



- Staff costs remain stable and in line with the development of number of employees
- The rate of other administrative costs remains unchanged compared to 2016

Source: CSSF, KPMG Banking Insights 2018

Top 10 banks in terms of number of employees

Number of employees as per year end	Rank	2017	Rank	2016	Rank	2015
BGL BNP Paribas	1	2,390	1	2,478	1	2,514
Banque et Caisse d'Epargne de l'Etat, Luxembourg	2	1,820	3	1,796	3	1,783
Banque Internationale à Luxembourg	3	1,803	2	1,815	2	2,050
RBC Investor Services Bank	4	1,339	4	1,327	4	1,424
Société Générale Bank & Trust	5	1,237	5	1,241	5	1,244
DZ Privatbank	6	912	6	909	6	863
Banque de Luxembourg	7	844	8	815	8	803
ING Luxembourg	8	825	7	838	7	818
State Street Bank Luxembourg S.C.A.	9	790	10	743	10	754
KBL European Private Bankers	10	702	9	765	9	771

Source: CSSF, KPMG Banking Insights 2018

Snapshot of the Banking industry Nov 2018

- EU regulation vs deregulation under current US Government;
EU goldplated standards (MiFID, EC re LU, IE, RO on AML 4th Directive)
- Bundesbank warns of procyclical effects: credit risks underestimated, assets and collaterals overstated; Markets' developments will have an immediate income/capital effect
- ECB interest policy as a cost (€20 bn negative interest paid vs US €80 bn received)
Loss of market capitalization, NPL €657 bn within Euro-zone
- RegTechs/FinTechs with a competitive advantage (Bank bashing, IT systems, customer base)
- Digitalisation reinforces competition (one click away) → best technology vs client wishes
- Reputation issues (AML, Governance, cum-ex)



→ No environment for success in operational banking

Focus Areas 2019



SSM agenda 2019

- Cyber criminality & IT disruptions
- Non-Performing Loans
- Low interest environment
- Risks in the financial markets
- Geopolitical uncertainties
- Euro-zone economic development

SSM agenda 2018

- Business models
- Determining factors of profitability
- Credit risk with focus on Non-Performing Loans
- Risk management
- BREXIT
- Stress tests

MiFID II - regulatory overkill ?

MiFID Checklist

- ✓ Financial background
- ✓ Check & risk assessment
- ✓ Appropriateness
- ✓ Recommendation
- ✓ Documentation/protocol
- ✓ Proof of product origin/certificate
- ✓ Tax implications
- ✓ Technical information
- ✓ Price comparisons
- ✓ Protocol of sales conversation

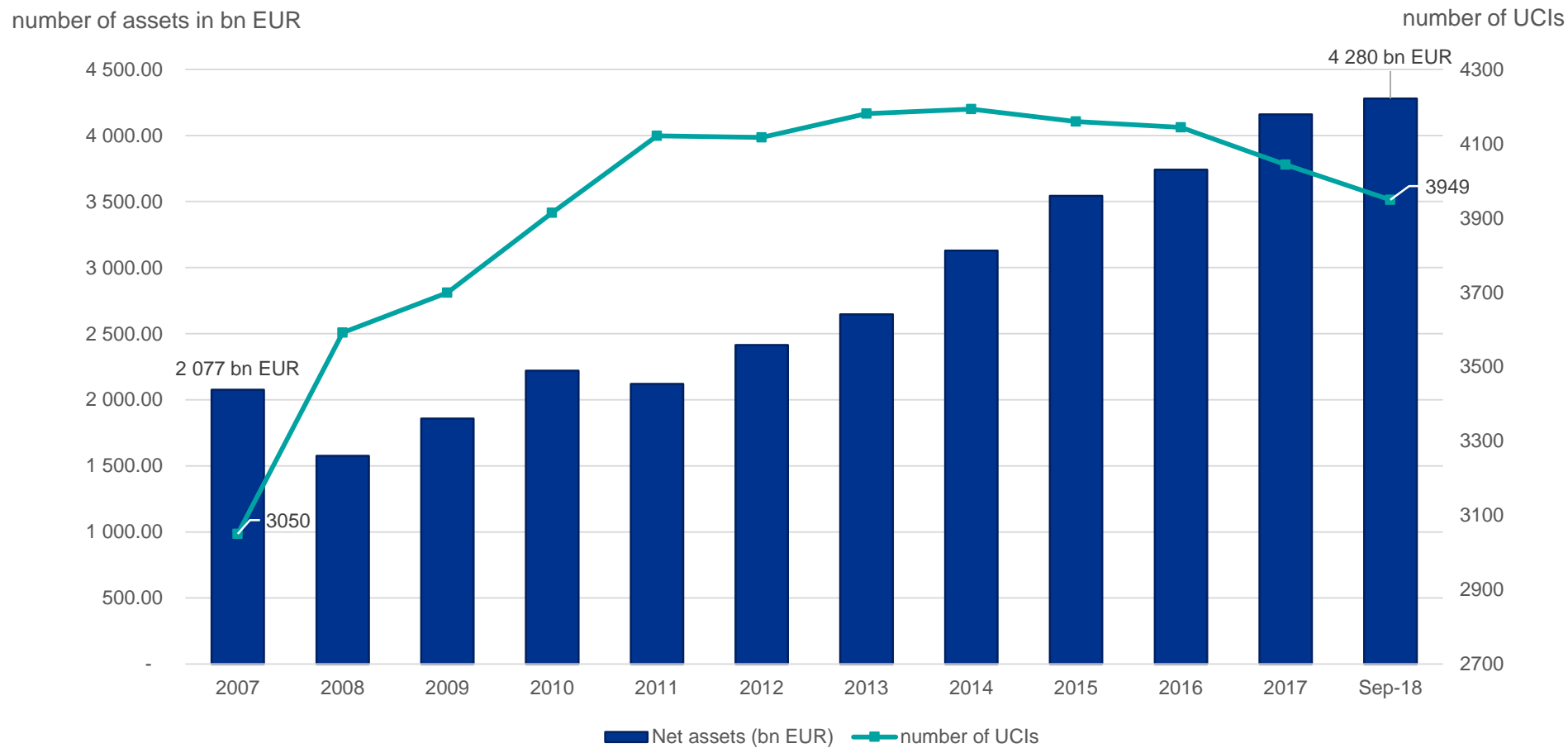


Source: DAS INVESTMENT – based on social media



Funds

Development of the funds sector



Source: CSSF



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Top players: Fund Administrators & Promoters

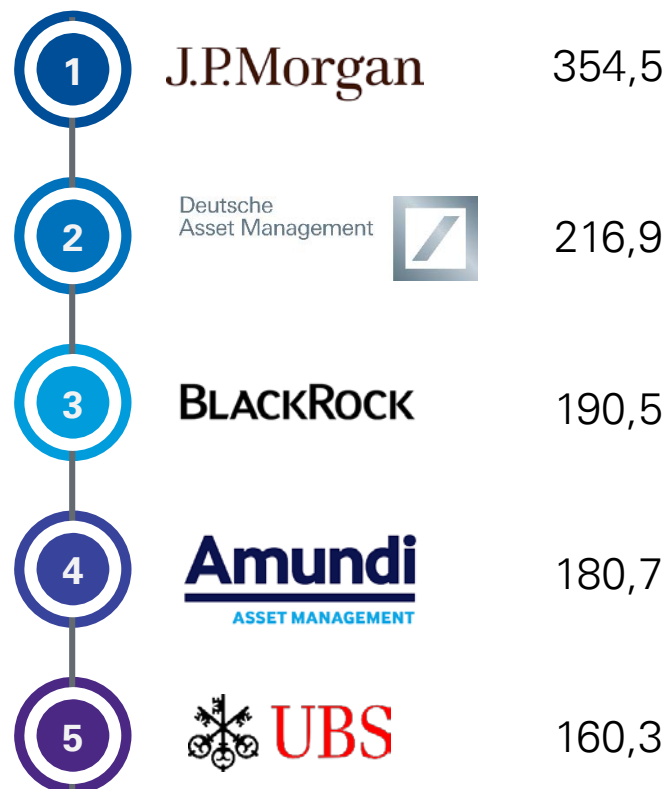
Top 5 Fund Administrators

Net Assets in billion USD, YE 2017



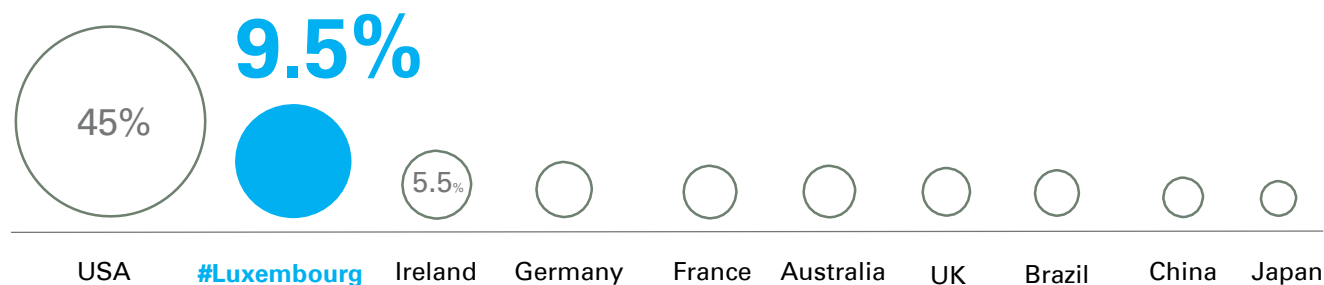
Top 5 Fund Promoters

Net Assets in billion USD, YE 2017



Source: Monterey Insight – Luxembourg Fund Report 2018

Luxembourg is leading in Europe



FIRST IN CROSS-BORDER
FUND DISTRIBUTION

€ 4.3 trillion

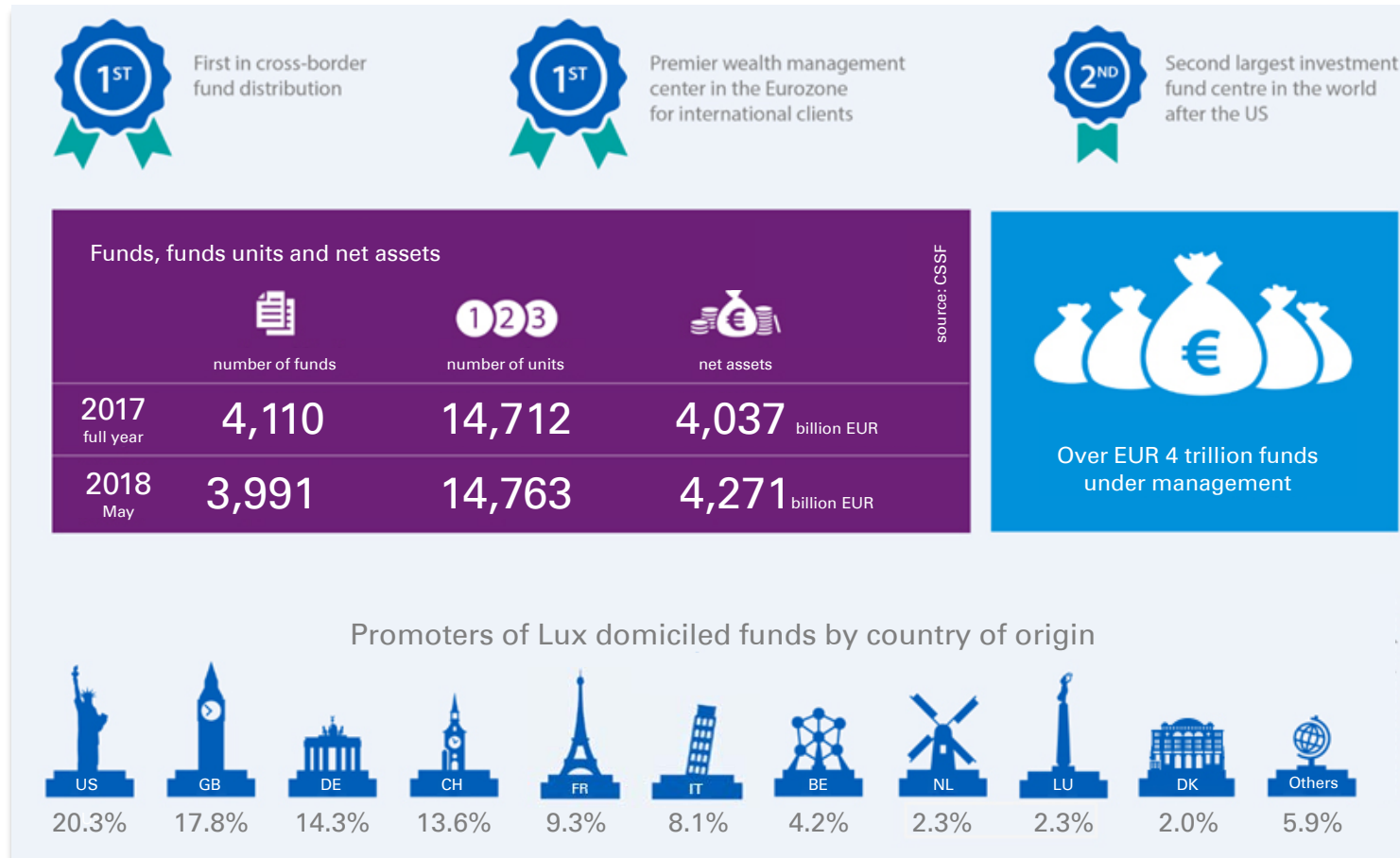
net assets under management in Luxembourg funds

Source: EFAMA - International Statistical Release (2018:Q1)



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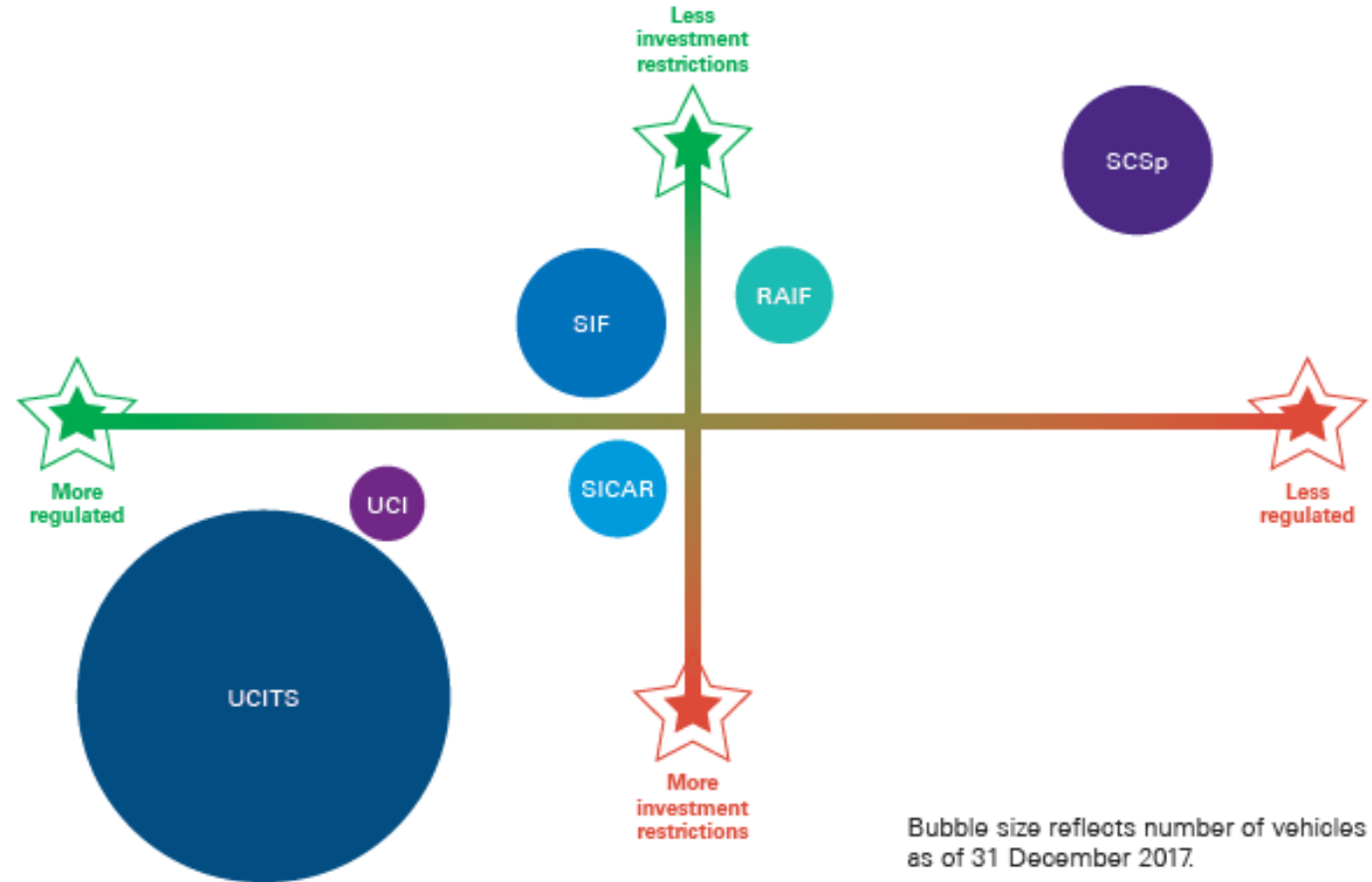
Why Luxembourg?



Source: CSSF

Funds Universe

Luxembourg's investment funds universe

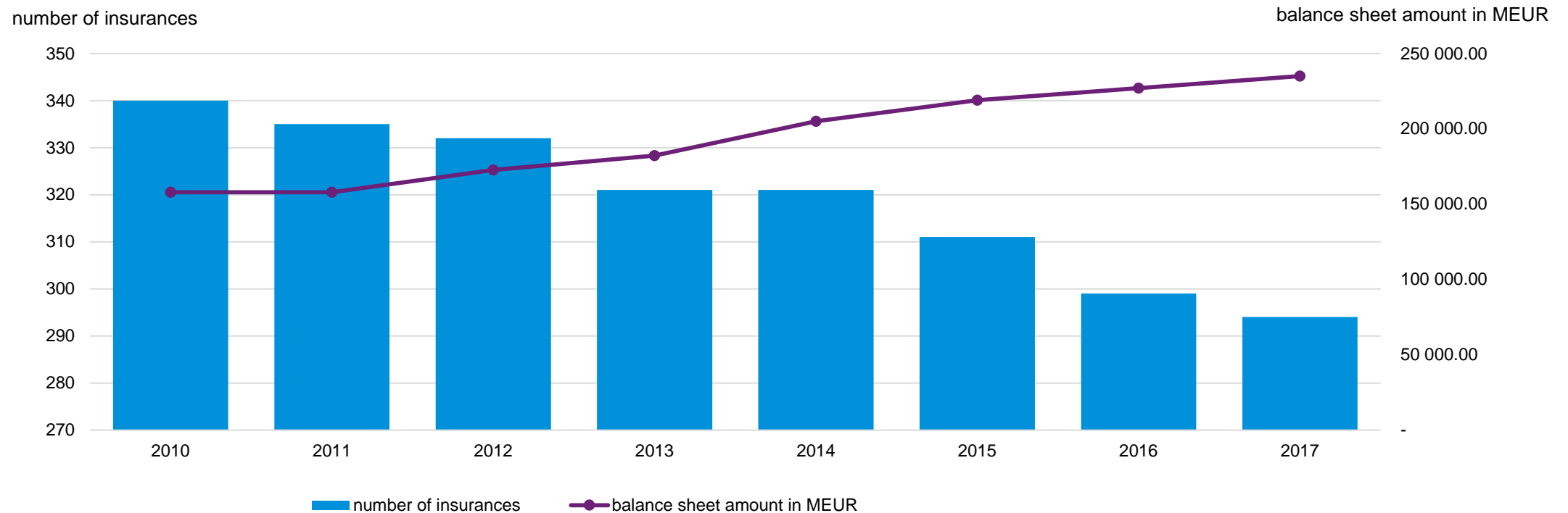


Source: KPMG Luxembourg Investment Vehicles brochure 2018



Insurances

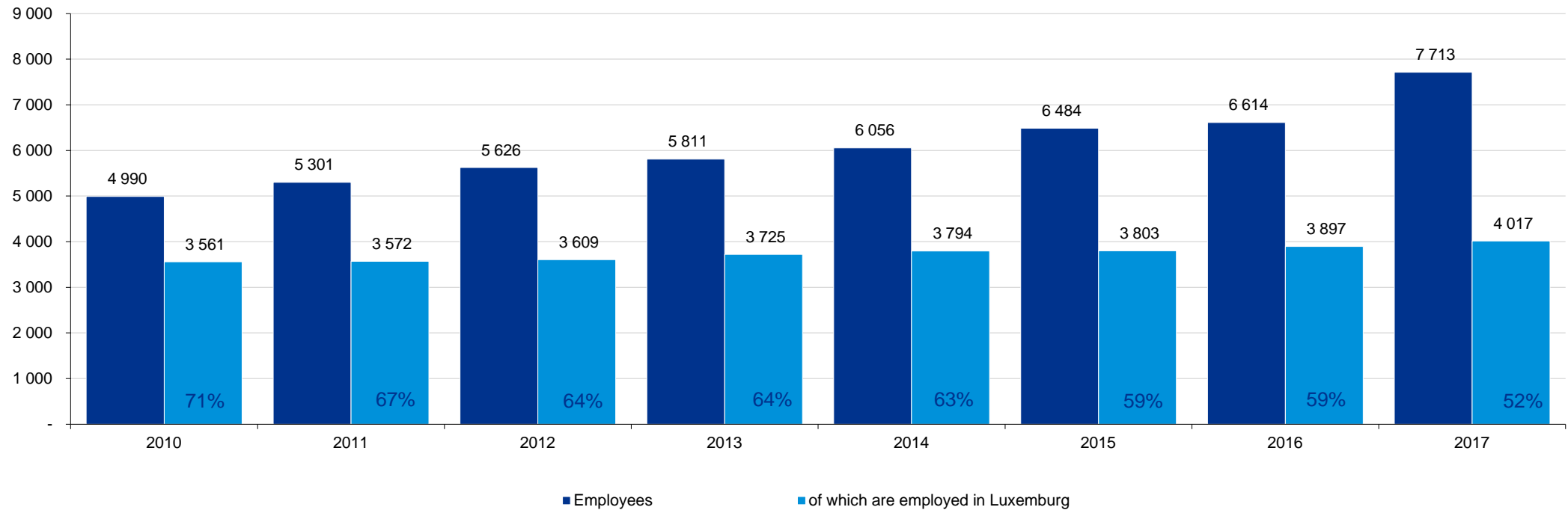
Development of the insurance sector



Source: CAA Annual Report 2010 - 2017

Employment in the insurance sector

Employees



Source: CAA Annual Report 2010 - 2017



BREXIT countdown

GBP/EUR remains low since Brexit referendum

CCY Conversion Rate GBP - EUR



BREXIT – be prepared! For what exactly?

“Everything is possible”

→ Brexit negotiations have led to political uncertainty

Implications for financial markets

- without an exit deal, bonds issued under UK law will no longer be eligible as MREL; roughly €100 bn of debt would lose their MREL status
- Euro-Clearing/Settlement outside the Euro-zone?
- Securities listed in London? Bail-in eligible?
- EBA/ESMA/EIOPA et al. working on MoU

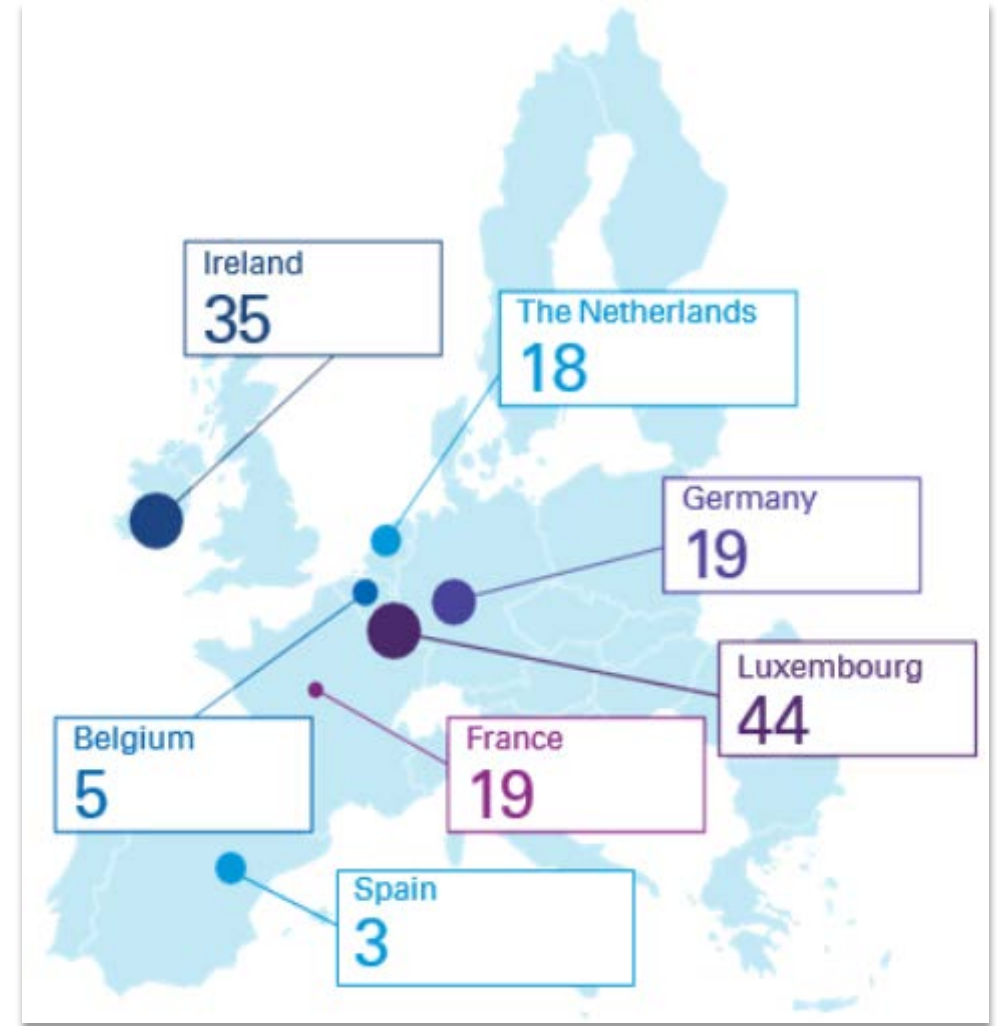


Where are companies relocating to?

On the Brexit Journey

Brexit transformation agenda

Corporates need to change from
PRE-BREXIT to POST-BREXIT
business models and operating mode



Source: KPMG



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Outlook

Clouds coming or passing?



Outlook



Banks

- Consolidation process
- Cost of banking vs low income
- EU level playing field while US deregulates
- Increased competition in a complex environment
- Digitalisation & new players



Luxembourg

- New Government committed to the financial place
- Initiatives to become less dependent on the financial sector
- Public debt & Pension system
- Sustainable growth is a political discussion



Funds

- Lux Fund ecosystem
- Demographic trend requires equity investments - Funds are ideal for long term saving ("Retirement is entirely linked to long term investing")
- Increased competition in a complex environment

Government Goal Setting

- **Solid financial budgets**
- **Support & represent the financial place in international gremiums**
- **Communication and exchange with authorities**
- **Competitive tax environment – level playing field**
- **Face the growth challenges: infrastructure, resources & pension system**





Thank you
for your attention!



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