A New Era of Corporate Lending:

Corporate Banking Survey 2023

Table of content

Foreword

We are pleased to introduce the second edition of the Luxembourg Corporate Banking Survey. We noted in the report's inaugural edition that corporate banking is a crucial component of Luxembourg's banking sector, and somewhat of a hidden jewel, providing vital services to a diversified client base spanning local small and medium-sized enterprises, multinational corporations, and investment funds (UCITS and AIFs), to name a few. We hope this report will help give this often-ignored side of banking the visibility that it deserves. Likewise, we hope to contribute to the effort to showcase the Luxembourgish financial system as a global hub in the heart of Europe.

While corporate banking has always been a feature of Luxembourg's financial ecosystem, the sector's meteoric rise in the Grand Duchy was kicked off in the late 1960s by German banks' entrance into pan-European markets. These banks took advantage of Luxembourg's favourable regulatory framework and planted the seeds of a global banking hub. This growth was further fuelled by the creation of the Eurodollar and Eurobond markets. In subsequent decades, Scandinavian, Swiss, and US banks contributed to the sector's expansion, with the 1990s proving pivotal due to the second EU banking directive, which introduced an EU-wide banking license. All this has made Luxembourg's banking sector truly internationalised. Brexit provided an additional push by incentivising UK institutions to open their EU branch in Luxembourg.

Our survey shows that market participants are reacting to the technological and ecological transformations taking place on a global scale, while also building upon their well-established strengths. Whereas the previous edition aimed to introduce and provide a broad overview of corporate banking in Luxembourg, this year we have chosen to explore the corporate banking sector in more detail, through the focused lens of the corporate lending business.

Thanks to the invaluable support of the Commission de Surveillance du Secteur Financier (CSSF), we have confirmed that corporate banking in Luxembourg has remained on its strong growth trajectory since the last edition. Corporate banking has further cemented its role not just in the banking sector, but also within the broader Asset and Wealth Management (AWM) industry.

We would also like to express our gratitude to the ABBL members who dedicated significant time and effort to provide us with forward-looking information on their strategic positioning vis-à-vis domestic and international lending, technology, sustainability, workforce management, and client relationship management. Their input and collaboration have helped inform the strategic priorities identified and the overall success of this survey.

We hope to provide meaningful insights and we would be glad to engage in a dialogue with you in order to continue the conversation around the future of corporate banking in Luxembourg.

Jerry Grbic
CEO of the ABBL

Jörg Ackermann
Partner, PwC Luxembourg

Key messages

Revenues at record highs

Revenues were estimated to nearly reach **EUR 5bn in 2022**, **signifying an increase of 24% from 2021** and mirroring the growth rate in the private banking segment. This corporate banking revenue figure also represents 35% of total banking revenues in Luxembourg.

Economic headwinds affected profits

Profits declined by 19% compared to 2021. Monetary tightening policies and uncertainty over economic growth have reduced demand for loans.

Funds' contribution to corporate banking revenues has grown

The fund industry's **contribution to corporate banking revenues rose by 14%**, while revenue from corporates declined by 19%. The survey indicated significant growth in non-interest-based services, many of which are often provided to the AWM industry.

The home front comes first

There was an **11% rise in revenue in the Americas region compared to 2021**, but most respondents expect long-term revenue growth to come from Europe

Sustainability and new technologies are expected to change the industry

Respondents believe ESG financing will be the main catalyst for change in the corporate lending sector in the coming years. AI is the second-most popular answer.

A global outlook

75% of corporate lending in Luxembourg is focused on the international market, but international corporate lending services fewer industries than domestic corporate lending.

Section 1.

Navigating a New Context: Corporate Banking in an Evolving Landscape

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Navigating a new context: Corporate Banking in an evolving landscape

This year's Corporate Banking survey came at the best possible time to analyse and reflect on the state of the corporate banking sector. The world appears to be heading into a new economic era marked by greater government involvement in the economy, geopolitical uncertainty, and of course, climate change. 2022 was a turbulent year on almost every front. The Russian invasion of Ukraine triggered an energy crisis in Europe and proved that we are also in a new period of geopolitical turmoil. Recent tensions in the Middle East have only underscored this reality.

Additionally, 2022 saw inflation reach new heights and central banks across the globe responded by dramatically raising interest rates for the first time since the global financial crisis (GFC). The sluggish economy was accompanied by gloomy European growth forecasts. The International Monetary Fund's (IMF) lacklustre 2022 predictions for the European Union have not improved in 2023, with core inflation not expected to reach target levels before 2025 at the earliest. Meanwhile, GDP growth is set to remain below 1.2% in Advanced European Economies[1].

These changes were not without impact on the banking sector. The monetary tightening policies that were put in place had a dual effect on bank incomes. While higher interest rates meant that banks stood to make more profit from lending, interest hikes were also accompanied by a general economic downturn and inflation, which reduced the demand for loans.

For the Luxembourg banking industry, the relevance of these developments cannot be over-emphasised. The current climate is even more significant for the country's corporate banking segment, which the 2022 edition of this survey uncovered as a little-known, but massively important feature of the Luxembourg business ecosystem. In that report, we found that corporate lending was one of the areas that the corporate banking sector was looking to expand in the future, with 71% of respondents saying it would be the main focus of their innovation strategy. For this edition, we have decided to explore this strategy in greater detail and focus our attention on the corporate lending business, in order to provide more granular insights into Luxembourg's dynamic corporate banking environment. Since this report is centred on corporate lending, it does not provide an analysis of the various corporate banking models present in Luxembourg.

Given the challenges of a new economic order, corporate lending is undergoing a major transformation. With the world now more fragmented than ever, banks find themselves navigating more severe risks than at any other point in recent decades. According to the European Central Bank's (ECB) October 2023 Bank Lending Survey (BLS)[2], banks throughout the EU have reduced their risk appetite because of this economic slowdown. High-interest rates have only reduced banks' risk tolerance further by "contributing to a deterioration in euro area banks' financing and liquidity conditions," according to the ECB.

In this new context, banks recognise the advent of game-changing technologies such as artificial intelligence (AI) and the ever-greater importance of sustainable finance as tools that can help them navigate rising tides, and this survey has shown that the sector is pivoting in this direction. The pressure and scrutiny being placed on the banking sector today are at heights that have not been seen since the GFC. Banks are scanning the horizon, deciding how to react to this new world. Given the central position Luxembourg holds in the global economy, corporate banks in the Grand Duchy are highly exposed to world-spanning trends and must position themselves accordingly to maintain their competitiveness.

1 International Monetary Fund (IMF), *The European Outlook and Policymaking: Seeing Off Inflation and Pivoting to Longer-Term Reforms*, October 2023

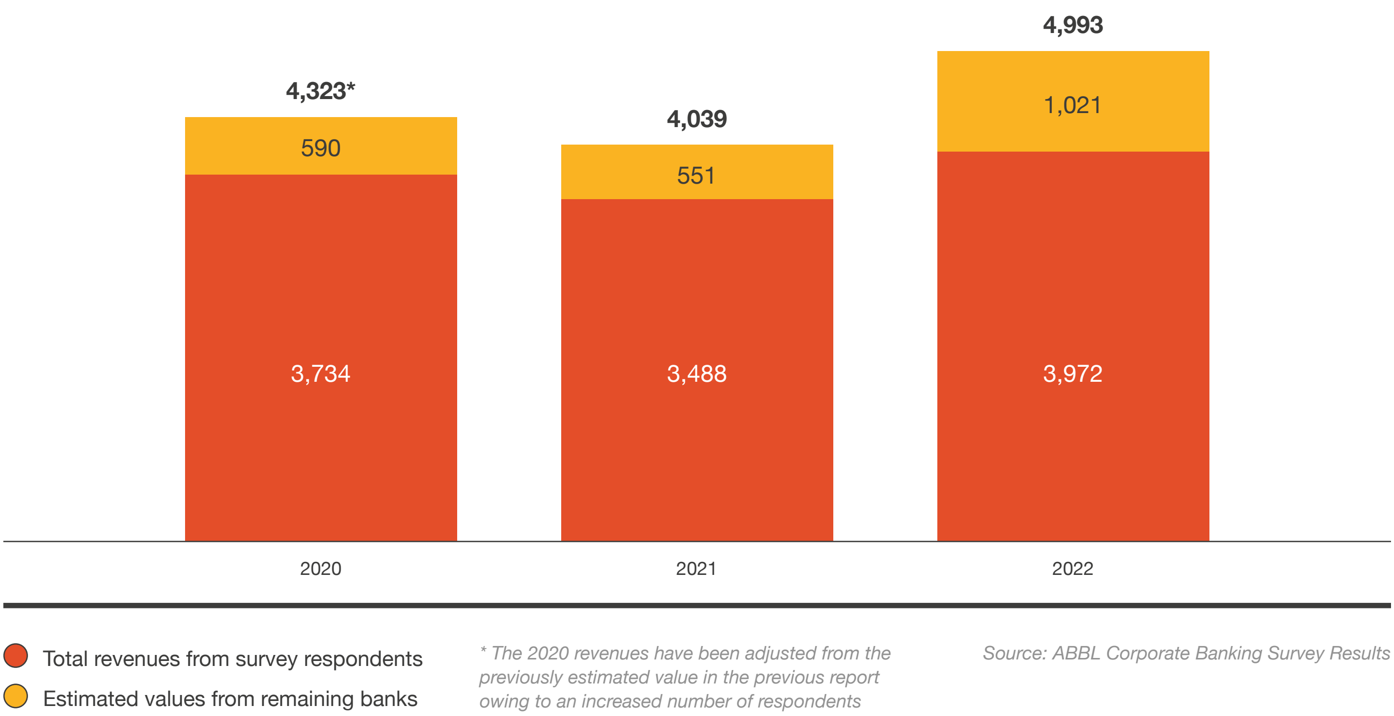
2 European Central Bank (ECB), *Bank Lending Survey*, October 2023

1.1 Evolution of The Luxembourg Corporate Banking Sector

Corporate Banking revenues continue growing, reaching nearly EUR 5.0bn

The results of this year's survey show that the strong upward trend in revenues that was highlighted in the last edition has accelerated. Total corporate banking revenues from survey respondents almost reached EUR 4.0bn. Given that our respondents represent 80% of the country's corporate banking segment in terms of number of banks, we estimated overall corporate banking revenues for 2022 to be EUR 4.9bn. This large increase, which represents a 24% surge from 2021, can be attributed to a significant rise in revenues from two of the respondents. It also mirrors the growth seen in private banking revenues during the period (24%)[3], underscoring how the upsurge in corporate banking is part of a broader upward trend within the banking sector – which saw revenues amount to EUR 14.1bn in 2022[4], with corporate banking constituting 35% of this total banking revenue in Luxembourg.

Exhibit 1 Estimated Corporate Banking Revenues – 2020-2022 (EUR mn)



** The 2020 revenues have been adjusted from the previously estimated value in the previous report owing to an increased number of respondents providing historical revenue data for 2020 and 2021.*

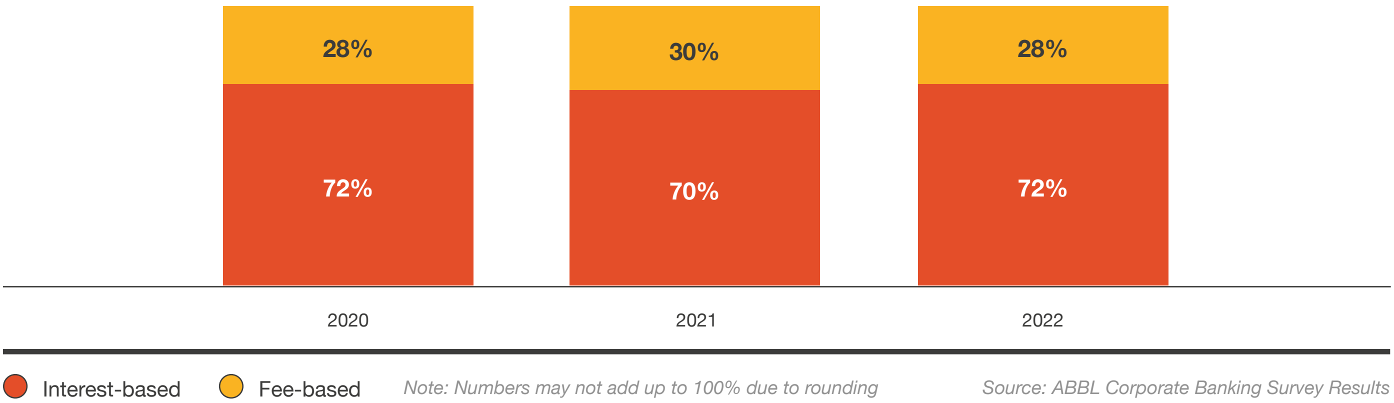
Source: ABBL Corporate Banking Survey Results

3 ABBL Private Banking Report 2023
4 *CSSF, Annual Report 2022*

If the two respondents who enjoyed a substantial increase in revenues from 2021 to 2022 were removed from the sample, the revenues from survey participants would have been EUR 3.5bn. The sample of respondents excluding these outliers represents 75% of all corporate banking institutions. In this scenario, the exclusion of these outliers would have seen the total estimated revenues for the corporate banking sector at EUR 4.7bn in 2022, representing a 16% rise from 2021. It is worth pointing out that this growth is comparable to – and even exceeds – the pre-COVID trend observed in the first edition of our report, in which total estimated revenues rose by an average of 13% per year between 2016 and 2020.

As in previous years, a significant proportion of corporate banks' reported revenues was derived from their interest-based businesses, while fee-based income normalised in relative terms to pre-2021 levels (Exhibit 2). The 2% rise in interest-based revenues in 2022 compared to 2021 cannot be attributed solely to the interest hikes that took place during 2022. Loan demand declined in 2022 and interest-based revenue for banks can also be derived from investments.

Exhibit 2 Share of interest and fee-based revenue for corporate banks in Luxembourg



Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

Profits fall with high operating costs

In contrast with revenues, net corporate banking profits among the surveyed banks have decreased considerably. In 2022, profits reached just shy of EUR 1.2bn, representing a 19% drop from EUR 1.4bn in 2021. However, it should be noted that a significant portion of this drop in profits is attributable to just three outliers, which together saw a profit drop of EUR 449mn.

The tight credit supply, along with higher provisioning requirements, has increased banks' overall operating costs. Thus, while high-interest rates provide a potential for healthy profits, the economic conditions and related risks that come with them have offset the potential benefits. Indeed, demand for loans from corporations declined in 2022 due to high borrowing costs[5], leading to a drop in profits compared to 2021. Another key reason for the drop in profits has been a 14% drop in bank deposits in 2022 across Europe[6]. This has greatly limited banks' money supply and caused them to adopt a more risk-averse stance[7].

Meanwhile many banks have made attempts to diversify their corporate banking income by providing more non-interest-based services[8]. Our survey highlights this, showing that revenues derived from the funds sector rose by 14% from 2021 to 2022.

The end of the third targeted longer-term refinancing operation (TLTRO III) has placed additional pressure on banks and contributed to their lower risk tolerance since 2022. TLTROs are a euro area programme to provide loans to credit institutions at favourable rates, sometimes 50 basis points below standard rates. The last of these loans reached maturity in June 2022 with no sign of TLTRO IV on the horizon.

5 European Securities and Markets Authority (ESMA), *Report on Trends, Risks and Vulnerabilities*, September 2022

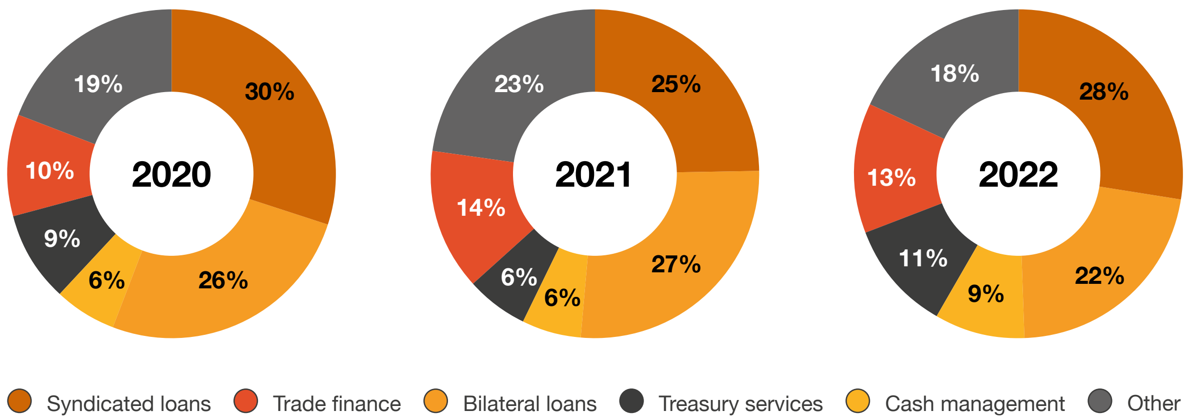
6 European Fund and Asset Management Association (EFAMA), *Asset Management in Europe*, December 2022

Growth drivers become more diversified and treasury services pick up pace

Corporate banking in Luxembourg encompasses a broad array of activities/services, spanning from the provision of financing solutions (bilateral and syndicated) and treasury services to cash management and trade financing. Our survey showed that while the contribution of these different banking products to revenue has mostly remained stable, banks' profit composition has shifted significantly in favour of fee-based activities, as previously observed.

Bilateral and syndicated loans, continue to be the main corporate banking offerings, collectively constituting 50% of revenues and 45% of profits for the corporate banks surveyed in 2022 (Exhibits 3 and 4).

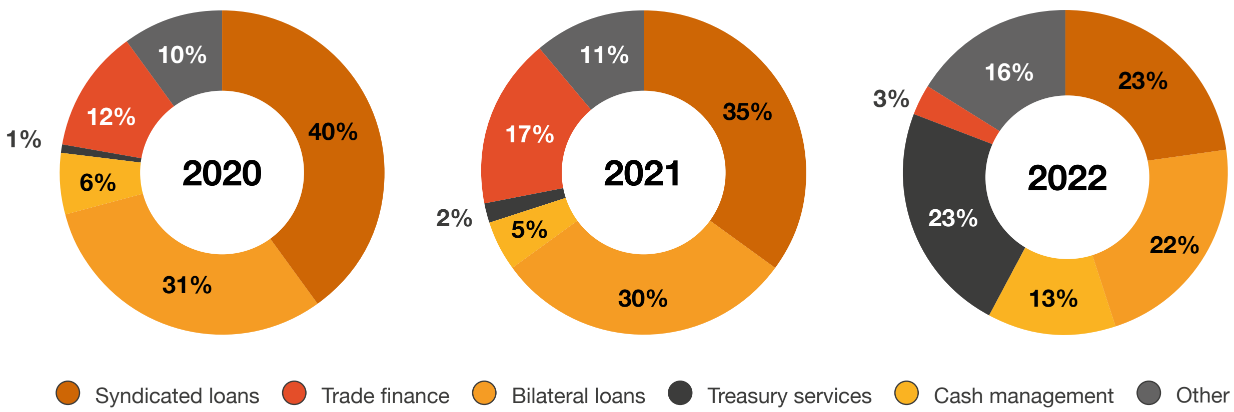
Exhibit 3 Corporate Banking Revenues by Product Type (2020-2022)



Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

Exhibit 4 Corporate Banking Profits by Product Type (2020-2022)



Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

7 ECB, *Targeted longer-term refinancing operations* (TLTROs)

8 S&P Global Market Intelligence, *Banks increasingly look to non-interest income to bolster revenue*, June 2022

Nevertheless, it is important to highlight that although bilateral and syndicated loans continue to be crucial for both revenues and profits, there has been a notable decrease in their prominence since 2020, when these activities collectively accounted for 56% and 71% of corporate banking revenues and profits respectively. This comes as no surprise, given the aforementioned shift in banks' focus to non-interest sources of income.

Conversely, we observed a very significant rise in treasury services' contribution to corporate banks' revenues, increasing from 9% in 2020 to 6% in 2021 and reaching 11% in 2022. There was a similar trend with regard to treasury services' contribution to profits, with this business segment making up 23% of corporate banking profits in 2022, up from less than 3% in the two previous years. This rise is consistent with the general increase in fee-based services across banks and is likely driven by ongoing disruptions to supply chains, uncertainties related to economic recovery, and the resulting impact on the demand for treasury services.

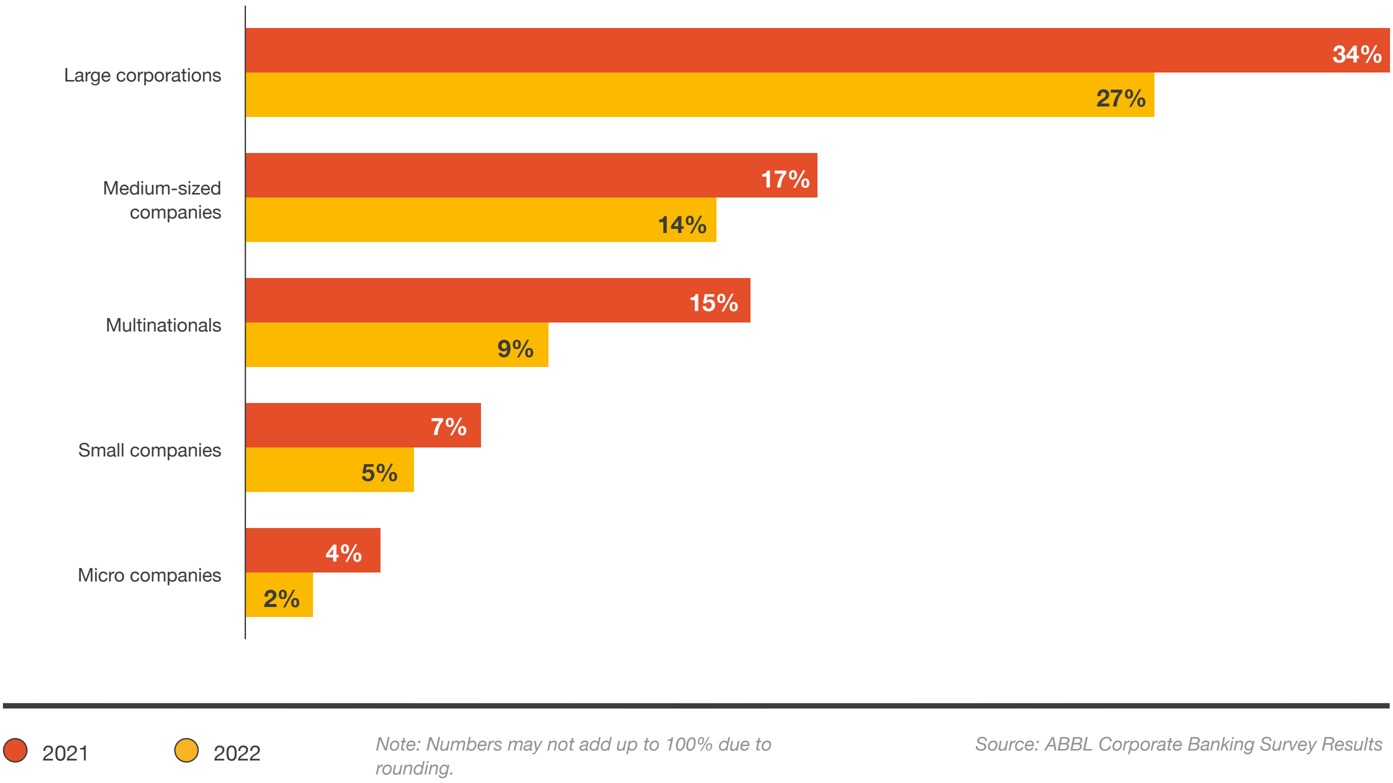
The overall evolution of revenue and profit composition since 2020 shows a more balanced sector, with no corporate banking product dominating either revenues or profits. This general balance also underlines the more risk-averse attitude banks adopted in 2022 in the face of the energy crisis and pessimistic economic outlooks. Reduced risk tolerance also means banks are lending more conservatively, which exacerbates the reduction of financing solutions' contribution to profits.

The non-financial sector continues to fuel revenue growth while UCITS gain momentum

Our survey demonstrated that corporate banking revenues continue to rely on non-financial institutions. This client segment accounted for 58% of surveyed banks' revenues in 2022, although this is much less than the 77% noted in 2021.

Large corporations – those with 250 employees or more – constitute a crucial subset of this client base, contributing to 34% and 27% of overall corporate bank revenues in 2021 and 2022 respectively (Exhibit 5).

Exhibit 5 Corporate Banking Revenues from Non-Financial Institutions

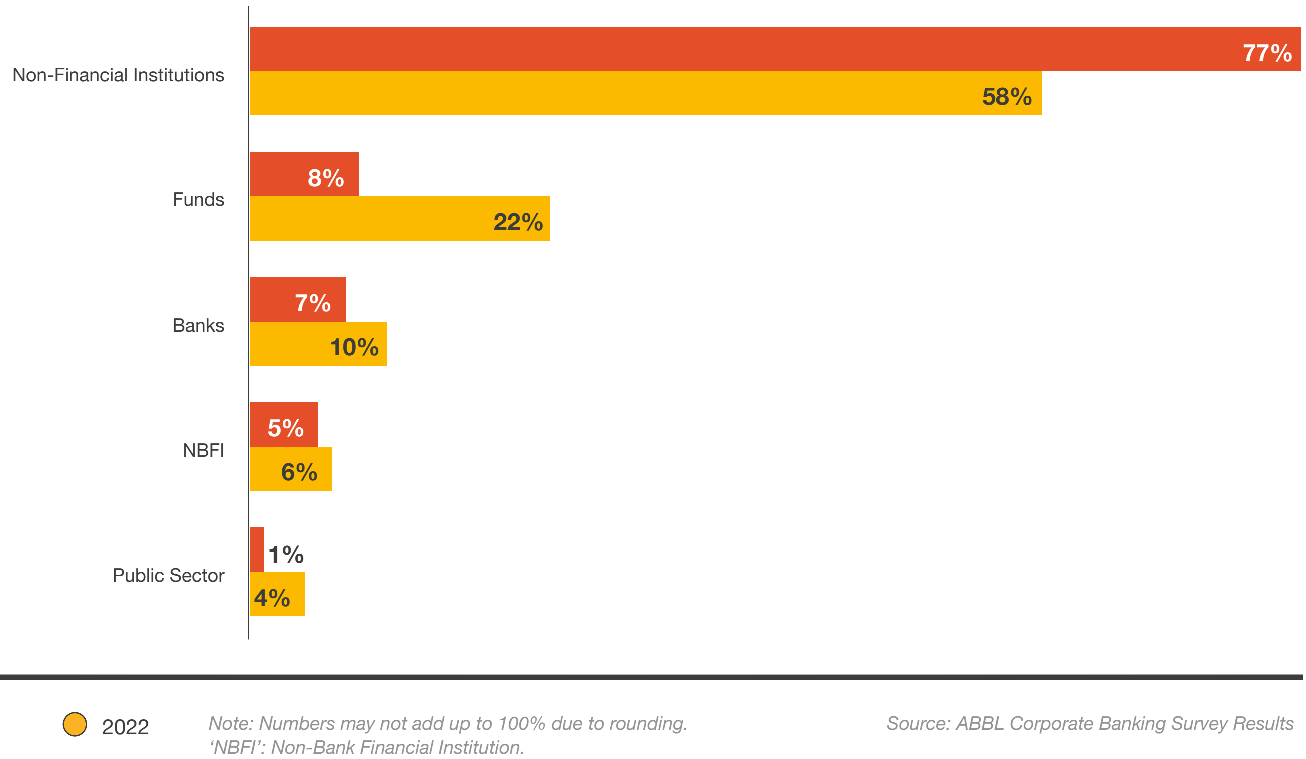


Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

There was also a notable increase in revenue generated from the financial sector, especially from the funds industry, which saw its contribution to corporate banking revenues rise to 22% from 8% in 2021. This was primarily driven by the UCITS sector, whose share more than quadrupled from 4% to 18% in that period. Given the decrease in the overall AuM of Luxembourg-domiciled UCITS from EUR 4.9tn[9] to EUR 4.1tn[10] between 2021 and 2022, this shift likely reflects a strategic repositioning of corporate banking towards custodial services, fund administration, and other relevant service offerings directed at Luxembourg's asset management space, although the material impact of UCITS' revenue growth relative to Alternative Investment Funds (AIF) remains to be seen.

Exhibit 6 Corporate Banking Revenue by Overall Client Segments



Note: Numbers may not add up to 100% due to rounding.
'NBFI': Non-Bank Financial Institution.
AIF: Alternative Investment Fund.
'Non-Financial Institutions' is made up all the categories in Exhibit 5 grouped together. 'Funds' is made up of 'UCITS' and 'AIFs'. All other client segments have been left unchanged.

Source: ABBL Corporate Banking Survey Results

Overall, this diverse client distribution underscores the highly integrated nature of Luxembourg's corporate banking space, and its ability to service both the financial sector and the non-financial sector. This further reflects the country's overall status as a well-connected, global financial hub.

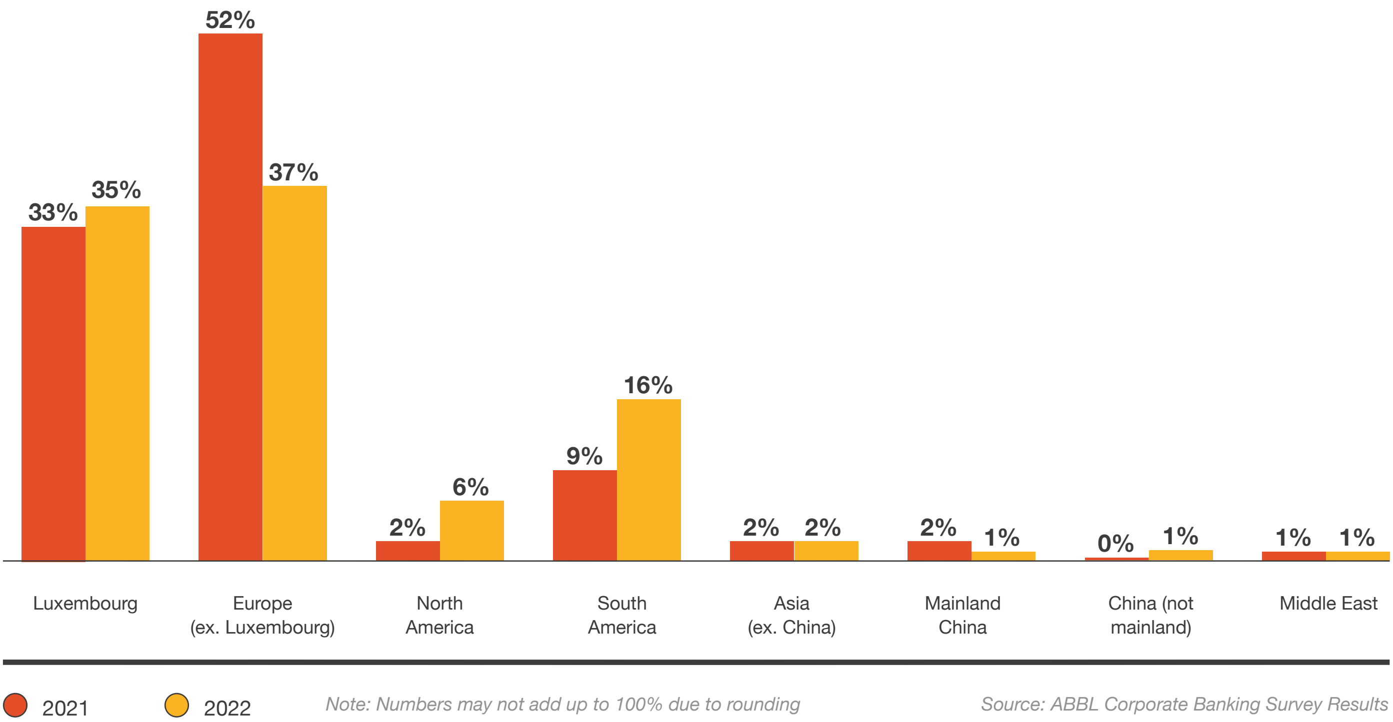
9 EFAMA Statistical Release for full year 2021

10 EFAMA Statistical Release for full year 2022

Revenues slightly shift away from Europe towards the Americas

Luxembourg and the rest of Europe remain the prime target market for corporate banks operating in Luxembourg, which comes as no surprise given the operational focus of most corporate banks' clients within Europe. However, we noted a dramatic drop in revenues in Europe from 2021 to 2022, accompanied by a surge in revenues in the Americas. Luxembourg banks raised revenues by 4% in North America and 7% in South America between 2021 and 2022 (Exhibit 7).

Exhibit 7 Corporate Banking Revenue by Geographical Distribution



Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

The surge in revenues in North America and drop in Europe in 2022 was likely caused by the energy crisis triggered by Russia's invasion of Ukraine. The EU was much more affected by this than the US due to its greater dependence on Russian gas. In the case of South America, the 2022 surge may be attributed to the region's drastic interest rate hikes in 2022. Indeed, South America is the region of the world where interest rates rose the most in 2022[11], with average deposit rates in the region rising by 5.7% from Q1 2022 to Q4 2022[12]. However, due to the dual effect of high-interest rates that was previously noted, this surge in revenues is likely unsustainable.

This shift underscores the evolving composition of Luxembourg's highly internationalised banking sector and customer base. Indeed, the shift towards non-EU territories reflects the sector's responsiveness to global macroeconomic trends and its ability to leverage its multilingual and international workforce to seize opportunities at a global level. In May 2023, Bank of America opened a branch in Luxembourg. The new location aims to provide corporate clients and non-bank financial institutions (NBFIs) with cash management solutions. This underscores the Grand Duchy's importance as a global banking hub. Furthermore, as highlighted in our previous report, the growing prevalence of Chinese banks in Luxembourg represents business development opportunities in China, and more generally in Asia.

11 IMF, *Investments That Pay Off: Latin America's Response to Recent Global Shocks*, September 2023
12 IMF Data

Section 2.

Unveiling Luxembourg's Corporate Lending Segment

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Unveiling Luxembourg's Corporate Lending Segment

Corporate lending is arguably the bread and butter of the corporate banking sector in Luxembourg. This much was highlighted in our last survey, in which nearly three-quarters of respondents referenced the business as a major area for expansion. Owing to its relevance and importance in banks' overall corporate banking strategies, this section provides an overview of corporate lending in Luxembourg, and aims to explore trends, drivers, and the strategies adopted by players in the business. That being said, it is important to mention that given the specialised nature of this business, our survey targeted a relatively smaller sample size for this section than the previous section (see methodology).

2.1 Thinking Globally and Acting Locally

There are various corporate lending business models in place in Luxembourg, with many banks operating along the full value chain of the lending process. The first step is origination, when financial experts identify solutions to corporate financing needs. It is followed by the execution phase. Here, the project undergoes a rigorous underwriting and approval process to ensure a robust loan portfolio. After this, the engagement is formalised via documentation, which then triggers disbursement. The risk management team monitors the project at all times to protect the portfolio from volatility, while the collections, recovery, and portfolio management teams ensure regulatory compliance throughout the entire lifetime of the loan.

Additionally, some banks in Luxembourg specialise as a booking centre for international loans within their banking group. This means they place loans originated by their group in other countries on their books, usually with some guarantees, and oversee the remaining lifetime of the loans. This model is most common in the Luxembourg branches or subsidiaries of big international banking groups.

On top of this, some banks also engage in agency business, which means overseeing the complexities of syndicated loans and multi-party transactions. Banks that do this are tasked with ensuring seamless coordination between borrowers and lenders. They must therefore wear multiple hats, acting as facility agent, information agent, and paying agent. Covenant monitoring and collateral management by the bank carrying out agency business are likewise crucial to maintain the integrity of loan agreements.

Our survey showed that corporate lending in Luxembourg is mostly oriented towards the international market, with 75% of survey respondents saying they have some corporate lending activities in markets outside Luxembourg (Exhibit 8). Two-thirds of all respondents (67%) claim that more than 50% of their corporate lending activities are "focused" on international lending (Exhibit 9). Indeed, Luxembourg's strategic position in the heart of Europe allows it to be one of the most agile banking hubs in the European Union, aided by its robust financial expertise and the European banking passport.

It is important to note that Luxembourg is more internationally oriented than other European markets. According to the Fédération Bancaire Française (FBA), French banks issued EUR 1,331bn in business loans in 2022, of which EUR 569bn went to small and medium enterprises (SMEs) based in France, and another EUR 385bn was issued to very small enterprises (VSEs)[13]. In all, 72% of all French corporate lending in 2022 went to small domestic enterprises. One of the reasons Luxembourg's lending is so international is the small size of the country, which allows its relatively large banking sector to easily satisfy all domestic needs. In contrast, banking sectors in larger countries like France tend to devote a larger share of their resources to meeting domestic demand.

Luxembourg's banking sector is especially international, and not just relative to large countries. Switzerland, like Luxembourg, is also a small European country with a major, international banking sector. Despite these similarities, the Swiss corporate lending system appears to be more domestically focused than the Luxembourgish one. The Swiss Bankers' Association (SBA) reports that in 2022 it issued CHF 8,300bn in corporate loans[14]. Of this, CHF 4,306bn or 52% was issued to firms with 9 employees or fewer. Overall, 76% of all Swiss corporate lending was issued to businesses with 249 employees or fewer. While the SBA does not provide a breakdown of domestic and international lending, the country's inclination to serve small and medium-sized companies indicates a stronger emphasis on domestic lending operations and hence suggests a heightened focus on lending to the domestic market compared to Luxembourg. Conversely, Exhibit 9 shows that 56% of Luxembourg banks report that at least 76% of their domestic lending operations are focused on the international market.

Despite Luxembourg's skew towards international markets, international and domestic corporate lending strategies tend to be very similar. This is because the underlying changes taking place in Luxembourg's corporate lending ecosystem concern large global transformations in finance and technology, namely markets' reaction to climate change and the advent of AI and machine learning (ML). These paradigms affect international and domestic lending alike.

Exhibit 8 Do you have any corporate lending activities focused on the international market?

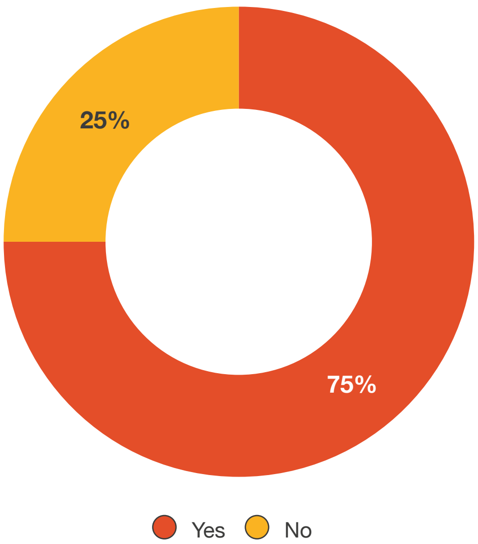
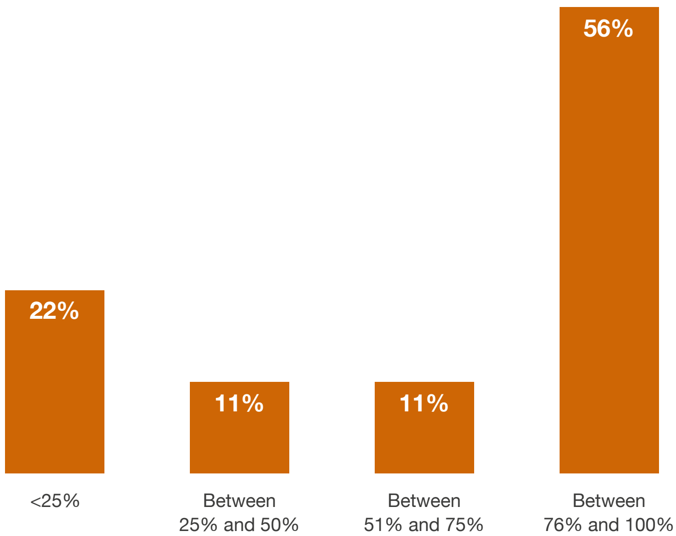


Exhibit 9 What percentage of your corporate banking lending activities are focused on the international market?



Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

13 Fédération Bancaire Française (FBA), *The Banking Industry 2022*, March 2023

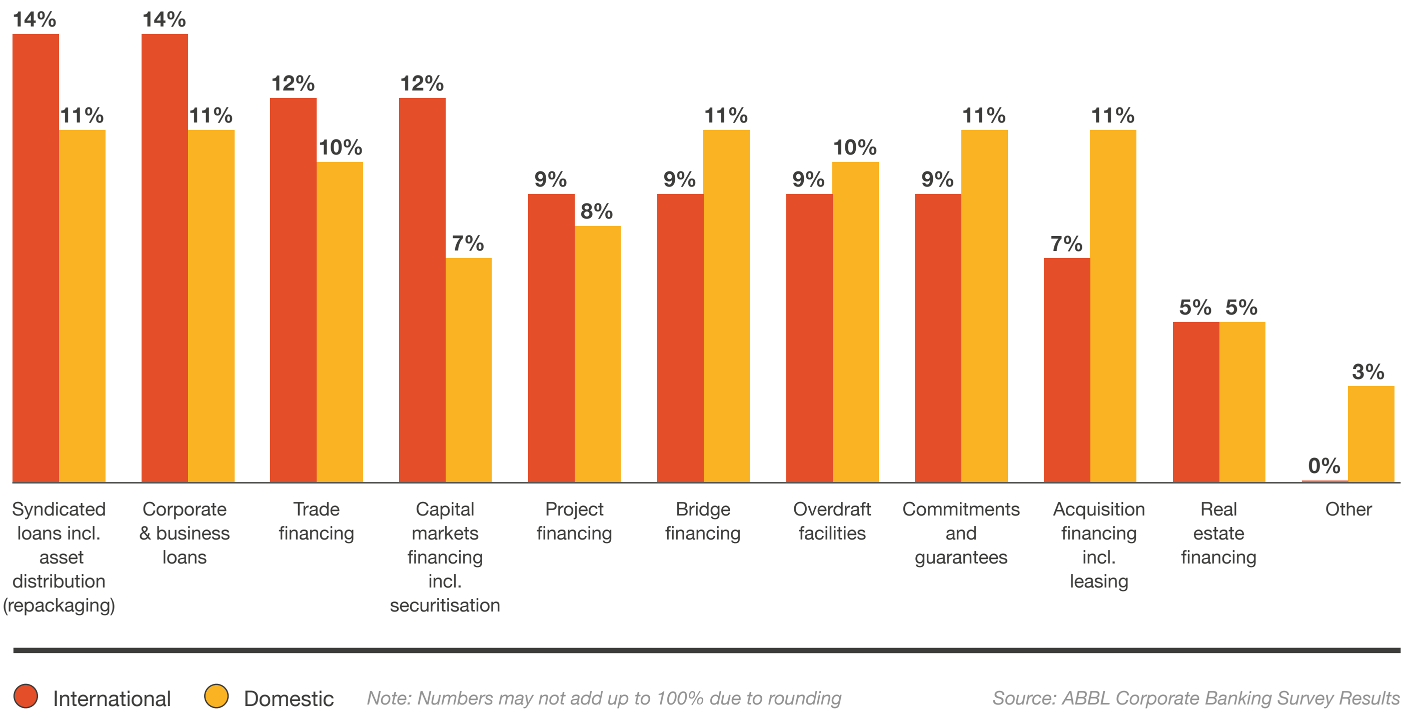
14 Swiss Bankers' Association, *Swiss Banking Trends*

Domestic and international corporate lending products are very similar

Syndicated and corporate loans are the main lending activities offered by both domestic and international lenders. Both types of loans are provided by 14% of international lenders and 11% of domestic lenders. In fact, there are no significant differences in the proportion of services offered by banks to their international and domestic clients (Exhibit 10). This highlights two things. Firstly, it suggests that the Luxembourg business ecosystem is aligned with top international markets, given that its corporate lending needs are so similar to those of competitive international markets. According to data from the United Nations Conference on Trade and Development (UNCTAD), 35% of all financial exports from the European Union to global markets come from Luxembourg, amounting to USD 69bn in 2022[15]. In fact, the UK is the only major economy in Europe that exports more financial services than Luxembourg, having exported USD 89bn in 2022. Germany, Switzerland, Ireland, and France exported USD 32bn, USD 25bn, USD 23bn, and USD 18bn respectively.

Secondly, it shows that the corporate lending ecosystem in Luxembourg is very balanced and diversified. None of the many lending services offered by Luxembourg-based banks are disproportionately represented in this survey, which means that banks offer a wide and balanced array of activities.

Exhibit 10 Which corporate lending activities do you offer?



Note: Numbers may not add up to 100% due to rounding

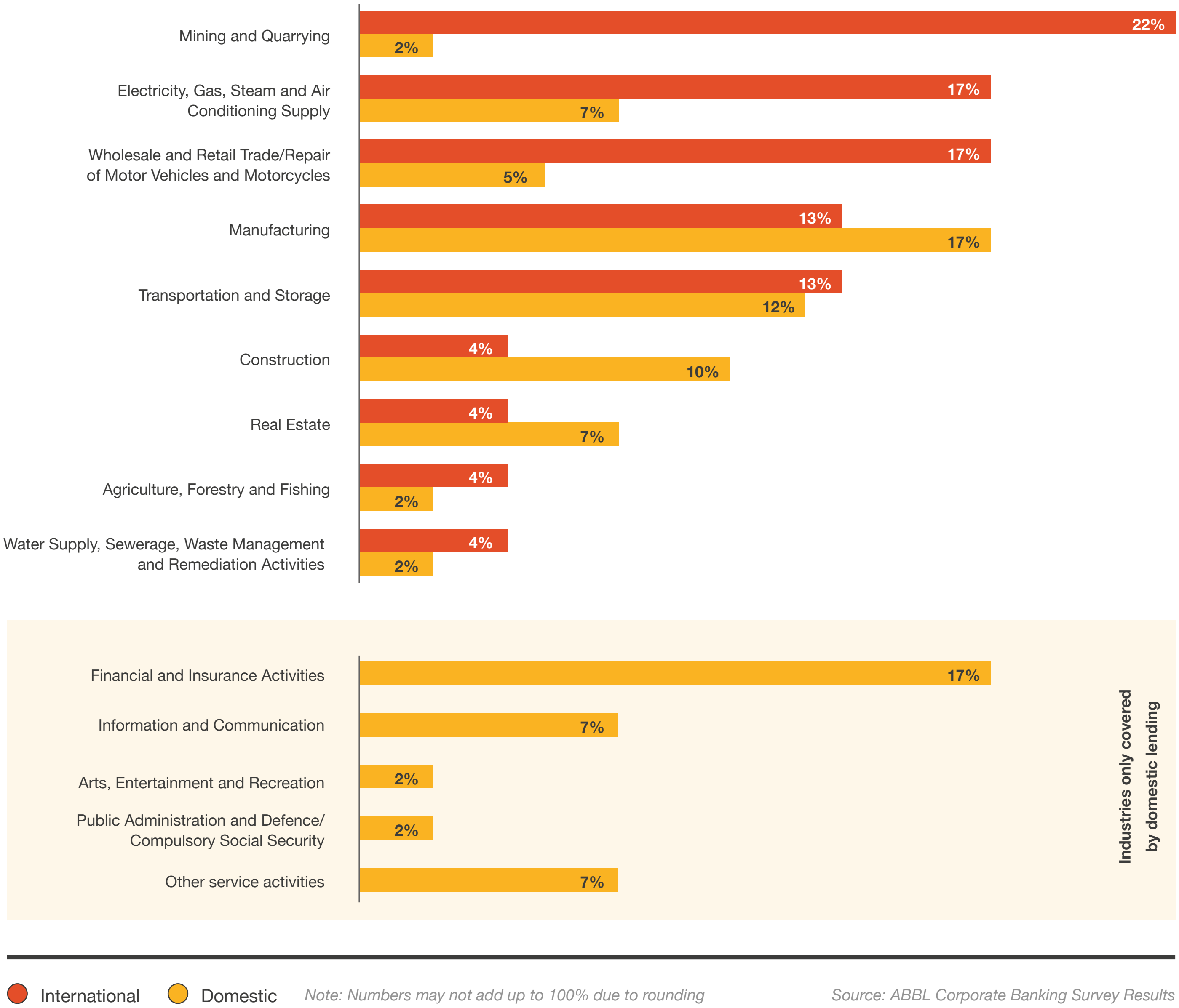
Source: ABBL Corporate Banking Survey Results

15 United Nations Conference on Trade and Development (UNCTAD) data

Domestic lending covers a wider swathe of industries

While banks' lending activities are very similar in international and domestic markets, the same cannot be said for the industries they lend to. Domestic lending activities are focused on a much larger range of industries than international lending operations. Furthermore, international lending activities are more heavily skewed towards heavy industry and mining. The is because the domestic corporate lending sector likely services the entire Luxembourgish economy, which is why it lends to sectors such as Arts, Entertainment, and Recreation. Similarly, the survey noted that Luxembourg banks that do not lend to international clients are less exposed to sectors like Electricity, Mining, or Retail Trade, likely due to the fact that these sectors are not particularly prevalent in the Grand Duchy (Exhibit 11).

Exhibit 11 What are the primary industries/sectors for lending to corporate clients?



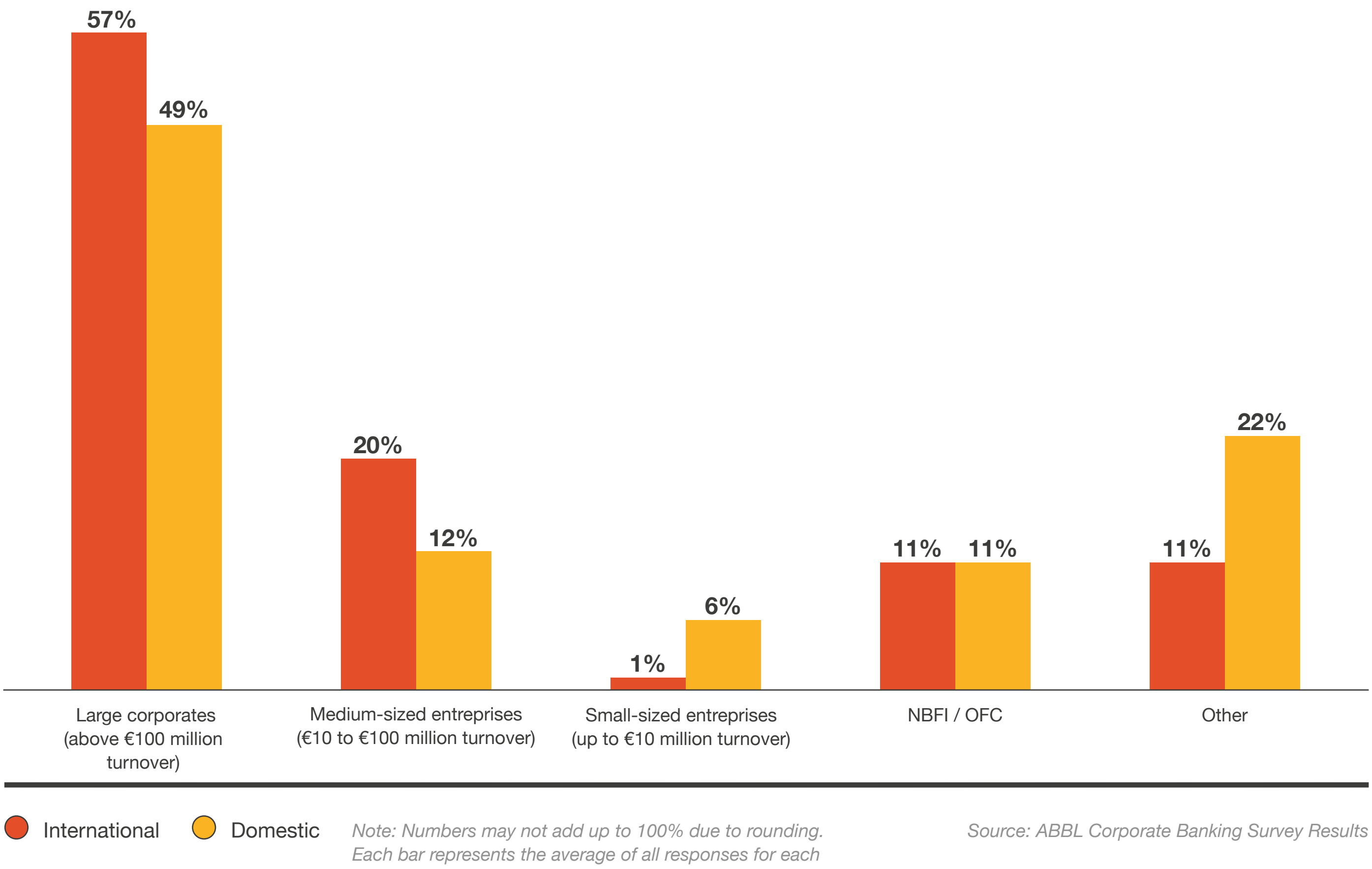
Note: Numbers may not add up to 100% due to rounding

Source: ABBL Corporate Banking Survey Results

Domestic lenders are the main service providers to small businesses

International lenders are generally more skewed towards large and medium-sized clients, given that they lend to a smaller set of industries than their domestic counterparts, as previously seen. In this context, it comes as no surprise that domestic lenders are more likely to be exposed to small businesses since they lend to a larger swathe of sectors (Exhibit 12).

Exhibit 12 Please indicate the split between the different categories of borrowers



Note: Numbers may not add up to 100% due to rounding. Each bar represents the average of all responses for each category.

Source: ABBL Corporate Banking Survey Results

Agency business is a specialised service

Our survey shows that approximately one fifth of both international and domestic corporate lending revenues are linked to syndicated loans. It is therefore worth highlighting that one-third of corporate banks in Luxembourg provide agency services to international clients (Exhibit 13). This is a significant amount, especially given that agency business is a relatively specialised activity. Some banks offer this service to their banking group or third parties as a way of generating additional revenues.

There may be potential for agency business to expand within the Luxembourg corporate banking sector, but it is unlikely to experience major increases. Agency business is the proverbial cherry on top: an additional activity that allows banks to stand out to their clients and banking groups. However, it is unlikely to develop into a substantial growth driver or a pillar of banking revenues overall. The current amount of agency business already allows Luxembourg corporate bankers to set themselves apart as fundamental to the market or their respective group. The extent to which agency business will develop in Luxembourg's syndicated loan segment remains to be seen and is worth observing, especially given that 29% of international corporate lenders believe that syndicated loans will be a key growth driver in the coming years. With that in mind, there may be opportunity for agency business to develop further, but likely only as a specialised activity.

Exhibit 13 Are you active in Agency Business for syndicated loans for your corporate clients on the international market?

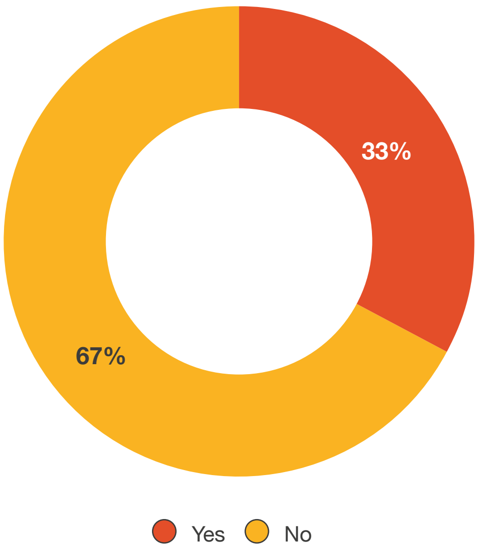
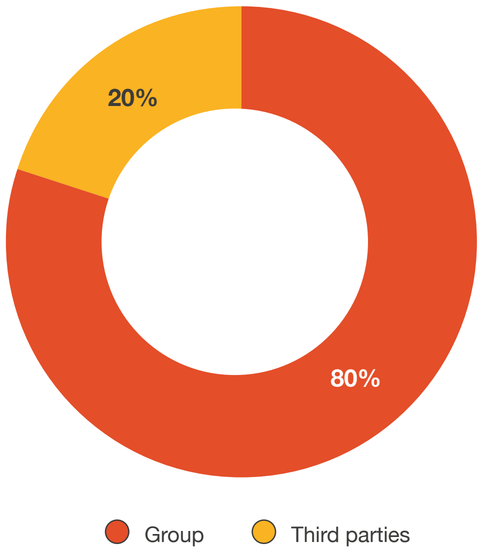


Exhibit 14 If yes, please indicate how much of Agency Business for syndicated loans is done for the group and how much for third parties.



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

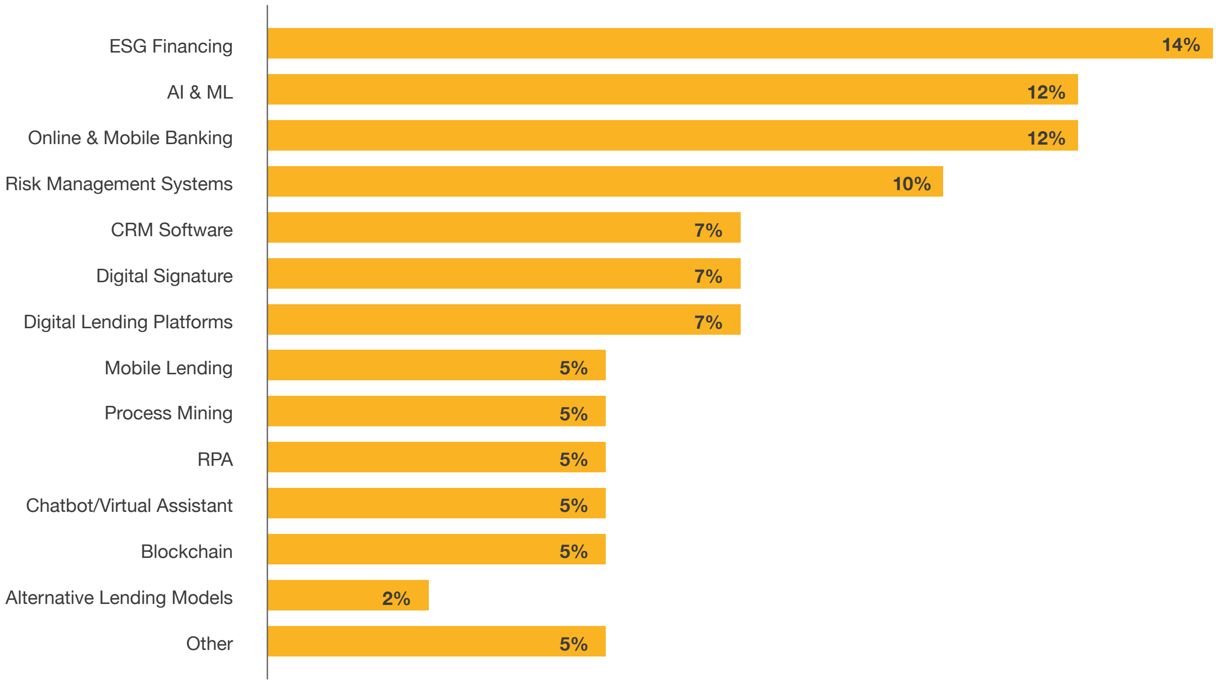
2.2 Corporate Lending Strategies: The Home Front Comes First

Given the tectonic shifts taking place in the economy, and by extension the banking sector, corporate banking teams across the industry are currently evaluating how to best adapt to new realities and grow efficiently. Lending teams have been quick to understand the importance that sustainability and technologies like AI will play in the banking sector in the near future, and their responses to questions concerning their overall strategy reflect this.

Indeed, when asked which solutions would be most pivotal to corporate lending in the coming years, the largest number of respondents (14%) answered ESG Financing (Exhibit 15). This highlights the attention the corporate lending business is paying to ESG, given that it was ranked first despite most of the other potential sources of transformation being technological.

That being said, a further 12% of respondents cited Artificial Intelligence (AI) & Machine Learning (ML). This is not surprising and is in line with a broader banking and financial industry trend of adopting AI and ML technologies, which has been taking place since the COVID-19 pandemic[16]. The uncertainty and need to act quickly during the early pandemic days proved to banks the need to make their processes more efficient and faster for their customers. This consensus appears to have even reached Central Banks, as the ECB began experimenting with AI in September 2023 as a way of speeding up operations[17].

Exhibit 15 In your opinion, which solutions are set to transform the way the corporate banking lending business is delivered within the next 3 to 5 years?



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

16 FT, *Global Banking's AI Leap*, April 2021

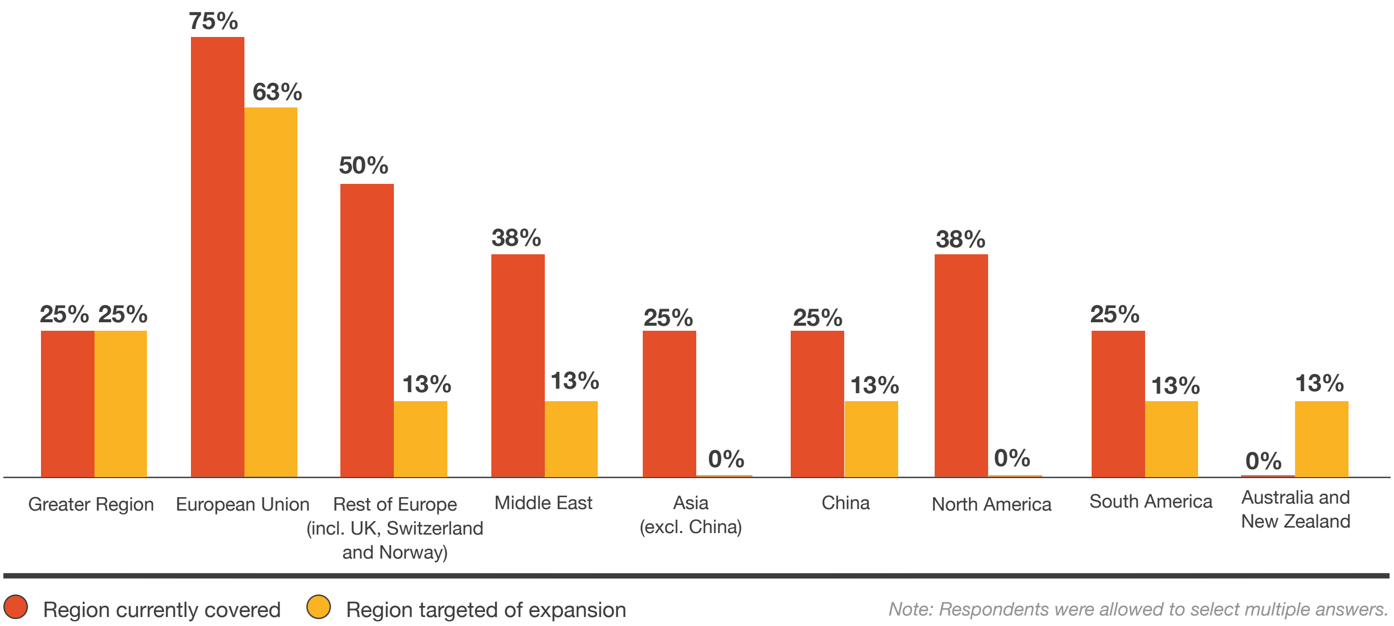
17 FT, *ECB 'infinity team' launches AI experiment to speed up basic tasks*, September 2023

Focusing on the home front

Corporate lending teams are overwhelmingly focusing on the Greater Region and Europe over other areas of the world when it comes to expanding their business operations (Exhibit 16). They appear to be focusing on these regions despite the fact that between 2021 to 2022 revenues dropped in the EU and rose in the Americas (see Exhibit 7). This suggests that corporate lenders believe long-term profitability to be in Europe, despite the short-term draw towards the Americas. It also means they are not chasing high-interest rate regions.

Our research shows that demand for corporate loans is, in fact, dropping in most markets – not just Europe – and it is likely that Luxembourg banks prefer to focus on the European markets they know best rather than try to expand during a recessionary period. In the US, corporate lending slowed down in Q2 and Q3 2023. As of the end of Q3 2023, the 25 largest US banks saw a 1.5% reduction in lending compared to the previous year[18].

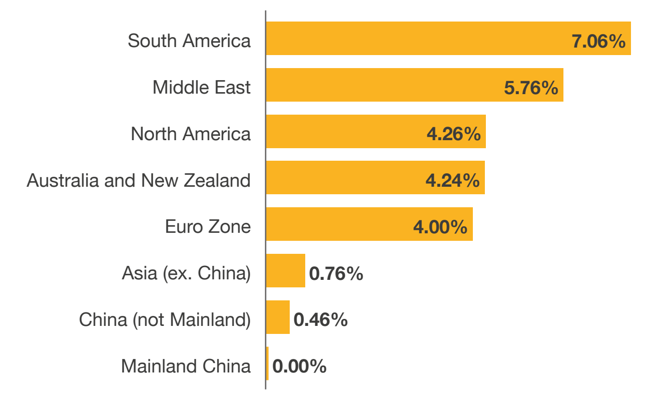
Exhibit 16 Which geographic regions do you currently cover/are you targeting for expansion within your corporate international lending business?



Note: Respondents were allowed to select multiple answers.
Source: ABBL Corporate Banking Survey Results

On the second point, high interest rates may have caused a brief rise in banking profits, but these were short-lived. There does not appear to be a relationship between regional interest rate rises (Exhibit 17) and the regions that survey respondents are planning to expand into (Exhibit 16). As previously explained, monetary policy tightening is a double-edged sword that can boost banks' potential profits, but also dramatically reduce the demand for loans. Indeed, the sudden spike in interest rates in Latin America in 2022 was accompanied by an 84% drop in debt issuance by private banks[19].

Exhibit 17. Average regional deposit rates rise Q1 2022 – Q3 2023



Source: PwC AWM & ESG Market Research Centre; IMF, ECB, Bank of Canada, Federal Reserve Bank of St. Louis

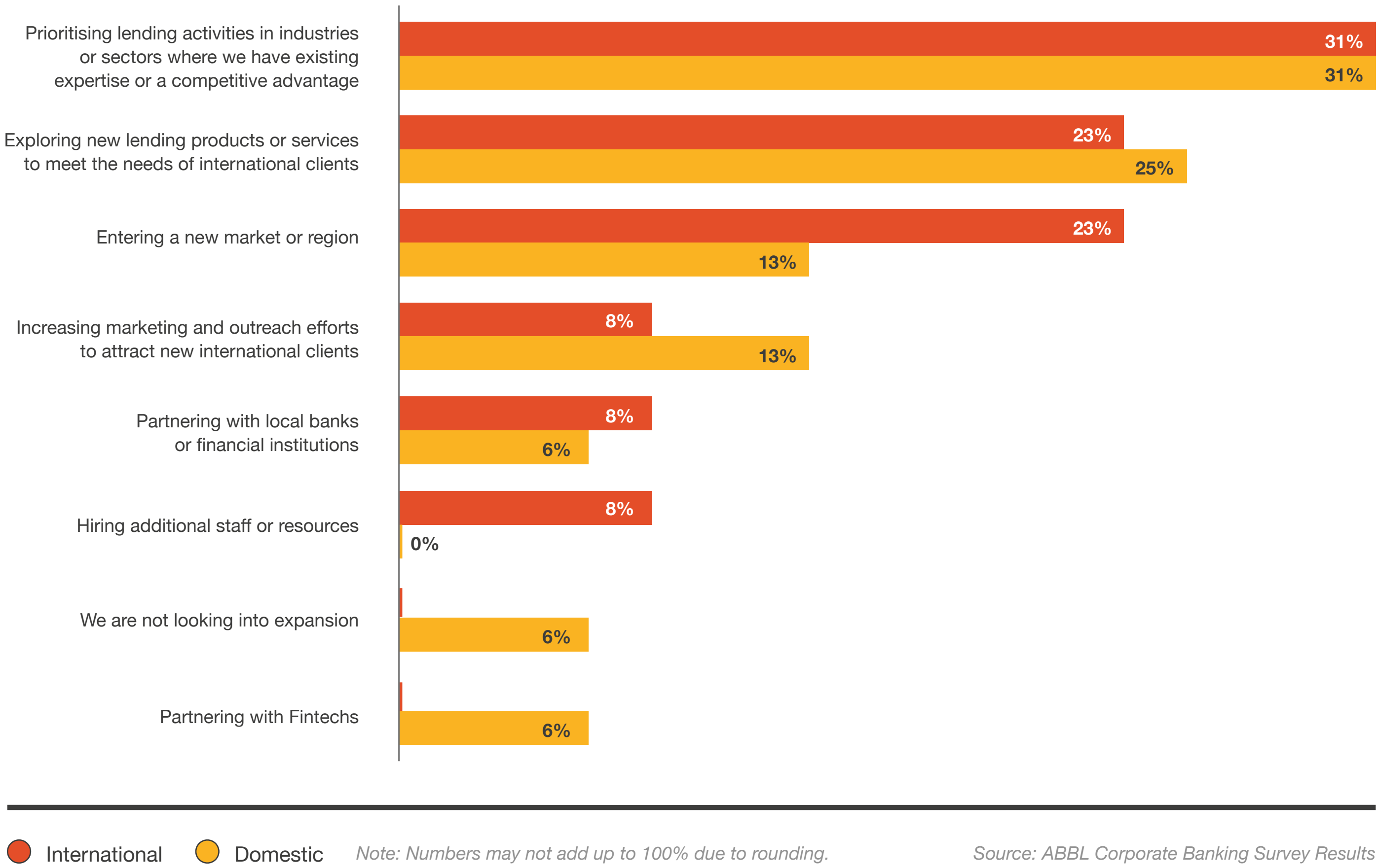
18 FT, *Rising interest rates curb lending growth for big US banks*, October 2023
19 Economic Commission for Latin America and the Caribbean (CEPAL), *Capital flows to Latin America and the Caribbean*, December 2022

Stability before expansion

Indeed, when it comes to expanding lending activities, respondents seem to prefer growing their corporate lending revenues in sectors and regions where they are already active, rather than entering new markets. 31% of both international and domestic respondents cited prioritising business in areas where they have existing expertise as one of their key lending strategies (Exhibit 18). Exploring new lending products or services for international clients was the second most popular option, with 23% of international and 25% of domestic corporate lenders citing it as a current strategy.

Corporate lenders' prudent strategy of sticking to their guns and prioritising existing knowledge and relationships is consistent with the larger trend of diminished risk appetites that has been observed in corporate banking. This explains why focusing on pre-existing business rather than taking on the risks of an expansion was the most popular response to this question.

Exhibit 18 What are your current strategies for expanding your lending activities?



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

20 Reuters, *JPMorgan begins private lending drive with $10 billion*, January 2023

21 Reuters, *Fall of the Zombies? Why Corporate Failures Could Surge in 2024*, October 2023

22 Scope Rating, *Europe faces further rise in corporate defaults: insolvencies to plateau only late 2024, early 2025*, October 2023

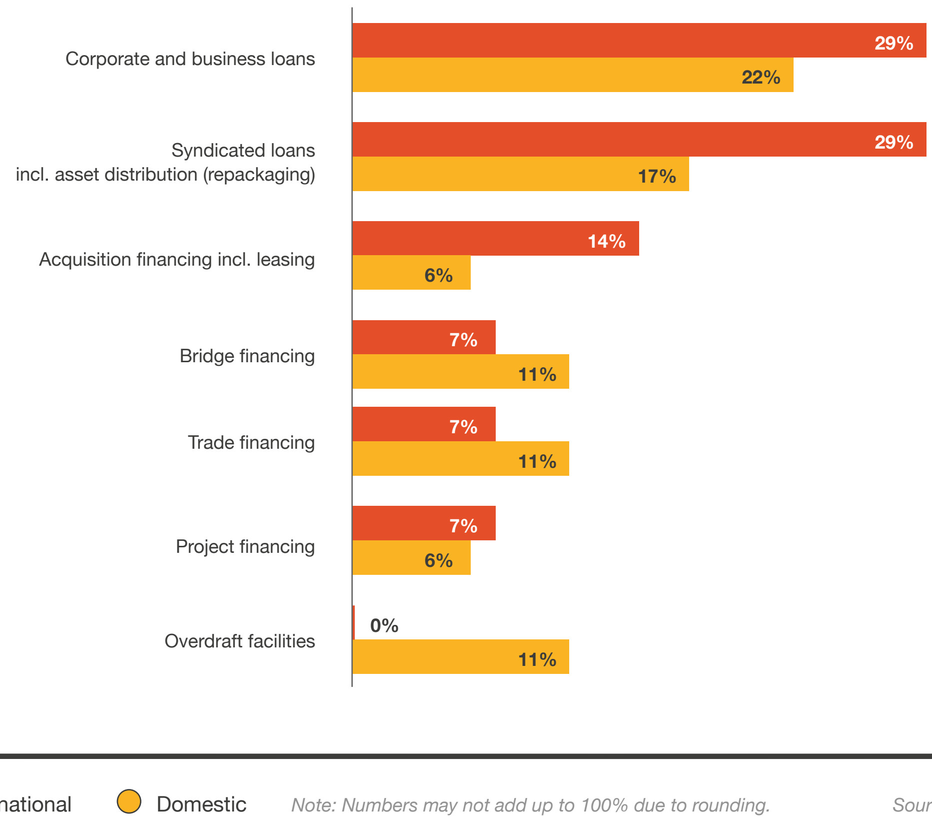
Financing solutions expected to lead the business

29% of international respondents and 22% of domestic ones in our survey believe Corporate and Business loans will be the biggest sources of growth through 2027. An additional 29% of international and 17% of domestic respondents say the same about syndicated loans (Exhibit 19). This suggests that 60% of corporate lenders believe that traditional loans will drive growth in the international corporate lending segment – with this proportion standing at 37% for domestic lending. Financing is therefore expected to be much more vital on the international stage than in Luxembourg.

Domestic lenders' view of financing is consistent with the generally gloomy economic outlook in Europe expected for the coming years. This poor outlook is not shared everywhere, as corporate lending is gaining popularity in the US – in January 2023, JPMorgan began a new USD 10bn private lending project[20]. This dichotomy further illustrates why Luxembourg's international lenders view financing much more favourably than domestic ones.

In addition to this, domestic lenders, who are more focused on Europe than their international counterparts, may view financing solutions as less robust due to what has been described as a "refinancing scramble", which is set to take place in the Europe, Middle East, and Africa (EMEA) region in H1 2024[21]. With a larger amount of loans due to reach maturity in that period than any other six-month stretch between H2 2023 and H2 2025, corporate clients seeking to refinance will likely face much higher borrowing costs than the last time they took out loans, and many businesses are expected to fail. Default rates in Europe have already been rising sharply since Q2 2022 and are not expected to plateau until Q1 2025[22]. It is therefore no surprise that corporate lenders more exposed to European markets have a less optimistic view of financing until 2027.

Exhibit 19 Which activities in the corporate lending business will drive the biggest growth until 2027?



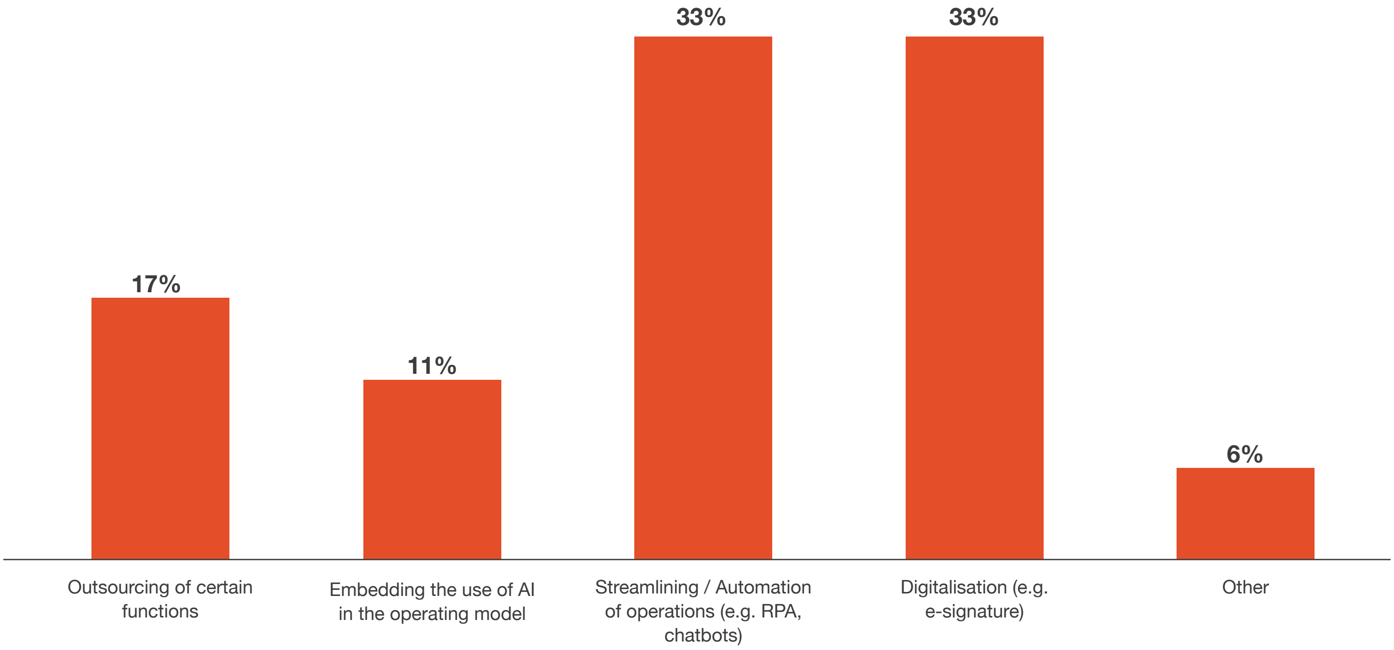
Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

Maximising efficiency through technology

Consistent with the move away from high risks that was observed throughout 2022, most changes to operating models are focused on generally increasing efficiency through technology. Digitalisation and Streamlining/Automation were each cited by 33% of respondents as the main expected changes to corporate lending operating models in the near future. This was followed by Outsourcing, which was also mentioned by 17% of respondents (Exhibit 20).

Exhibit 20 What changes do you envisage in your operating model of your corporate lending business



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results


1

Section 3.

Adapting For Long-Term Value Creation

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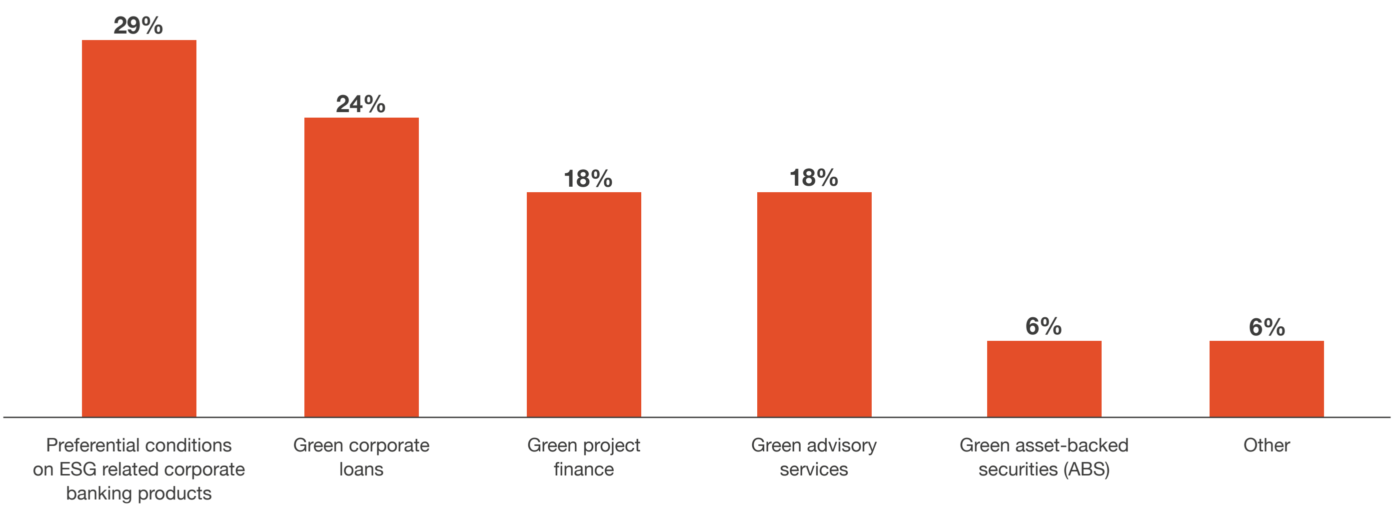
As corporate lending continues to play a pivotal role within banks' corporate banking portfolios, there is an urgent need for institutions to explore avenues for differentiation and value addition, benefiting both their operations and client services. This section highlights three areas where banks are intensifying their focus to strengthen their lending business amid a changing environment and emerging challenges.

3.1 Facilitating a Sustainable Future Through ESG Financing

Nearly one-third of respondents are helping to bring about the green transition by offering better conditions on sustainable products than non-ESG products to their clients and stakeholders. This is a very important incentive to motivate the private sector to implement green strategies. On top of offering preferential terms, green corporate loans (24%), project finance (18%) and advisory services (18%) were seen to be the top products on respondents' ESG product shelves (Exhibit 21). This trend remains in line with our first edition, which also showed that preferential conditions on ESG-related projects and green corporate loans were the most common ESG products/services offered to corporate banking clients, followed by project finance and advisory services.

Exhibit 21 Which type of ESG products or services do you currently offer to your corporate clients?



Note: Numbers may not add up to 100% due to rounding.

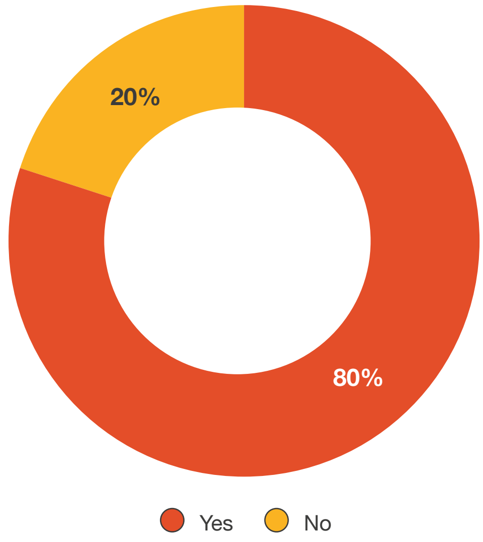
Source: ABBL Corporate Banking Survey Results

Corporate lending teams believe ESG will transforms banking in general and their business in particular in the coming years. The attention being given to sustainability is not only because banks realise the importance of ensuring a liveable planet, but also because it is crucial for the banking sector. Environmental catastrophes and the uncertainty that climate change brings about the future greatly enhance lending risks for banks, by making the world more unstable[23].

The results of the survey overwhelmingly show that corporate lenders are actively reacting to the climate crisis and the growing importance of ESG to the financial world. This is not only in Luxembourg but extends more broadly. Banks are increasingly cracking down on greenwashing and demanding higher ESG standards from their clients in exchange for sustainability-linked loans (SLL)[24]. While banks' greater sustainability scrutiny has caused a slump in loan demand, with global SLL issuance dropping by 36% from USD 480bn in 2022 to USD 310bn in 2023, this will likely be short-lived. Given increasing external pressure to help the green transition, corporate banking clients will eventually need to accept being held to the standards that corporate lenders are trying to meet. The COP28 UAE's focus on sustainable finance and public and private institutions' responsibility to tackle climate change provides an excellent example of the ever-growing accountability that is expected of these entities[25].

As providers of financing solutions, banks hold immense influence over their partners/clients and stand to be a catalyst for good in the fight against climate change. That is why 80% of banks in Luxembourg offer ESG financing in some form (Exhibit 22), which represents a 20% increase from the results from our previous survey, when only 60% of respondents stated they applied ESG criteria to their lending process. Further, these findings are consistent with the previous section, where we showed that ESG is the area that 14% of corporate bankers have cited as a key source of transformation for corporate lending.

Exhibit 22 Do you offer ESG financing within your corporate banking lending business?



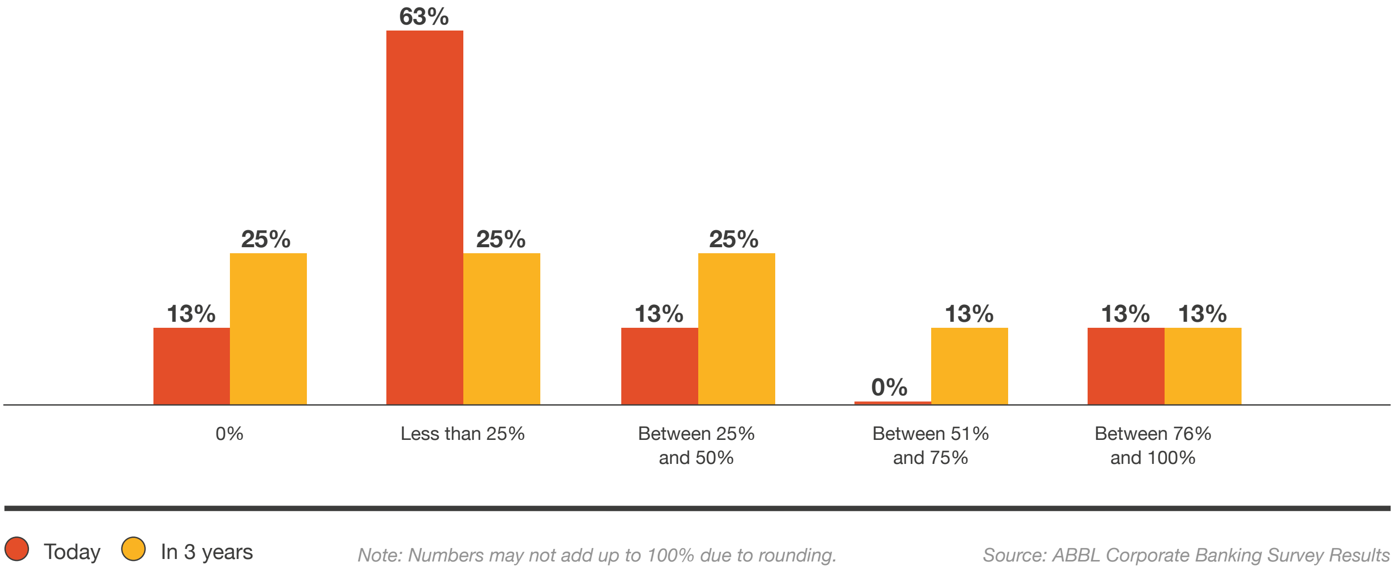
Source: ABBL Corporate Banking Survey Results

In terms of applying ESG as a strategy, most banks (63%) only apply ESG criteria to less than 25% of assets (Exhibit 23), similar to the trend observed in the previous report, in which the majority of respondents also applied ESG criteria to 25% of assets or less. However, this is set to change in the next three years. There is a clear split between future strategies on ESG applications. According to the results of the survey, 25% of corporate lenders expect that they will not be applying ESG criteria to any of their assets in three years, which is more than the 13% that currently do not apply ESG criteria. Nevertheless, the survey also shows that ESG criteria application will grow for other organisations. As of 2022, only 13% of corporate lenders apply ESG criteria to over half of their assets, but this figure is set to double in the next three years.

23 ABBL, *ESG risks – Time for banks to practice what Central Banks preach*
24 Reuters, *Loans Linked to ESG Face Overhaul by Under-Pressure Banks*, November 2023

25 Bruegel, *COP28: key issues at stake and indicators of success*, November 2023

Exhibit 23 For what percentage of your total corporate lending/investment non-distributed assets do you apply ESG criteria?



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

Luxembourg is a global sustainable finance leader, with more than half of UCITS AuM domiciled in the Grand Duchy invested in either SFDR Article 8 or Article 9 funds. It is also a leading international venue for listing (corporate) green bonds[26]. The local banking sector is therefore in the ideal place to offer more green corporate banking products, which aligns with the national financial industry's ambitions and established expertise.

Becoming more involved in ESG lending means that banks will have to perform increased due diligence on their clients and the projects they are financing. With several new EU regulations, such as the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) requiring regulated entities to disclose the impact of their operations on ESG factors, it could be easier for the banks to ensure that their loans are going to the sustainable objectives they are intended for. However, regardless of disclosure levels, the due diligence banks will need to carry out is likely to increase and will be one of the challenges the sector will have to overcome on the road to net zero.

26 Sustainable Finance in Luxembourg, LSFI (https://lsfi.lu/what-is-sustainable-finance/)
27 Paperjam, *200 millions, 300 emplois: The Bank of London postule à Luxembourg*, September 2023
28 The Trade, *Bank of London launches with big ambitions as the UK's sixth clearing bank*, December 2021
29 The Banker, *Adapting is key to staying ahead for BofA Corporate Banking*, September 2023
30 Reuters,Stalled Talks resume on EU's AI Act, December 2023

3.2 Leveraging Emerging Technology to Enhance Productivity

The Luxembourg banking ecosystem is currently developing rapidly, and the corporate banking segment is no exception. Luxembourg continues to establish itself as a hub for both corporate banking and technology, attracting major players looking to expand their footprints in both segments. In July 2023, the Bank of London, the sixth-largest clearing bank in the UK, requested a Luxembourg banking license from the CSSF[27]. The Bank of London aims to develop an EU presence via Luxembourg and leverage its specialisation in fintech and software as a banking service[28].

In this context, expansion through technology is one of the main trends that is developing across the European corporate lending ecosystem. Top corporate banking players consider fintech, health technologies and broader technological applications to be high-growth sectors, and even in other areas being targeted for expansion, such as infrastructure, there is a strong focus on digitalisation and technologically upgrading pre-existing assets[29]. Some banks have already implemented some technological processes into their lending operations (Exhibit 24), but there is still room for improvement. For instance, despite the strong belief we previously highlighted that AI, and technology more broadly, are set to transform the sector in the coming years, AI has not yet been widely adopted, with just 3% of banks stating that they use AI or ML to facilitate their tasks. Apart from the technology being nascent within the sector, there is also no solid AI governance at the time of writing. With the EU AI Act under negotiation[30] and set to enter enforcement within the next few years, many banks are unsure about how or whether they should begin implementing AI, as they do not want to assume the risk of investing in operations that may not be permitted under the pending regulations. Clear regulatory guidelines on this technology would certainly help the banking sector understand the risks, rules, and potential benefits associated with it, and may lead to more widespread adoption.

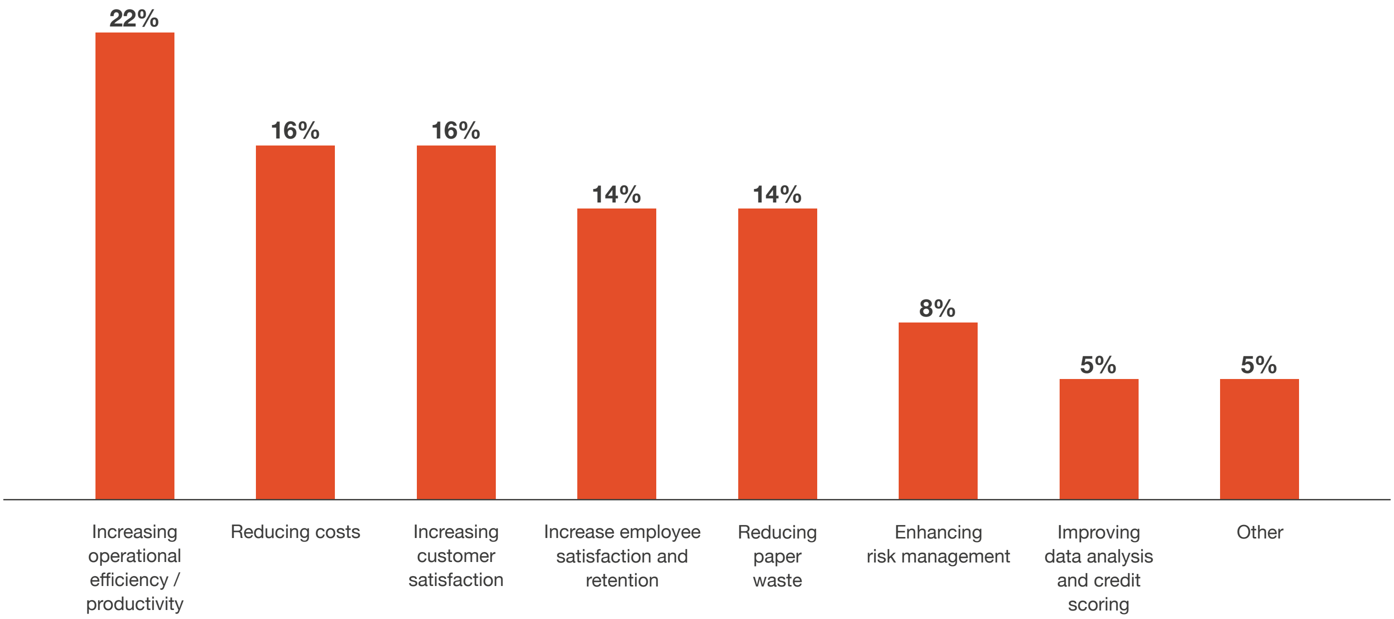
Exhibit 24 Which of the following technological solutions are already adopted within your corporate banking lending business?

Note: The total of these answers does not add up to 100% since this graph only shows the top six responses.

Source: ABBL Corporate Banking Survey Results

Respondents claim the main benefits from implementing new technologies have been productivity increases (22% of respondents) and cost reduction (16%) (Exhibit 25). Banks' overall risk aversion and cautious operations given economic headwinds suggest they might continue to implement more technologies in order to continue to capitalise on these benefits. In this context, it remains to be seen whether banks' use of technology will increase in future editions of this report, given respondents' expectations of technology.

Exhibit 25 What benefits have been experienced so far as a result of implementing technological solutions within your corporate banking lending business?



Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

3.3 Empowering Employees to Embrace Adaptability

Compared to the last edition of this survey, the personnel skills that respondents have cited as necessary for competitiveness are extremely varied. Whereas 56% of respondents in the previous report stated that regulatory skills were crucial for competitiveness, in this edition no single answer was chosen by more than 11% of respondents, underscoring the diverse changes in strategy that banks have started adopting in 2022 in the face of economic turmoil.

“Problem-solving” was the most widely cited skill when respondents were asked about necessary skills to maintain competitiveness in the corporate lending business (Exhibit 26). Following this were ESG-related skills, credit risk skills, digital skills, and KYC/KYT skills in equal proportion, underscoring the importance of well-rounded and easily adaptable personnel within a rapidly changing business landscape.

Exhibit 26 Which skills/competencies are necessary in order to remain competitive in the corporate banking lending business?

11%	Problem solving skills	9%	KYC/KYT
9%	ESG-related skills	8%	Communication Skills
9%	Credit Risk Skills	5%	Legal Skills
9%	Digital/Technology skills	5%	Cultural Skills

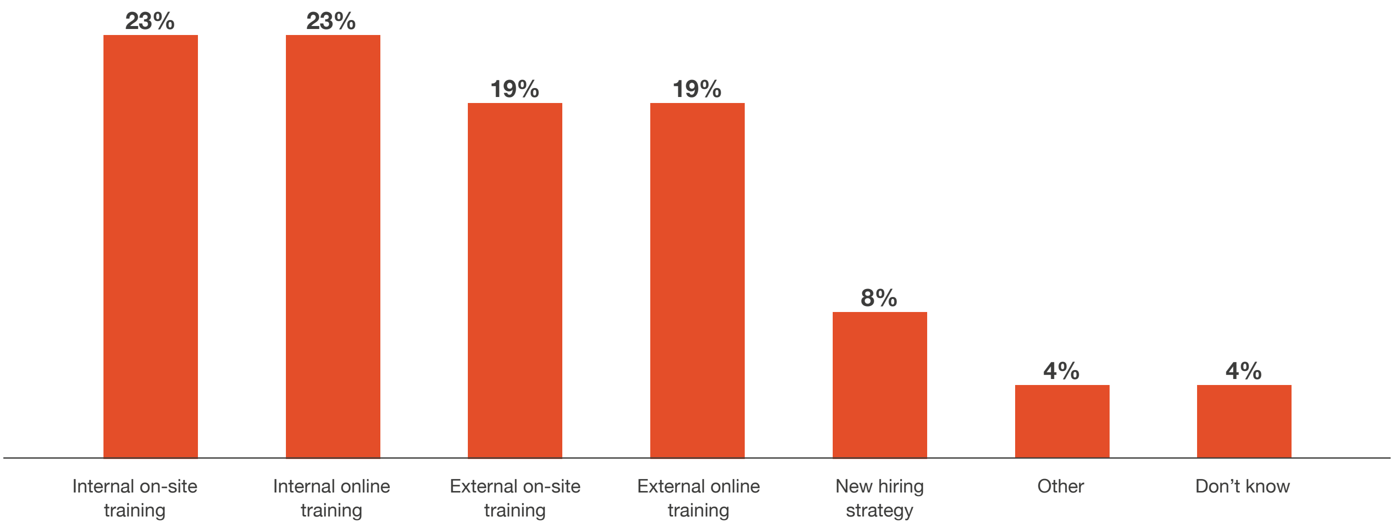
Note: The total of these answers does not add up to 100% since this graph only shows the top eight responses.

Source: ABBL Corporate Banking Survey Results

In line with general changes taking place in the corporate lending industry, all survey respondents stated they were providing some form of training to their personnel in order to adapt to new challenges in the corporate lending landscape. This shows how seriously corporate lending teams are taking the changing tides within the greater economy. Roughly half of all training provided by banks to their employees is internal, with 23% of it on-site and 23% off-site.

Upskilling and training the existing workforce is a common strategy across Luxembourg's corporate lending sector. This priority within the corporate banking space is consistent with the broader tendency among Luxembourg CEOs, 73% of whom consider upskilling their company's workforce to be a priority in 2023, according to PwC's 26th Annual Global CEO Survey[31]. This is unsurprising given that 58% of Luxembourg Financial Sector CEOs believe labour shortages will impact profitability over the next decade.

Exhibit 27 What training development strategies are applied for employees corporate banking lending business?



Note: Numbers may not add up to 100% due to rounding.

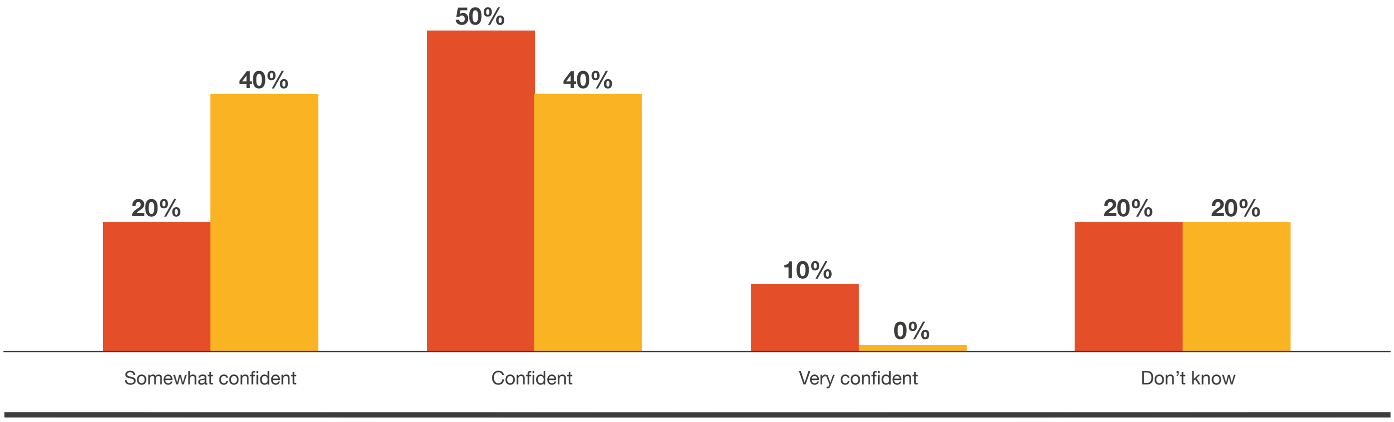
Source: ABBL Corporate Banking Survey Results

Overall, our survey also showed that corporate lending teams tend to have a positive view of their workforce's ability to adapt to changes. 60% of respondents stated they were either "Confident" or "Very Confident" in the adaptability of their workforce compared to just 40% who said they were confident in their ability to find skilled workers (Exhibit 28). Conversely, 40% of respondents said they were only 'Somewhat Confident' in their ability to find skilled workers. This uncertainty about finding skilled labour extends beyond the corporate lending space and rather reflects Luxembourg's high demand for high-skilled labour. The European Centre for the Development of Vocational Training (CEDEFOP) estimates that between 2022 and 2035, 63% of job openings in Luxembourg will be for high-skilled jobs, compared to just 56% across the EU[32]. As of 2022, 50% of jobs in Luxembourg were already high-skilled compared to 37% across the EU. This means that the professional sector's demand for labour within Luxembourg exceeds European supply, which underscores the importance of reskilling the existing workforce in the corporate banking sector.

31 PwC, *26th Annual Global CEO Survey*, 2023

32 European Centre for the Development of Vocational Training (CEDEFOP), *2023 Skills Forecast Luxembourg*

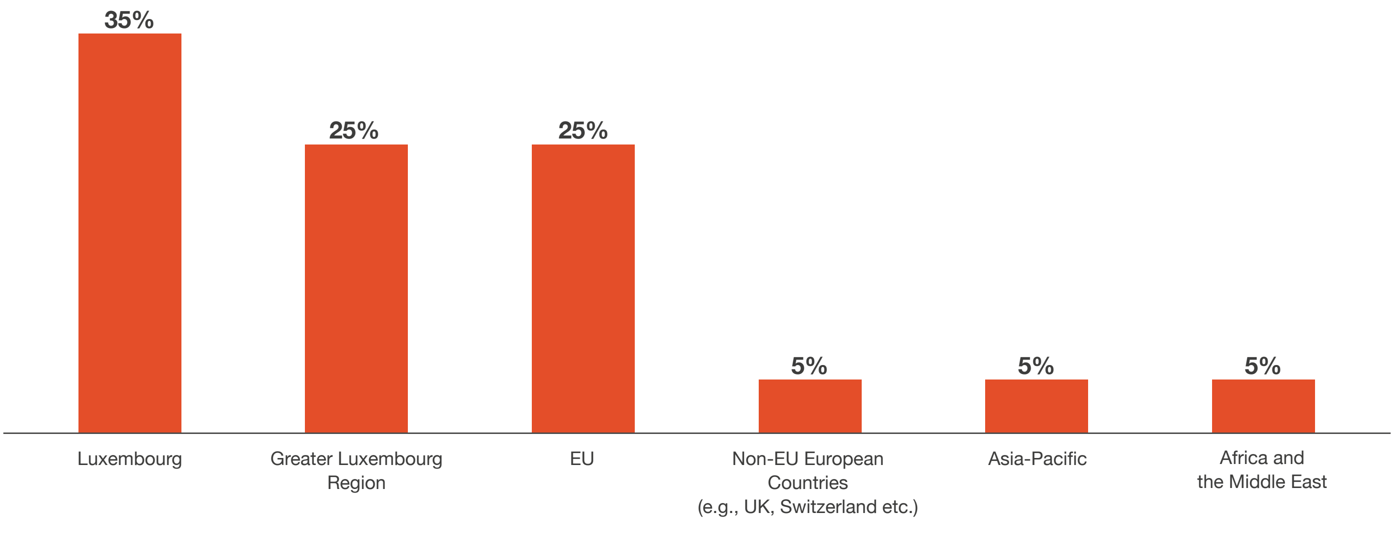
Exhibit 28 Overall, how confident are you in the adaptability of your workforce in corporate banking lending business and its ability to embrace emerging trends and the possibility to find skilled profiles on the market?



Note: Numbers may not add up to 100% due to rounding.
Source: ABBL Corporate Banking Survey Results

In response to this, it is unsurprising that while most banks in Luxembourg hire employees based in either Luxembourg or the Greater Luxembourg Region, with 60% of all corporate lending employees coming from these two areas (Exhibit 29), an additional 25% are hired from the wider EU. Further, non-EU countries, Asia-Pacific, the Middle East and Africa collectively make up 15% of corporate bank employees' places of origin prior to coming to Luxembourg.

Exhibit 29 Where do you currently find the skilled personnel needed?

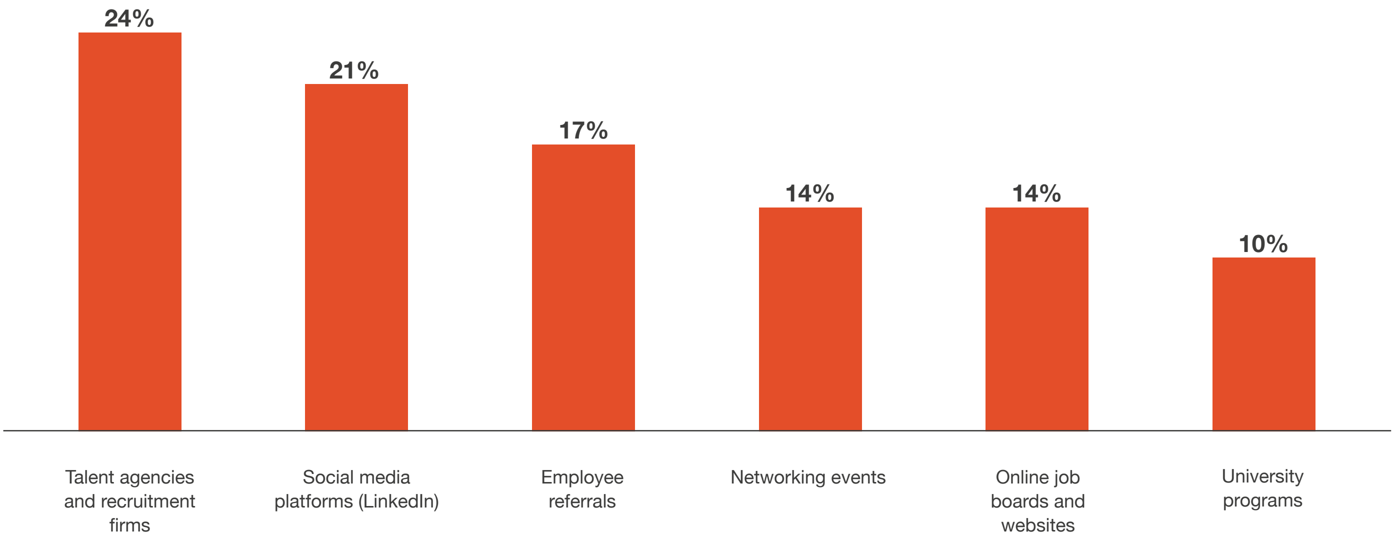


Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

In line with the widespread use of technology in corporate banking that has been outlined throughout this survey, 21% of corporate banks stated that employees are recruited through social media platforms like LinkedIn. This is nearly the same proportion of employees that are found through talent agencies or recruitment firms, which is 24% (Exhibit 30).

Exhibit 30 How do you currently attract personnel?



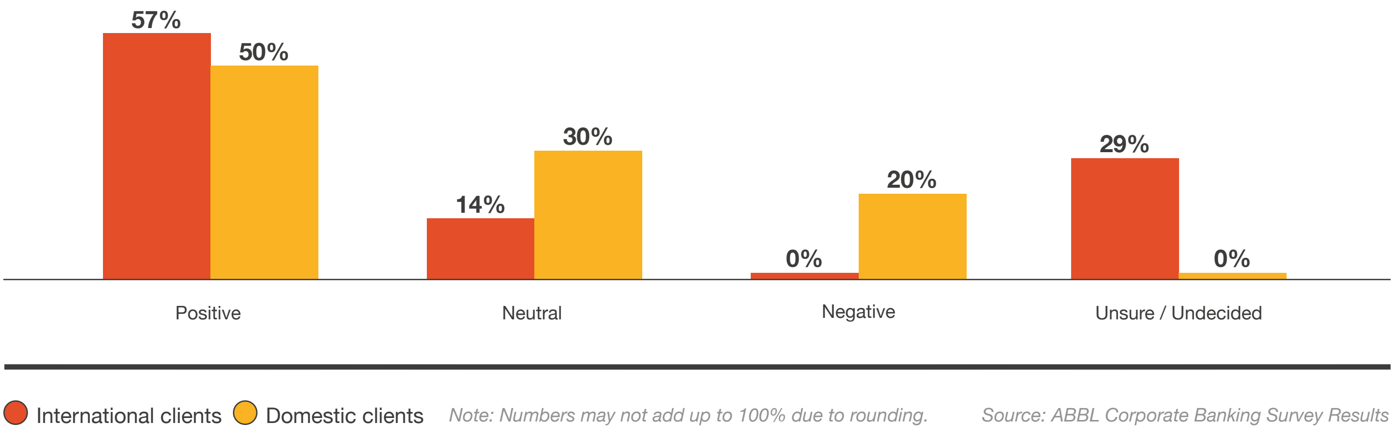
Note: Numbers may not add up to 100% due to rounding.

Source: ABBL Corporate Banking Survey Results

3.4 International Lenders Have a More Positive Outlook

Despite the transformation the global economy is undergoing, corporate lending teams generally have a favourable outlook on the future, suggesting they are successfully adapting to new conditions. 57% of respondents said they have a positive outlook for international lending, and 50% said the same concerning domestic lending. However, 1 out of 5 respondents have a negative outlook on the domestic segment, with none expressing this view of their international prospects (Exhibit 31).

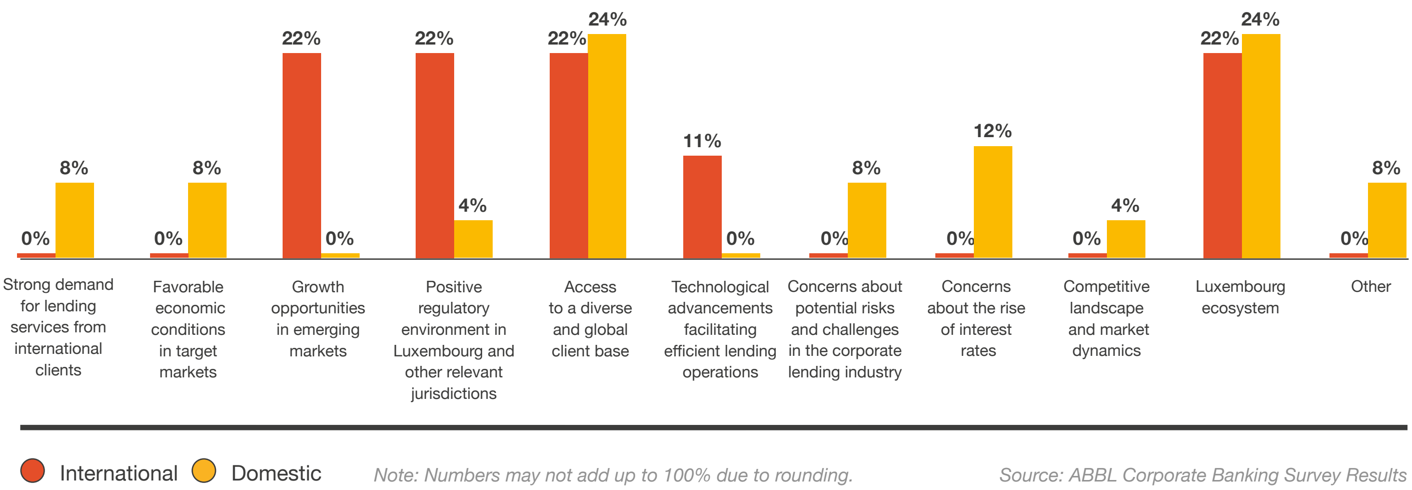
Exhibit 31 How would you characterise your outlook on the corporate lending business activities at your bank, considering the clients you serve?



Note: Numbers may not add up to 100% due to rounding. Source: ABBL Corporate Banking Survey Results

International lenders seem to be more focused on just five factors that are affecting their outlook on corporate lending: growth opportunities in emerging markets, the regulatory environment, accessibility to a diverse client base, technological advancements, and the general Luxembourg ecosystem. Domestic lenders, on the other hand, are concerned with a wider array of issues that define their forward view of corporate lending (Exhibit 32). This may be because, as previously mentioned, domestic lenders deal with a wider array of industries than their international counterparts, as well as small businesses in addition to large ones.

Exhibit 32 What are the primary factors influencing your outlook on the corporate lending business activities for your clients?



Note: Numbers may not add up to 100% due to rounding. Source: ABBL Corporate Banking Survey Results

Section 4.

Conclusion

Section 4.

Conclusion.

This survey is the fruit of a collaboration between the ABBL, PwC Luxembourg, and the CSSF. It is based on the insight of the top banking minds in Luxembourg, who gracefully provided us with the responses necessary to create the second edition of this survey.

Corporate banking stands at the dawn of the new economic age and is still adapting to its realities. However, this report has found that corporate lending teams are quickly pivoting and making the best of a new situation.

Rather than resisting it, the corporate lending sector is proving to be ready for change and is actively embracing the future. Corporate lending is one of the keys to turning the green transition up to eleven. Bankers appear to be aware of this and are hinging their adaptation to the new economic context on sustainability. At the same time, they recognise the tectonic shift that new technologies represent and are actively leveraging them to their advantage, all while preparing themselves and their workforce to be ready to face new realities as they manifest.

The results of this survey highlight the need to think globally and act locally, all while accepting changes and adapting quickly to new strategies in order to thrive in an ever-evolving world. The ability to fully embody this will play a key role in bolstering Luxembourg's competitiveness as a vibrant and dynamic hub for the global corporate banking industry.

Methodology.

The 2023 ABBL Corporate Banking Survey was conducted in collaboration between the ABBL and PwC Luxembourg, together with the support of the CSSF. To generate meaningful insights, the ABBL circulated an invitation-only survey comprised of an online qualitative questionnaire for CEOs and a set of quantitative questions addressed to bank CFOs.

PwC's ESG & AWM Market Research Centre then analysed the results to obtain the qualitative and quantitative findings in this report. The survey was designed to focus on banks' corporate lending activities and strategies rather than their geographical origin, which was the focus of the first edition.

A note on the sample

The survey was addressed to 44 banks that have been identified by the CSSF as offering corporate banking services in Luxembourg. Out of these, 35 participated in the quantitative survey and 12 in the qualitative survey. The sample size of the qualitative survey was somewhat smaller than the one in the first edition, which had 29 respondents. However, this smaller response rate is attributed to the fact that the previous edition had a much broader focus whereas this one is highly granular and focused on specific banking activities.

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Acknowledgements

We would like to express our heartfelt gratitude to **Anastasia Vlassova**, **Daniel Theobald**, **Nana Duah Poku** and **Fabio Mandorino**, for their exceptional contributions to the production of this new issue of our Corporate Banking Survey. The collaborative spirit and professionalism each of them brought to the table were truly commendable, while their dedication, expertise, and attention to detail have significantly elevated the quality of our work. Their insights and hard work have played a pivotal role in shaping a comprehensive and insightful survey that will undoubtedly provide valuable perspectives for our corporate banking stakeholders.

PwC Luxembourg (www.pwc.lu) is the largest professional services firm in Luxembourg with over 3,700 people employed from 94 different countries. PwC Luxembourg provides audit, tax and advisory services including management consulting, transaction, financing and regulatory advice. The firm provides advice to a wide variety of clients from local and middle market entrepreneurs to large multinational companies operating from Luxembourg and the Greater Region. The firm helps its clients create the value they are looking for by contributing to the smooth operation of the capital markets and providing advice through an industry-focused approach.

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