



Overview of the CSSF annual report 2023

On-site inspections

This newsletter marks the beginning of a six-part series, offering an overview of the CSSF Annual Report for the year 2023. The initial edition of this series is dedicated to highlighting the outcomes of on-site inspections.

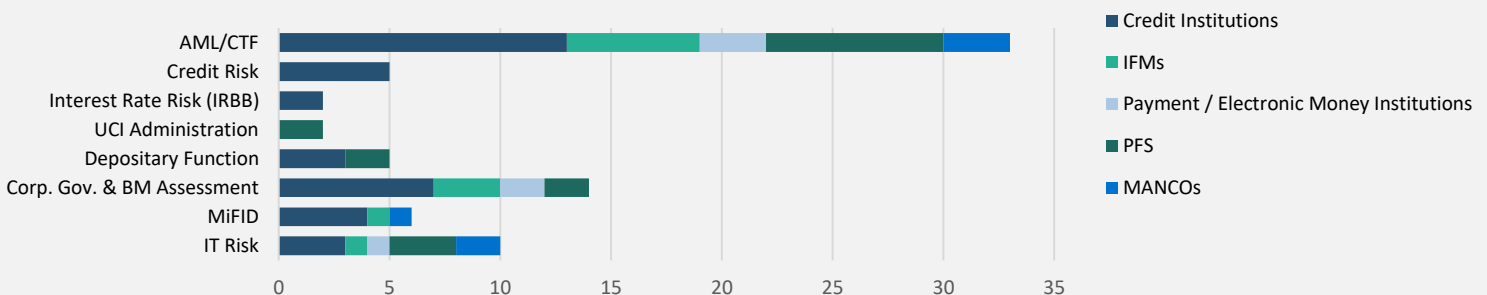
On the 19 September 2024, the CSSF published its annual report focusing on the overview of the CSSF activities and initiatives in 2023. This publication aims to provide valuable information to assist relevant entities in gaining an understanding of areas requiring attention based on the CSSF observations.

In upcoming publications, we will firstly deliver an overview of the key institutions under CSSF's supervision, offering insights into various dimensions of CSSF supervision practices. Additionally, we will highlight significant past and forthcoming priorities, along with key findings from off-site inspections. Secondly, our focus will shift to the noteworthy regulatory changes that unfolded in 2023, providing a glimpse into anticipated developments for the years ahead.

On-site inspections – Key findings I/II

This section provides an overview of key topics, and when disclosed, significant weaknesses and deficiencies identified by the CSSF during its on-site inspections.

Breakdown of the on-site inspections in 2023 by topic



Legend:



Credit Institutions



PFS



IFMs and UCIs



Payment Institutions



Credit risk

Verifying the soundness and prudence of credit risk

- Risk Coverage and Monitoring: Gaps in addressing key risks (e.g., ESG) and poor monitoring of credit concentrations;
- Insufficient Resources: Lack of adequate staffing and tools to manage credit risk;
- Weak Procedures: Inconsistent and outdated credit risk procedures;
- Delayed Default Recognition: Late recognition of defaults and weak controls for credit monitoring;
- Real Estate Loans: Issues with Loan-to-Value (LTV) ratio calculations and limit applications..

Depository function

Verifying compliance with laws and regulations

- Ownership Verification: Weaknesses in verifying asset ownership, especially with alternative assets, and inadequate use of external evidence.
- Oversight and Monitoring: Failures in ensuring timely transaction settlement oversight and risk-based supervision of tasks under the responsibility of IFMs.
- Valuation of Illiquid Assets: Deficiencies in ensuring compliance with asset valuation policies for UCIs investing in illiquid assets.
- Governance Issues: Specialized PFS showed governance, control, and resource deficiencies.





Interest rate risk

Verifying how interest rates arising was managed

- **Risk Control Oversight:** Insufficient involvement of the risk control function in understanding overall risks.
- **Modelling Assumptions:** Inadequate assumptions for non-maturity deposits.
- **Economic Value of Equity:** Incomplete quantification, excluding interest payments and non-performing loans .
- **Risk Management Tools:** Failure to account for product optionalities, like implicit caps and floors.
- **Quantification Tools:** Lack of robustness, insufficiently granular data, and poor documentation of data flows and controls.



UCI Administrations

Ensuring proper implementation of CSSF Circular 22/811 on the authorization and organisation of entities acting as UCI administrators

- As of today, no results have been disclosed.



ICAAP (Pillar II)

Verifying that the credit institutions have established a suitable procedure for maintaining a sufficient capital level

- **Internal Control Deficiencies:** Weaknesses in the internal controls related to the ICAAP process.
- **Economic Capital Models:** Models that do not capture entity-specific risks.
- **Stress Testing:** Stress scenarios were not severe enough and failed to account for entity-specific vulnerabilities.
- **Profitability Consideration:** Lack of consideration for profitability and economic perspectives in the capital allocation process.



Pillar I

Verifying the correct application of the requirements for the computing of own funds

- **Risk-Weighted Assets (RWA) Non-Compliance:** The inspection found incorrect application of risk weights, leading to higher risk-weighted assets.
- **Solvency Ratio Impact:** Miscalculation caused a drop in the bank's solvency ratio, increasing capital requirements.



On-site inspections – Key findings II/II



Corporate Governance

Evaluating the governance arrangements of some supervised entities pursuant to the regulatory and legal requirements.

- **Board and Management issues:** Boards of Directors and management committees showed weaknesses in strategy definition, internal control oversight, and conflict of interest management.
- **Outsourcing deficiencies:** There was inadequate risk assessment and monitoring of outsourced activities, along with insufficient reporting to decision-makers.
- **Compliance and Risk Control:** Compliance functions lacked proper resources, comprehensive risk assessments, and timely execution of control plans. Risk control functions also suffered from inadequate procedural frameworks and human resource shortages.
- **Internal audit shortcomings:** Internal audit functions showed gaps in scope, systematization, and risk-based planning, often relying on external experts due to poor resource planning.
- **EMIR compliance gaps:** Deficiencies were noted in the supervision and reporting of EMIR activities, including trade confirmations.
- **Climate and environmental risks:** For the first time, inspections included analysis of climate and environmental risks, with attention to materiality assessments and action plans.



MiFID

Assess whether the implemented MiFID framework is compliant with the legal and regulatory requirements

- **Suitability and appropriateness:** Deficiencies in the collection of client information and the assessment of product suitability or appropriateness.
- **Conflicts of interest:** Insufficient mechanisms to identify/prevent/manage conflicts of interest.
- **Client information:** Inadequate communication with clients, particularly regarding ex-ante and ex-post information on costs and charges.
- **Product governance:** Weak measures in the product manufacturing and distribution processes, as well as poor information exchange among stakeholders.
- **Internal controls:** Gaps in the scope and formalization of controls performed by compliance and internal audit functions.
- **ESG considerations:** Verifications on how entities consider clients' sustainable investment preferences in the suitability assessment of investment services.





IT Risk



Assessing whether the implemented IT framework is compliant with the legal and regulatory requirements



- **IT security:** Issues with outdated IT systems, inadequate security testing, and failure to manage critical vulnerabilities effectively.
- **Access management:** Excessive use of privileged accounts, lack of proper logging for access activities, and insufficient supervisory controls to detect suspicious activity.
- **IT Risk management:** Inadequate IT risk management practices, including poor risk identification, incomplete risk processing plans, and a lack of IT risk reporting to management.
- **Internal audit:** Weak internal audit practices, including inadequate IT risk assessment, superficial audit work, and poor follow-up on audit findings.
- **Outsourcing:** Incomplete risk assessments of outsourced IT services, inadequate contractual provisions, and insufficient monitoring of external IT service providers.



On-site AML/CTF supervision



Assessing whether the implemented AML/CTF framework is compliant with the legal and regulatory requirements



- **Weaknesses in name matching tools:** Many institutions lacked proper controls for verifying the effectiveness of tools used for name matching against sanctions lists. There were delays in updates, missing names, and inadequate database feeding.
- **Deficiencies in alert handling:** Significant delays in processing alerts related to financial sanctions were found, along with inadequate controls such as a lack of oversight by compliance functions.
- **Inadequate Due Diligence:** Customer risk assessments were often incomplete, resulting in inappropriate due diligence, especially in the monitoring of transactions and beneficial owner verification for complex structures.
- **Delayed reporting:** Several institutions failed to report ML/TF suspicions to the FIU on time or at all.
- **Oversight of outsourced AML/CFT controls:** Some institutions did not properly supervise third-party AML/CFT controls, even when the delegate was part of the same group.



In 2023, administrative fines and prudential enforcement measures totaled EUR 2,436,420.50, marking a **58% decrease** from the previous year's total of EUR 5,880,931.8.

This newsletter, the first in a series of 6 publications.



On-site Inspections

Published 22/10/2024



Credit Institutions

By 28/10/2024



IFMs and UCIs

By 04/10/2024



PFS

By 11/11/2024



Payment, Electronic Money Institutions and VASPs

By 18/11/2024



Challenges for the next years

By 25/11/2024

Why Forvis Mazars for you?

Joined-up Forvis Mazars engagement team

As a truly integrated partnership and firm, we operate seamlessly across borders. Our commitment to clients is absolute – we furnish you with a seasoned senior team well-versed in the intricacies of the field. You will benefit of senior leaders ‘on the ground’, poised to deliver not just insights but transformative, value-enhancing recommendations.

Tailored, pragmatic, joined-up approach

In these challenging times, Forvis Mazars is committed to support you navigating the regulatory challenges. As a service provider, our work is practical, and our conclusions and action plans will be pragmatic and fine-tuned to our clients’ needs. We will tailor our approach to ensure our work meets each and every client's specific requirements.

Personal and personable approach

We strongly believe that this sets us apart from the competition. Our commitment is to invest time and effort in truly understanding the unique environment of each entity we engage with. We approach every interaction with a willingness to listen, to empathize, and to adapt.



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