



Overview of the CSSF annual report 2023

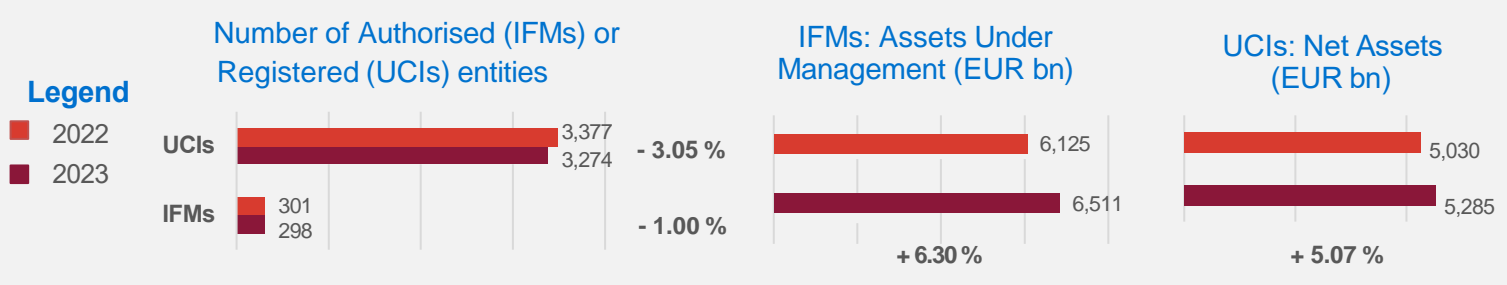
Investment Fund Managers (IFMs) and
Undertakings for Collective Investment (UCIs)

This newsletter marks the third publication of a six-part series, offering an overview of the CSSF Annual Report for the year 2023. This edition of this series is dedicated to the key highlights for IFMs and UCIs.

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 the first publication, we focused on highlighting the outcomes of on-site inspections. In this and future publications, we provide an overview of the key institutions under CSSF's supervision, offering insights into various aspects of CSSF's supervisory practices. Additionally, we 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.

Investment Fund Managers and Undertakings for Collective Investment



Off-site Supervision

Off-site Supervision of UCIs

- As part of the evaluation of annual reports, management letters, and long form reports, the CSSF found it necessary to intervene with specific funds and/or their IFM;
- In the context of errors in NAV calculations, failure to observe the legal and regulatory limits of diversification, holding and borrowing has been a source of non-compliance with investment rules;
- In 2023, several key geopolitical events occurred, including the war in Ukraine, financial sanctions on Russia and Belarus, and the Israel-Hamas conflict. Elevated interest rates impacted economic activities and investment funds, contributing to three major developments: a crisis in U.S. regional banks, a downturn in the real estate sector, and a shift in asset allocations.

Off-site Supervision of IFMs

- Following Circulars CSSF 21/788, 21/789, and 21/790, the CSSF developed an IFM assessment methodology based on the responses from the **Self-Assessment Questionnaire (SAQ)**.
- Key findings include discrepancies between SAQ responses and reports from external auditors, particularly in areas like office resources, compliance, and IT. **Key remarks:**
 - IFMs must calculate own funds quarterly and maintain them in liquid assets;
 - Management bodies must document decisions regularly;
 - Internal control functions, including compliance and audit, must remain independent and report regularly to senior management;
 - Procedures, including those related to voting rights and conflicts of interest, must be reviewed annually;
 - Delegation and IT risk management must follow a risk-based approach.

Thematic reviews

In 2023, the CSSF conducted thematic reviews on several key areas for IFMs (Investment Fund Managers). These included:

- **Conflicts of Interest Management:** The CSSF found that most IFMs had satisfactory policies in place, but some lacked comprehensive identification of potential conflicts and detailed procedures for managing them. They emphasized the need to incorporate risks from relationships with depositaries, delegates, and sustainability risks into conflict assessments.
- **Delegation of Portfolio Management:** While most IFMs complied with delegation regulations, the CSSF identified areas for improvement, including the need for a unified framework procedure, missing due

diligence reports, formal written contracts with delegates, and better alignment of staff with the number of delegates being monitored.

- **Market Abuse Regulation:** The CSSF assessed IFMs' measures for preventing and detecting market abuse, focusing on risk assessment, supervisory systems, staff training, and delegation of market abuse supervision. Recommendations will be published in 2024.
- **Risk Management Reports:** The CSSF reviewed IFMs' annual risk management reports, noting weaknesses in reporting on system effectiveness, corrective measures, and governance issues. They emphasized the need for follow-up on corrective actions and clearer reporting on the status of these measures.

On-site supervision

- In 2023, the CSSF undertook a comprehensive series of **on-site inspections** aimed at evaluating the operational effectiveness, governance, and regulatory compliance of investment fund managers (IFMs). The findings revealed a range of shortcomings that underscored the need for improved supervision and adherence to regulatory standards, leading to enforcement actions in certain cases. **The key findings were as follows:**
 - **Supervision of Delegates:** Many IFMs demonstrated inadequate oversight of their delegated portfolio managers and intermediaries, particularly regarding marketing activities. This led to administrative fines being imposed on two IFMs for failing to implement sufficient controls.
 - **Internal Control Deficiencies:** Numerous IFMs were found to have significant weaknesses in their internal control functions, particularly around risk management. Common issues included outdated risk profiles and incomplete stress tests, which did not fully account for market risks and liquidity challenges.
 - **Asset Valuation Practices:** Some IFMs did not ensure robust controls over asset

valuations, especially when relying on external or group services. Valuation committees often lacked independence, and their decisions were poorly documented. In several cases, the frequency of committee meetings did not align with the periodicity of NAV calculations.

- **ESG compliance:** A number of IFMs were found to have insufficient oversight of the ESG methodologies employed by their delegated portfolio managers. This resulted in incomplete or inaccurate ESG disclosures, with some funds including assets that did not meet the criteria outlined in their pre-contractual agreements.
- **Branch supervision:** IFMs with branches often failed to provide adequate supervision over the administrative and marketing activities of their branches. In some cases, branch employees lacked access to the IFMs' policies and procedures, leading to compliance gaps.

As a result of these findings, the CSSF imposed administrative fines on three IFMs, issued injunctions to two, and revoked the "Fit and Proper" status of a director at one IFM.

Revision of Circular CSSF 11/512

In 2023, the CSSF, undertook a comprehensive revision of Circular CSSF 11/512, which governs the **organization of the permanent risk management function** and the **risk management policies and processes of management companies**.

The aim of this revision is to incorporate recent legal developments in risk management, particularly in relation to AIFMs (Alternative Investment Fund Managers), and to consolidate the applicable rules for all Luxembourg-authorized IFMs into a single circular.

NEW - CSSF Circular 24/856

The new CSSF Circular 24/856, **effective from January 2025**, repeals Circular CSSF 02/77 and introduces significant updates to the error management framework for UCIs in Luxembourg. Key enhancements include the **introduction of a 5% threshold for NAV** (Net Asset Value) errors in alternative UCIs, as well as an expanded scope that now covers additional error categories, such as **swing pricing deviations** and **fee discrepancies**. Furthermore, the circular imposes stricter governance requirements on both UCIs and their service providers, ensuring a more robust oversight process. Auditors will play a pivotal role in overseeing and verifying compliance with these enhanced standards, reinforcing the overall integrity of the regulatory framework.

IFMs are reminded to review their auditor's conclusions and ensure legal compliance in key areas such as maintaining adequate own funds, governance processes, risk management, and IT security.

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



On-site Inspections

Published 22/10/2024



Credit Institutions

Published 28/10/2024



IFMs and UCIs

Published 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

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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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