



Dossier risk management

RISKY BUSINESS IS EVERYONE'S BUSINESS

Ernst Wilhelm Contzen

FUTURE OF THE FINANCIAL CENTRE

Fund industry

RESPONSIBLE INVESTING GOES MAINSTREAM

Financial crisis

SIFTING THROUGH THE RUBBLE

Lifestyle

GAMES OF THE SMALL STATES OF EUROPE

CHANGE ALWAYS COMES BEARING GIFTS

The first months of the year 2013 have held many opportunities for the Luxembourg financial centre. The introduction of the automatic exchange of information from January 2015 on and the adoption of Model I of the Foreign Account Tax Compliance Act (Fatca) are two of the milestones that will impact the future of the financial centre. Ernst Wilhelm Contzen is Chairman of the Luxembourg Bankers' Association and CEO of Deutsche Bank Luxembourg. He shares his opinion on the recent developments with us.

*Ernst Wilhelm **CONTZEN**,
Chairman of the Luxembourg
Bankers' Association (ABBL)*

► LFF: THE FINANCIAL CRISIS IS IN ITS SIXTH YEAR AND LUXEMBOURG IS FARING RELATIVELY BETTER THAN MOST OTHER EU COUNTRIES. HOW CAN WE CONTROL THE RISKS THAT ARE STILL LOOMING?

► **EW:** The main business lines of the Luxembourg financial centre, particularly our fund administration activities and our wealth management industry, are generally low-risk. This is one reason why the financial crisis has so far only had a limited impact on the Luxembourg financial centre, both in terms of overall employment and net results. Luxembourg banks have traditionally always been

highly liquid and strongly capitalised and our conservative provisioning in particular has meant that we were well equipped to deal with contingencies, such as the write-down on Greek debt, for instance.

As an international financial centre, the risks weighing on Luxembourg are almost exclusively external. In this sense there is little we can actually control. But the Luxembourg financial centre has always been adept at anticipating, preparing and adapting to international developments, often turning regulatory harmonisation to our benefit: the success of UCITS is a good example. The financial crisis has triggered a flood of new regulations. One of our biggest challenges in the coming years will be dealing with this plethora of regulations,



many of which are overlapping or fail to sufficiently take into account the specificities and day-to-day realities of certain business models. This is, of course, not just a challenge for Luxembourg, but for the European financial sector as a whole. What we want is better regulation, not simply more regulation.

► **LFF: AUTOMATIC EXCHANGE OF INFORMATION WILL BECOME A EUROPEAN, INDEED AN INTERNATIONAL STANDARD. IS THE INTRODUCTION OF THE AUTOMATIC EXCHANGE OF INFORMATION A RISK OR AN OPPORTUNITY?**

► **EWC:** As a Banking Association, we are certainly not pleased with the introduction of an automatic exchange of information. It is a costly and rather useless system. A final withholding tax model, coupled with an exchange of information upon request, would have been by far the more efficient and cheaper solution to fight tax evasion. But the international trend has been going towards the automatic exchange of information, so this is something we have to live with. We have been preparing for this switch to the automatic exchange of information for a number of years now.

One thing that is certain, however, is that the automatic exchange of information is a risk if it remains limited to the European Union. I am glad that Minister Frieden is insisting on the fact that it should become the international standard. I also agree with the government's position that we should get third party countries like Switzerland on board before we decide on extending the scope of the European Savings Directive. By rushing ahead in this matter, the European Union will only shoot itself in the foot. We need a level playing field among international financial centres. If we're going in this direction then we must make sure that everyone plays by the same rules.

While it will not be a painless exercise, the impact on Luxembourg of introducing an automatic exchange of information, as foreseen in the Savings Directive, will remain limited. Only 40% of our clients are EU residents, and the large majority of these clients are tax compliant.

For many years now Luxembourg has been increasingly successful in attracting international entrepreneurs and very wealthy clients, in particular outside of Europe. Our niche is not based on taxes, but on cross-border finance. The more a client's needs and problems are multi-jurisdictional, multi-lingual and multi-currency, the more likely it is that he or she will choose Luxembourg as a hub from which to manage his or her wealth or companies. Luxembourg will remain the Eurozone's primary wealth management centre.

► **LFF: WHAT ARE THE ASSETS OF LUXEMBOURG'S FINANCIAL CENTRE IN THE FUTURE, BOTH FOR FOREIGN FINANCIAL INSTITUTIONS AND INSTITUTIONAL INVESTORS?**

► **EWC:** As I said before, Luxembourg's niche is its international dimension. Our unique selling proposition is our unrivalled expertise and know-how in providing cross-border financial services across the globe. This is something clients find difficult to get elsewhere. With the exception of London, other European financial centres mainly focus on their domestic market. And unlike London, we are at the heart of the Eurozone. Moreover, we are a centre of expertise in a very broad range of financial services such as insurance, funds, international loans, venture capital, clearing and many others. Non-European groups are increasingly choosing Luxembourg as their European headquarter from which to invest into Europe, market their products and service their clients in Europe and around the world. This is a very encouraging sign for the future of our financial centre.

► *LuxembourgforFinance*

THE REGULATORY AGENDA ALSO INCLUDES FATCA (FOREIGN ACCOUNT TAX COMPLIANCE ACT). WHAT DOES THE ADOPTION OF MODEL I MEAN FOR LUXEMBOURG?

► *Ernst Wilhelm CONTZEN*

After the government's announcement that Luxembourg will switch to the automatic exchange of information, as foreseen in the EU Savings Directive, the choice of Model I no longer came as a surprise. Although I find it difficult to condone the unilateral arm twisting that the US is undertaking by forcing FATCA on the rest of the world, Model I has the advantage that Luxembourg banks will exclusively work with the Luxembourg tax authorities, who will then transfer the information to their US counterparts. This is much easier for us than having to communicate directly with the US authorities. Given that our big European countries have chosen Model I, it would also have been damaging in terms of reputation to break ranks with our European partners in this matter.

► *LuxembourgforFinance*

ANOTHER PIECE OF REGULATION IS THE FINANCIAL TRANSACTION TAX, WHICH A GROUP OF 11 EU MEMBER STATES AGREED TO INTRODUCE. WHY IS LUXEMBOURG NOT AMONGST THE 11 COUNTRIES THAT ARE TRANSPOSING FTT INTO NATIONAL LAW?

► *Ernst Wilhelm CONTZEN*

Luxembourg has rightly argued that a Financial Transaction Tax will only make sense if applied on a global scale. The Swedish experience has shown that such a tax is incredibly damaging if introduced unilaterally. Moreover, Luxembourg, as an international financial centre, would be affected at a disproportionately high level by such a tax. The Commission's proposed solution to prevent the offshoring of financial transactions to countries outside the scope, namely its extra-territorial effects resulting from a combination of residency and issuance principles, makes matters even worse, as it risks further crippling the European financial sector and making it uncompetitive at a time when Europe is in dire need of economic growth. It is hard to see how the adoption of such a measure could be said to protect the interests of the European Union. The good news, if you can call it that, is that the participating Member States currently do not even agree amongst themselves on what they want to achieve with the tax and where the revenues should go.

► **LFF: RECENT MONTHS HAVE SHOWN THAT (DUE TO A LACK OF PROPER RESEARCH), MISINFORMATION IN THE INTERNATIONAL PRESS ABOUT LUXEMBOURG HAS MULTIPLIED. ARE YOU WORRIED ABOUT THIS TREND OF UNFAIR AND PARTIAL REPORTING?**

► **EW:** Over the years, we have gotten used to this misinformation. This does not make it less damaging. The highly respected Financial Times recently wrote, amongst other absurdities, that Luxembourg is ready to abandon banking secrecy for companies. Now, either the journalist in question does not understand that

there is no such thing as banking secrecy for companies (nor has there ever been), which would be worrying for a "financial" journalist, or he simply wrote it in bad faith. Either way, it perfectly illustrates the extent of this misinformed and partial reporting. It is something I worry about. We often manage to overcome a journalist's preconceived notions about Luxembourg by simply telling them how things really are. But you do not change a bad image over night. Regular contact with journalists is crucial in this respect.

RESPONSIBLE INVESTING GOES MAINSTREAM



Despite market turmoil, the European ESG (Environment, Social, Governance) funds market is buoyant in terms of asset growth and new product launches.

The second ALFI-KPMG European Responsible Investing (RI) survey provides a feast of data on this elusive market sector. Assets under management in ESG funds have grown by 19% in two years to a total 238 billion euros in 1,775 funds.

This figure remains well below the USD 8.7bn in ESG mandates reported by the European Social Investment Forum (EuroSIF), illustrating the fact that ESG investing remains primarily an institutional activity in Europe. The EuroSIF figure includes segregated mandates and all assets managed by companies that are signatories to the UN Principles for Responsible Investment.

Almost two thirds of funds, representing 83% of assets under management, apply positive or negative screens (or both) to a broad portfolio of assets. The most widely applied negative screens are the exclusion of armaments (33%), tobacco (25%), gambling (20%) and nuclear power (18%).

More complex exclusions include human rights violations (18%) and the exploitation of labour (14%). Green screens are applied by less than 10% of these funds.

"YOU PAYS YOUR MONEY AND YOU TAKES YOUR CHOICE"*

The growing sophistication of ESG sectoral funds is a sign of the increasing maturity of this market.

The environment funds category was the only sector to shrink over the period under review, with assets falling from 15.7% to 11.8% of the total RI market. This performance reflects difficulties in the renewable energy sector after European governments were forced to cut back on environmental subsidies. Both forestry and carbon funds showed positive growth.

The social funds sector is dominated by microfinance investment vehicles with 60% of assets under management. Social solidarity and impact funds experienced minor growth, reflecting the fact that these funds are complex to sell to investors. Indeed, many promoters of socially engaged funds avoid retail distribution for this reason.

The ethical (faith) funds sector is dominated by Islamic funds, many of which were launched in the period under review: 87% of funds represent just 35% of assets under management. These figures reflect a concern in the Islamic finance sector that there are a great many small, non-profitable funds on the market.

DIFFERENT STROKES FOR DIFFERENT FOLKS

Luxembourg and France are in the forefront of the ESG funds industry, accounting for 42% of funds and 51% of assets under management. However, Belgium, Denmark, the Netherlands, Switzerland and the UK are all big players in different categories. The absence of Germany, an ESG conscious market, reflects the fact that German funds destined for broad distribution are often domiciled in Luxembourg.

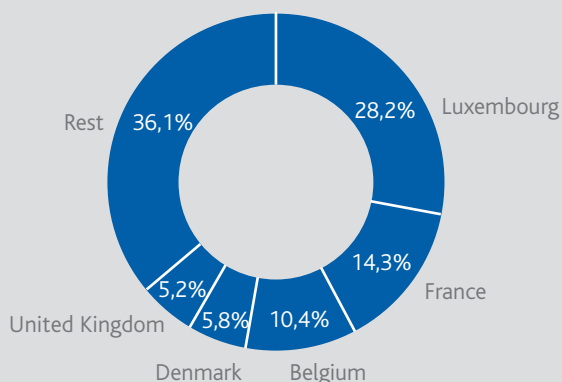
The report highlights a number of trends. For instance, whilst transparency initiatives have mushroomed, external third-party attestation is likely to become "best practice" in the future. Recommendations include the need for ESG information providers to link their research to concrete consequences in terms of investment performance and a call on the European Commission to establish rules on non-financial information disclosure by companies.

Several interesting debates are raised, featuring the views of market specialists. These include the danger that overuse of the RI label will devalue its meaning and the question of future distribution: where is the greatest growth potential – retail or institutional – and can retail investors be targeted cost-effectively?

Investors looking to place their money in a responsible manner no longer need to look very far. The ESG sector has crossed the bar from niche product to mainstream investment process. **ER**

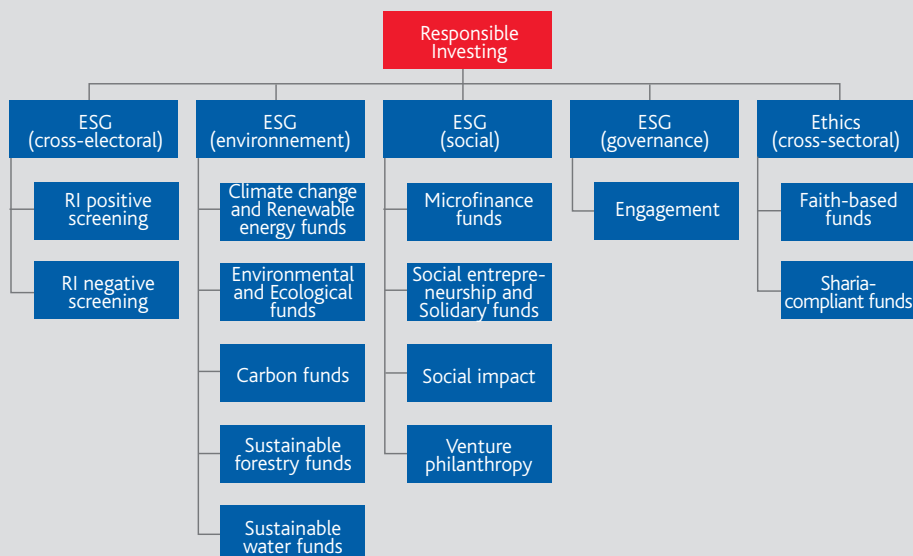
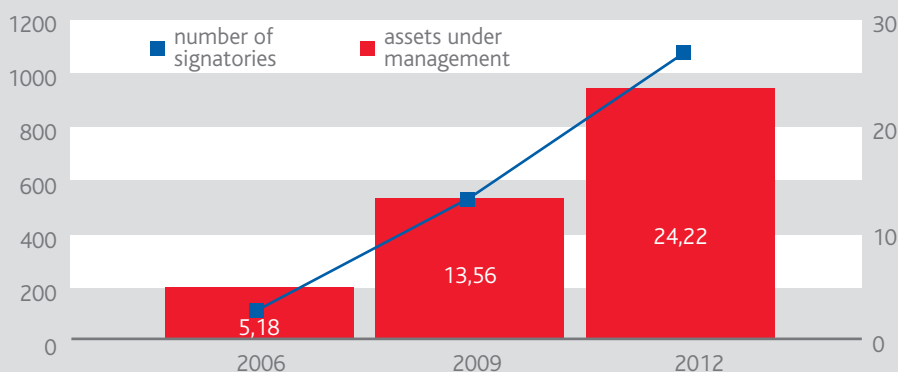
MARKET SHARE OF RESPONSIBLE INVESTMENT FUNDS IN % NB OF FUNDS

Total = 1,775 funds



UNITED NATIONS PRINCIPLE FOR RESPONSIBLE INVESTING SIGNATORIES EVOLUTION

in EUR trillion





Dossier Risk management

RISKY BUSINESS IS EVERYONE'S BUSINESS

There is no such thing as a free lunch. If an investor wants performance, he has to accept a certain degree of risk. Understanding risk is undoubtedly one of the most important parts of financial education. LFF spoke to three risk management experts on the lessons learnt from the financial crisis and investors' risk tolerance.

A common definition for risk is a deviation from an expected outcome. Though human beings tend to see risk in predominantly negative terms, they have to accept that risk is part of the game. Be it a company, an investor or a fund manager, they all have to accept a certain degree of risk. Dr Luc Neuberger is Head of Risk Management at BCEE Asset Management (the Management Company of the Banque et Caisse d'Épargne de l'État), relates it to the idea of "no pain, no gain". *"If a product looks too risky or too dangerous, use your common sense and don't buy it. After some time, people discover that finance is not a magic tool; you don't realise a high return without taking risk. Unfortunately, people need to learn from experience, meaning by making errors and incurring big losses".*

Risk management is about managing risk rather than avoiding it altogether, says Professor Georg Hübner (Ph.D., INSEAD), who holds the Deloitte Chair of Portfolio Management and Performance at HEC Management School University of Liège, where he is a member of the Board of Administrators. In his opinion, every company, including financial institutions, should accept a certain degree of risk, because this is part of their activities and this is the way it is going to provide the risk premium to their shareholders. At the same time, he stresses that human beings should remain humble, because

they cannot control all of the risks. So how can they solve this conundrum? By developing the best tools to better understand at least part of the risks. Being conservative certainly helps to stay on top of situation. *"Some measurement may help get a better handle on how risk could occur but we have to be modest with these measurements because the crisis has shown that the black swan exists. A lot of corporations blew up because of this lack of modesty. Good risk management has to be complemented with scenarios and stress testing because we need to have the most creativity possible in assessing what could happen, by thinking outside the box".*

It is a fact that risk management has gained in status as a result of the crisis, but trying to avoid another crisis by emphasizing risk management too much is not realistic either. Dr Pierre Weimerskirch is Managing Partner of Luxembourg Investment Solutions S.A. (LIS), an independent management company that provides full management company services to Luxembourg-domiciled funds. As an expert for alternative asset classes, he underlines that before you invest, you generally do a thorough analysis of the products you put your money into, be it real estate or private equity. So risk management is not only ex-post but also ex-ante. But these concepts were often put aside, thus triggering and accelerating the financial crisis. *"It would be too harsh to say that risk management practices could be fully blamed for the crisis, but some of the risks were probably not analysed thoroughly when the investments were made. Investors had probably been pushing too hard when going into certain investments and frontier markets just to look for a return. If I look back at the origin of the financial crisis, there was so much repackaging of the mortgage sector that certainly the investors and banks lost sense of which types of assets they were investing in. The risk indicators were probably all right, but investors were not aware of what these risks meant at the time".*

One of the most important lessons to be learnt from this financial crisis is: risk management capabilities need to be improved and risk managers need to get a seat at the decision table. Professor Georg Hübner holds that you cannot expect directors to be risk managers, so they have to rely on specialists. At the same time, directors should have a fair understanding of the strategic elements of risk management. All in all, he believes that the risk manager needs to be independent from the rest of the organisation. *"The risk manager has the absolute responsibility to sound the alarm if he sees that there is a severe danger for the corporation. The responsibility of the director is then to listen to the risk manager and not discard his opinion on the basis that it is a cost factor for the corporation. We saw that in the DEXIA case for instance. A couple of years before the bank collapsed, the risk managers alerted the board of directors, who then dismissed their opinion, saying that top management was in line with their views in terms of profitability".*

For Dr Neuberg of BCEE Asset Management, board members are increasingly linked with the culture of risk. Fifteen years ago risk management was just a computation guy who provided some figures. Those times have passed, he believes. *"Now it is also about the governance of risk. It is not just about figures; it is also about behaviour of the portfolio. The board*

"It would be too harsh to say that risk management practices could be fully blamed for the crisis, but some of the risks were probably not analysed thoroughly when the investments were made."



"Providing data is one thing, but interpreting the figures is also very important. A computer or a mathematician is not enough; we also need experienced people".

should be informed about the best direction. It is like a GPS; are you heading in the right or wrong direction? Providing data is one thing, but interpreting the figures is also very important. A computer or a mathematician is not enough; we also need experienced people".

In the alternative funds space a lot of risk management is being done the same way as it is in the regulated UCITS (Undertakings for Collective Investment in Transferable Securities) sphere. For Pierre Weimerskirch of LIS, there is nothing wrong with using the criteria and principles from the regulated world. On the other hand, you cannot just copy the techniques because alternative funds like real estate, private equity or hedge funds are quite different animals, as he puts it.

In real estate for instance, you have the different strategies these funds are following, such as core funds and opportunistic funds. The latter are much closer to private equity but here the risk management criteria are different. The same can be said for the relationship of the risk manager with investors and companies, which is different from the one in traditional asset classes. *"When funds invest in securities, a lot of information is available from sources like Bloomberg, Reuters and others. Based on this readily available information, you develop your mathematical models in risk management. In the alternative sphere, on the other hand, it is important for the fund manager to receive key information on companies they have invested in on a regular basis. You have also to be closer to the investments your fund has realised. You probably have visited the companies you invest in and know the people who are running them".*

A totally unexpected calamity can always occur, but this is not an excuse not to improve risk management. At the end of the day, risk is contagious and it is everybody's business, be it bankers, fund managers, investors, politicians or regulators. They play different roles in society, but they belong to the same one that is likely to pay the price to quench the thirst for profit of a few irresponsible companies. **CW**



Dossier risk management

TAKING SMART RISKS

As an author of more than 90 publications on risk management and a considerable number of books, Prof. Philippe Jorion is considered a guru in that field.

Professor of Finance at the Merage School of Business at the University of California at Irvine, his research impact places him in the top 30 finance researchers in the world. In an interview with LFF, he speaks about technological innovation and catalysts of the crisis.

► LFF: HUMAN BEINGS TEND TO THINK OF RISK IN PRE-DOMINANTLY NEGATIVE TERMS. DO INVESTORS FORGET THAT RISK IS LINKED TO PERFORMANCE?

- PJ: Risk is indeed generally viewed as the possibility of negative outcomes, or losses. But in fact, taking some risk is necessary to achieve returns higher than the risk-free rate. So, risk management is not about avoiding risk but rather to take smart risks, with full awareness of the scope of outcomes.

► LFF: THE MAJORITY OF BANKS ARE IMPLEMENTING CHANGES IN RISK MANAGEMENT PROCESSES TO STRENGTHEN RISK GOVERNANCE. WHAT ARE THE MAJOR CHANGES IN REPORTING AND FORECASTING?

- PJ: Risk needs to be understood better and by more stakeholders. This requires more education at all levels. Reporting needs to be more intuitive in order for institutions to manage risk better. In terms of risk forecasting, there is more emphasis now on stress testing, which evaluates potential losses in extraordinary scenarios. Value-at-Risk still plays an important role, but is not supposed to identify extreme losses. The same risk systems can be used for stress tests.

► *LuxembourgforFinance*

RISK MANAGEMENT, EVEN WELL EXECUTED, DOES NOT GUARANTEE THAT BIG LOSSES WILL NOT HAPPEN. WHEN CAN BIG LOSSES OCCUR?

► *Philippe JORION*

Risk management will have served its purpose if losses are within the scope of outcomes described by the risk model. For example, taking a large exposure to the stock market can create large losses if the market drops sharply. Banks took large losses during the crisis because their leverage was too high. In these cases, big losses are due to large exposures. On the other hand, big losses can also happen with flawed risk models, processes, or management. The recent case of JP Morgan certainly shows that such big losses are unacceptable.



*Philippe JORION,
Professor of Finance at the Merage School of
Business at the University of California at Irvine*

► **LFF: TECHNOLOGICAL INNOVATION HAS BECOME MORE AND MORE IMPORTANT FOR FINANCIAL INSTITUTIONS. HOW CAN TECHNOLOGY HELP TO SUPPORT RISK MANAGEMENT?**

- **PJ:** Risk measurement at the top level of a large institution or portfolio can be quite complex because it can involve vast numbers of positions and risk factors. Technology can make this process faster. More importantly, however, we still need experts who can evaluate weak spots in risk models.

► **LFF: CAN RISK MANAGEMENT PRACTICES REALLY BE BLAMED FOR THE FINANCIAL CRISIS?**

- **PJ:** Not really. One of the catalysts of the crisis was the overvaluation of the U.S. real estate market, which fell in value by about \$8 trillion. Such massive numbers can only be explained by macro factors, such as monetary and government policies, in my opinion. Certainly, distorted incentives in the private sector played a role too. But we also learned that financial markets create intricate network connections. Private institutions can measure their exposure to their direct counterparties, but not their counterparties' counterparties. Such network effects can create contagion, in which case the central bank is the ultimate risk manager. **CW**

For several years now, the Luxembourg Institute for Training in Banking (IFBL) and ALRIM (the Luxembourg Association for Risk Management) have jointly organised training programmes designed for people who register for the FRM examination offered by GARP (Global Association of Risk Professionals). This qualification is considered a milestone in each risk managers' career. This year, part 1 under the leadership of Prof. Georg Hübner and Dr. Luc Neuberg was run in April 2013, part 2 will take place from 7-11 October 2013, under the leadership of Prof. Philippe Jorion.

► www.ifbl.lu

Dossier Risk management

ZERO RISK TOLERANCE

While the absence of adequate risk management practices certainly triggered the financial crisis, it basically started outside the financial sector. This is the opinion of Marco Zwick, President of ALRIM, the Luxembourg Association for Risk Management. In an interview with LFF, he speaks about controversial topics, investor's risk tolerance and lessons learnt from the crisis.



Marco **ZWICK**,
President of the Luxembourg Association
for Risk Management (ALRIM)



► LFF: WHAT ARE THE MOST CONTROVERSIAL TOPICS IN FINANCIAL RISK MANAGEMENT TODAY?

- **MZ:** The modelling of risk scenarios is a subject that has been widely debated. Critics argue that you can only test scenarios that rely on past events. As it is difficult, not to say impossible, to foresee upcoming events that have never occurred before, there are limits to defining risk models and different scenarios.

Another topic is regulation that has to be adopted by companies individually. During the financial crisis, a lot has been said about systemic risk. But I underline that this is a risk to which every firm contributes without really having any influence on, though they still have to analyse external events that are likely to impact them. The fact is that many companies first ask themselves how they will survive rather than what happens if they don't. The role of regulators – both locally and internationally – is to make sure that risk is considered in a holistic way.

► LFF: HAVE BANK AND FUND MANAGERS LEARNT THE LESSONS FROM THE FINANCIAL CRISIS WHEN IT COMES TO ASSESSING RISK?

- **MZ:** Yes, I believe they have. There is more awareness on model risk and the cyclical character of assumptions made in risk management, which themselves bear risks. If everybody looks at the same scenarios, set up under the same assumptions, everybody risks reacting in the same manner to a significant event impacting the markets, which will exacerbate the problem, even to the extent of becoming a self-fulfilling prophecy.

Another example is the creation of products like Credit Default Swaps (CDSs), which have been misused in the past. Underlying assets of CDS contracts have been insured many times over. In the end, CDSs have not been used as an insurance vehicle but for speculative purposes only. People have understood that this is not the way to invest. It is particularly encouraging to see the prohibition of short selling on countries. Naked short selling on countries, which face economic difficulties, contributes to aggravating the situation and, in my view, is contrary to moral and economically defensible investment behaviour.

► **LFF: DO YOU THINK THAT RISK MANAGEMENT WILL EMERGE STRONGER FROM THIS CRISIS?**

- **MZ:** As a risk manager, I am probably more pessimistic than other people, and when I see – such as is the case now – that the mood on the stock markets is very bullish, the time will come when everybody starts selling his stocks because the mood has become way too optimistic. Investors haven't forgotten the fragility of the financial markets, as volatility remains an issue. What is more, investors face risks they haven't encountered before. Who would have thought the unthinkable before, for instance that a bank where you deposit your money would go bust?

Institutional investors, such as pension funds and insurance companies, ask detailed questions about risk management and due diligence processes. Personally, I think that risk management, if correctly explained and marketed to investors, constitutes an essential part of strengthening investor confidence.

► **LFF: HAS THE INVESTOR'S RISK TOLERANCE CHANGED OVER RECENT YEARS?**

- **MZ:** We need to distinguish retail from professional investors. We observed retail investors going back to a more cash-based economy when the financial crisis started. They withdrew substantial amounts of cash from their banks. This meant that risk tolerance was zero and investors accepted zero capital remuneration.

Institutional investors, by contrast, focused on capital preservation. They are risk adverse but at the same time they don't expect a five per cent return every year. Consequently, their risk tolerance hasn't changed.

Generally speaking, considering low interest rates and negative performance in commodity markets, investors are returning to equity markets, which implies that risk tolerance is on the rise.

► *LuxembourgforFinance*

CAN RISK MANAGEMENT PRACTICES BE BLAMED FOR THE FINANCIAL CRISIS?

► *Marco ZWICK*

If there were no appropriate risk management practices at the time, I consider this absence to be one of the triggers of the financial crisis. However, we should not forget that the financial crisis started outside the financial sector with structural problems in the US real estate market. The vision of a number of past US Presidents was to make every US citizen a homeowner; even those people who could not afford to become one.

You get caught in a vicious cycle: housing prices increase artificially; banks grant more and more loans until the moment when the original borrowers are unable to pay back their mortgages. Though I think that the financial sector has to be blamed partly for this crisis, we must also be permitted to question how risk management was applied in public finance. Living beyond one's means doesn't work; neither in the public nor in the private sector. **CW**

SIFTING THROUGH THE RUBBLE



The financial crisis has led investors to a demand greater transparency, but it has also given them a distaste for long term commitments .

Luxembourg for Finance recently undertook a major research project to assess the effects of the financial crisis on the investment behaviour of retail and high net worth banking clients. The objective was to find out whether there had been a permanent shift in attitudes or behaviour and whether this varied by client type or country of origin.

The study was carried out by the University of Toulouse Financial Economics Group with the help of Opinium Research, who conducted the interviews. Focusing on Luxembourg's immediate neighbours Belgium, France and Germany, the study is based three sources: desk top research quantitative analysis of household savings and investment data over the period of 2004 to 2012 and the input of professionals from 33 financial institutions.

At first view the findings suggest that investor behaviour has reverted, once again, to the status quo ante bellum. However, a closer look reveals some unexpected results with regard to geographical origin and client type, and a major shift in the underlying attitudes and expectations of investors as a whole.

For instance, despite the close economic and political ties between the three markets, all hard core Eurozone members, savings and investment patterns were strikingly different from country to country with investors reacting to different events as the crisis evolved.

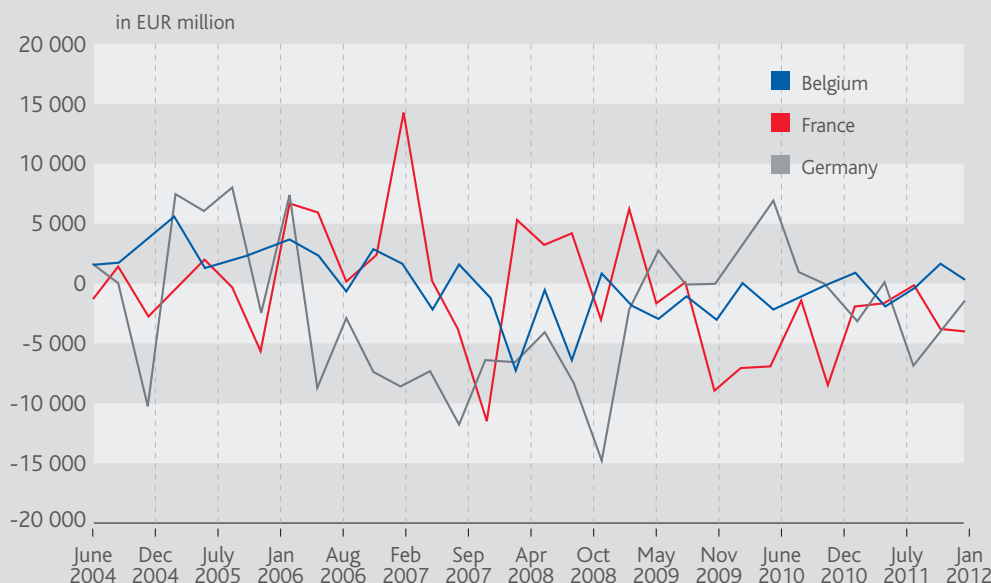
THE INFORMATION GAP HAS NARROWED

Existing studies indicated low levels of investment knowledge among retail investors at the start of the crisis, resulting in inappropriate asset allocation. However, the interviews conducted in October and November 2012 suggest that the actual differences in behaviour between retail and HNW customers was less evident than might have been expected. This may reflect a narrowing of the information gap between HNW and retail investors due to widely available and affordable media coverage of financial and economic topics.

A rapid increase in digital communications as a result of the surge in use of mobile devices will also have contributed to bridging the gap, along with the proliferation of online trading platforms.

The narrowing knowledge gap may also be due to partial breakdown (or drastic transformation) in established economic rules and assumptions during and following the crisis, eroding the authority of investment professionals and undermining the usefulness of accumulated experience, thus in a sense bringing HNW investors 'down' to the level of retail investors.

HOUSEHOLD HOLDINGS IN MUTUAL FUNDS SHOW NO CORRELATION BETWEEN MARKETS



AVERSION TO LONG TERM COMMITMENTS

Financial intermediaries report a self-declared increase in risk aversion by both high net worth and retail investors. However, actual investment behaviour contradicts this, particularly among HNW investors who have returned to pre-crisis trading patterns, albeit with shorter-dated instruments (an average six months). Retail investors are asking for security but reject structured products as being opaque in structure, cost and performance.

Both developments are worrying. With "short term" now equating to "safe", this is not likely to improve the yield of retirement savings plans. Europe needs to find a way to encourage long-term savings, a project that has been adopted by the European Commission with its Green Paper on Long-Term Financing of the European economy.

FINANCIAL INTERMEDIARIES

Of all these developments, the one that is likely to be irreversible is the change in attitudes towards financial intermediaries. Clients no longer judge their advisers in terms of risk-reward strategies. Brand name (reputation) and customer service are now cited as the most important factors by both retail and high net worth investors in all the markets observed. Risk minimisation and transparency with regard to products and fees, have emerged as a dominant concern.

In demonstrating that they understand these new priorities, financial intermediaries face a challenge. Either they must come up with "safe" products that do not look complicated, or they must find a way of explaining their products in a cost-efficient way. Ironically, the call for simplicity is likely to result in more complicated structured products. One way or another, the relationship with clients will take more work and effort than it did before the crisis.

Nothing, however, will replace the common sense of the investor. Financial education has failed to keep up with the rapid evolution of financial services, the explosion of online information or the challenge facing state pension schemes.

More must be done to educate investors. **ER**

A copy of the study, "The Janus effect" can be downloaded from the LFF website Media Centre.



SMALL BUT POWERFUL

For the second time in their history, the Games of the Small States of Europe were hosted by the Grand Duchy.

Contrary to the Olympic Games, this sporting event is not well known in Europe.

For the athletes from the participating countries (Andorra, Cyprus, Iceland, Liechtenstein, Malta, Monaco, Montenegro, San Marino and Luxembourg), it is a rare opportunity to match up against opponents at eye level.



The decision to organise games for countries with less than one million inhabitants was taken in 1984 on the occasion of the Olympic Games in Los Angeles. Officially launched in 1985, San Marino was the first country to host the games. Since then, they have taken place every two years, organised by the local European Olympic Committees.

André Hoffmann is President of the COSL, the Luxembourg Olympic and Sports Committee. *"The ultimate goal in founding the Games of the Small States of Europe was to give small states the opportunity to participate at a high level sporting event. Those countries often don't have enough high-class athletes to enable them to take part in the Olympic Games. The two-year rhythm of the games contributes on the one hand to a better sporting development of the athletes and on the other to the evolution of the sports infrastructure in the countries concerned. The games are often used as a springboard for an international career".*

This year's sporting disciplines included tennis, shooting, swimming, table tennis, gymnastics, judo, athletics, basketball, cycling, beach volleyball and volleyball. *"The organising country can choose one or two additional disciplines, apart from the fixed sports. In 2007 for instance, Monaco decided to add boules and petanque to the games. We chose gymnastics. The organiser is not obligated to organise sports that aren't practised in his country",* Hoffmann explains.

The Games of the Small Countries are also an opportunity to promote the hosting country. Thousands of visitors came to Luxembourg this time to see a match at one of several venues and to take advantage of the cultural programme that was offered around the games. With 800 athletes and their 450 companions, for one week Luxembourg was the venue of an exciting sporting event. More than 1,200 volunteers helped to keep the organisational costs low. Financing was indeed an issue for one of the participating countries, Cyprus. But the COSL, the European Olympic Committee and the Luxembourg government pooled resources to enable the participation of the Cypriot athletes: the Olympic spirit at its best. **EA**

► RESULTS 2013

	Gold	Silver	Bronze
Luxembourg	36	39	31
Iceland	28	30	30
Cyprus	28	17	24
Liechtenstein	11	15	8
Montenegro	9	0	2
Monaco	7	8	15
Malta	2	10	14
Andorra	2	1	3
San Marino	1	4	8

► ALL-TIME MEDAL TABLE

	Gold	Silver	Bronze	Total
Cyprus	390	330	295	1015
Iceland	386	278	278	942
Luxembourg	261	274	267	802
Monaco	97	119	174	390
Malta	57	103	145	305
San Marino	54	89	112	255
Liechtenstein	42	43	68	218
Andorra	38	81	99	218
Montenegro	4	2	2	8



UPCOMING LFF EVENTS



FINANCIAL MISSION TO PRAGUE AND WARSAW

► 20 - 22 October 2013

Luxembourg for Finance will organise a financial mission to Prague and Warsaw from 20 to 22 October 2013.

Seminars on the Luxembourg financial sector are planned as follows:

- Prague: Monday 21 October 2013, from 9 to 12 am
- Warsaw: Tuesday 22 October 2013, from 9 to 12 am

Each seminar will be followed by a walking lunch offering participants possibilities for networking.

If you are interested in joining Luxembourg for Finance for this financial mission, please contact Ms Sophie Henry sophie.henry@lff.lu.

LIFESTYLE

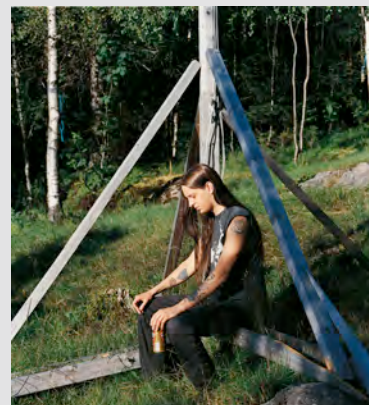
ALTARS OF MADNESS

► 18 MAY – 15 SEPTEMBER 2013

► Casino Luxembourg

The Altars of Madness exhibition project displays and brings together the works of art of a generation of artists affected by extreme metal, accompanied by a few others who were pertinent witnesses of this musical scene or brilliantly contributed to shaping its iconography. Following the three musical genres of extreme metal and their different characteristics, the exhibition is divided into three parts.

www.casino-luxembourg.lu



Torbjørn Rødland, *Fenriz no. 2*, 2001
courtesy of Air de Paris, Paris and Nils Stærk, Copenhagen

SUMMER IN THE CITY

► 21 JUNE – 14 SEPTEMBER 2013

► Luxembourg City

The Summer in the City campaign organised by the Luxembourg City Tourist Office celebrates its 16th anniversary! More than just a simple label, Summer in the City encourages participation in a campaign that creates a synergy between the organisers, tourists and the various institutions in the capital. Most of the events take place outdoors or in public spaces and are, with a few exceptions, free. Events include open-air concerts, music festivals with international artists, theatre and street art, outdoor screenings, exhibitions, markets, folk festivals and tourist attractions.

www.summerinthecity.lu

MICHAEL CLARK COMPANY

► 20/21 JUNE 2013

► Grand Théâtre

Michael Clark is an iconic British dancer, choreographer, and artist who first came to prominence in the early 1980s. His work combines the classical ballet of his training with a more complex, contemporary sensibility. He is renowned for his legendary collaborations with bands, fashion designers and visual artists including Wire, Leigh Bowery, Trojan, Peter Doig and Sarah Lucas.

www.theatres.lu

SMASHING PUMPKINS

► 9 JULY 2013

► Atelier

The Smashing Pumpkins have created one of the most acclaimed bodies of work in musical history, having sold more than 30 million albums and won multiple Grammy awards in the process. The group's many hits defined the alternative music era and continue to resonate on modern rock radio, influencing a whole new generation. The Pumpkins returned in 2007 with their acclaimed sixth album *Zeitgeist* and they have since remained on the cutting edge of music and technology with various online releases.

www.atelier.lu

REOPENING - THE FAMILY OF MAN

► 05 JULY 2013

► Clervaux Castle

The Family of Man is the artistic embodiment of an image of humanity that understands mankind as one family, regardless of nationality, race or religion. In his exhibition, Edward Steichen combines iconic photos of various photographers with the most important topics in a man's life: birth, work, war or love, to name only a few. After a long period of restoration, the exhibition can now be seen again in the North of Luxembourg.

www.steichencollections.lu

Impressum

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