EMEA AML Survey 2024

Luxembourg competing for effectiveness

Extended Executive Summary

July 2024

pwc

Introduction

Earlier this year, PwC released its Europe, Middle East, and Africa (EMEA) AML Survey 2024, which displays how the financial sector across EMEA is responding to the new focus on effectiveness that is taking place across the AML space. Both AML professionals and regulators are increasingly making strides in the fight against financial crime. This report explores the findings of this survey from Luxembourg respondents and offers a deep dive into how AML is being tackled in the Grand Duchy.

Spotlight on Effectiveness

Measures to prevent money laundering, terrorist financing, and the proliferation of weapons of mass destruction (abbreviated as 'AML' in this report) have improved significantly over the last decade, evolving from a compliance check in some jurisdictions, to one of the financial system's main security measures. In recent years, regulators in Luxembourg, the EU, and beyond as well as international bodies like the Financial Action Task Force (FATF) have begun shifting their perspective on how to regulate AML practices and have increased their focus on effectiveness. Whereas previously AML compliance had been mostly concerned with whether AML systems were in place or not, more recent initiatives are instead examining whether these measures are effective and how they can be harnessed to contribute as much as possible to the fight against financial crime.

The Luxembourg Financial Centre

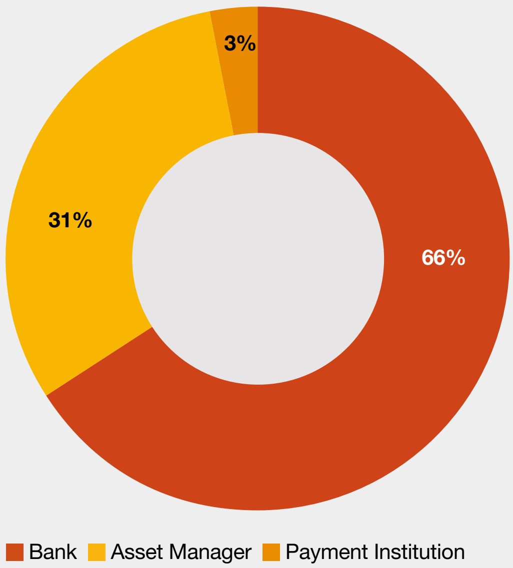
In many respects, Luxembourg is an outlier within the EMEA region. As an international financial hub focused on the asset & wealth management (AWM) industry, the complexity of the financial products and operations carried out in Luxembourg on a daily basis make AML an especially important and complicated task. Indeed, this small country is the second-largest fund domicile in the world by assets under management (AuM), after the US. The Luxembourg banking centre specialises in custodian services for the AWM industry as well private and corporate banking. Furthermore, some banks in Luxembourg are effectively part of the asset servicing industry due to their focus on AWM. Complex financial services often require much more documentation than retail services. For example, establishing beneficial ownership is often a lengthy process that requires information from several jurisdictions around the world. For this reason, the needs of Luxembourg AML professionals do not always align with those of more retail markets due to their significant exposure to cross-border business.

Our sample

This report offers a detailed analysis of the Luxembourg respondents to PwC's EMEA AML Survey. The survey had 396 respondents across 40 countries. Roughly 10% of them were Luxembourg institutions. It should be noted that to carry out the survey PwC reached out to the main financial stakeholders in each territory and in many cases interviewed large, institutional respondents directly. As such, we ensured that the responses are representative of the overall financial industry in each territory, including Luxembourg. Indeed, the Luxembourg survey captures a significant portion of systemically important banks, including 39% of the Financial Stability Board's (FSB) 2023 Global Systemically Important Banks (G-SIBs) and 43% of the European Central Banks' (ECB) Luxembourg Systemically Important Institutions (O-SII), which are the institutions considered integral to the Luxembourg financial centre.

As shown in this pie chart, our Luxembourg respondents are divided into three industries within the financial sector – banking, asset management, and payment services. Banks are the largest group, making up 66% of the sample. The next largest group are asset managers (31%), followed by payment institutions (3%).

Luxembourg survey respondents by industry



Note: The percentage may not add up to 100% due to rounding. The UK and Ireland region includes the UK, The Republic of Ireland, the Isle of Man, and the British Channel Islands as separate respondents.

Source: PwC Global AWM & ESG Research Centre

The Path Forward for Luxembourg

Luxembourg needs to step up its effectiveness in the face of increasing international competition. In recent years other financial centres have been increasing their footprint in the AWM industry as fund domiciles, particularly for exchange-traded funds (ETFs). Luxembourg must continue to assert itself as the main European financial hub; AML is a crucial part of this process.

The key to setting the Luxembourg market apart is process streamlining. By significantly investing in its people and its technological infrastructure, Luxembourg can upgrade its AML capacities and use its position as a haven from financial criminals to boost its international standing even further. Luxembourg's complex products already require sophisticated AML techniques, meaning that the Grand Duchy has everything it needs to set itself apart in the AML space. By embracing the future Luxembourg can attract top talent and continue to thrive.

Regulations: A Call for Clarity

Luxembourg respondents are more sceptical of current and upcoming AML rules than their EMEA counterparts. Only 22% of Luxembourg respondents believe that current and upcoming AML rules are fully effective. Meanwhile, 53% of EMEA respondents are confident in current rules and 54% in upcoming rules.

When it comes to upcoming AML rules, 31% of Luxembourg respondents believe they lack practical industry guidance and another 25% believe they lack uniformity. This is likely because Luxembourg is a highly complex financial centre where AML regulations – which are often created with retail operations in mind – may not address the practicalities necessary for the Luxembourg financial sector.

90% of Luxembourg respondents believe implementing universal regulatory standards would significantly improve AML effectiveness. This view is held by 100% of Luxembourg asset managers and 86% of bankers. Since Luxembourg is an international financial hub where AML teams interact with clients from various jurisdictions, it follows that they would value regulatory consistency.

Operations: Human and Machine Resources

AML costs in Luxembourg have increased by 18% over the last two years, compared to 13% in the rest of EMEA. 69% of Luxembourg respondents have seen their AML costs increase by at least 10% while 31% have seen them increase by at least 30%.

Staff increases and investments into new digital tools have been the main cost drivers over the past 24 months. It is important that Luxembourg increase its AML investments to boost its effectiveness, as failure to invest may result in even greater costs. Luxembourg AML teams with legacy systems saw a 20% rise in costs compared to 17% among those with modern systems. While this is not a major difference, it still indicates that those that are already investing in technology will likely try to hold onto their competitive advantage, making it more difficult for those with legacy systems to catch up.

48% of Luxembourg respondents believe Customer Due Diligence (CDD) is the strongest AML control, contrary to the rest of EMEA where CDD is widely viewed as ineffective. CDD is a crucial part of the AML process, and it is a positive sign that Luxembourg financial institutions value it as such. Luxembourg respondents likely see CDD as more important than the rest of EMEA because the financial sector in the Grand Duchy specialises in non-retail clients and operations, which require much more documentation and oversight than retail clients.

Luxembourg respondents tend to believe upskilling their staff is the least effective AML control, with 38% reporting as much. This suggests Luxembourg respondents are undervaluing the positive impact of upskilling their employees as a measure to boost effectiveness and solve the labour scarcity issue they face.

Despite scepticism about the effectiveness of upskilling, recruiting skilled staff is one of the biggest AML operational challenges in Luxembourg, according to 44% of respondents. For comparison, only 24% of EMEA and 25% of EU respondents cite this as an AML challenge. Having skilled staff is necessary for any increase in AML effectiveness. Even technological upgrades cannot be undertaken without an appropriately trained workforce. The main impediment for Luxembourg financial entities to grow their workforce is the salary package, according to 31% of respondents; there is a lot of internal competition in the Grand Duchy for skilled AML professionals.

Technology: A Key to Effectiveness

Legacy AML operating systems are a persistent problem in Luxembourg. 38% of Luxembourg respondents claim their systems are "outdated". This impedes adopting newer technologies such as AI, which are incompatible with older operating models. Indeed, 65% of respondents say that the maturity of their operating systems is a constraint to AI adoption.

Data quality is the most often-cited impediment to increasing AML technological capabilities in Luxembourg, according to 53% of respondents. This issue is directly related to system maturity and the lack of skilled employees. Without modern systems and the necessary staff to operate them, the high-quality data needed for effective AML cannot be collected or processed.

Luxembourg AML teams tend to be more reluctant to adopt new technologies than their EMEA counterparts. This may be holding Luxembourg's AML effectiveness back. The Grand Duchy must bet on technology to set itself apart from its competitors, although the complexity of its financial products makes streamlining AML processes difficult. Only 13% of Luxembourg respondent have implemented cloud solutions compared to 53% in EMEA. Similarly, only 53% in Luxembourg are considering adopting AI compared to 81% in EMEA.

Besides being disinclined to adopt new technology, Luxembourg respondents are also reluctant to invest in it, with banks being the least willing to invest. 13% of respondents say they will not allocate any of their AML budget to new digital tools over the next two years. This figure is 5% in the rest of EMEA. Meanwhile 42% of Luxembourg respondents will allocate over 10% of their budget to digital tools, compared to 56% that will do the same in EMEA.

Banks are largely behind this resistance to technology; 20% of them are not allocating any of their budget to digital tools. Conversely, all asset managers will carry out some investment in technology over the next two years.

There is some overconfidence over technological capabilities among Luxembourg AML teams. 42% of respondents who said their systems were outdated also said they were "fully confident" in those systems. Similarly, 19% of respondents who said they were "fully confident" in their operating systems had not tested those systems for errors or effectiveness.

There remain some topics to be tackled and issues to be addressed in the general strive for effectiveness. Luxembourg will continue to expand its AML capabilities and remain a centre of excellence within the financial industry and beyond.

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