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‘Lax’ Luxembourg defends regulatory regime

By Chris Newlands

Fund groups that feel an affection for Luxembourg – the world’s only remaining grand duchy that has ballooned into the second-largest investment fund centre after the US – cite its close-knit community and eagerness to please as its two significant draws.

Those very selling points, however, now appear to be causing considerable consternation for some end investors who suspect the fund jurisdiction might be, well, too close knit and eager to please.

The suggestion is that regulators are putting the needs of the fund community first and those of investors a distant second. Indeed, as reported in last week’s FTfm, Luxembourg’s financial regulator is under attack for refusing to help a group of investors who lost money in a fund that violated the grand duchy’s investment laws.

The refusal comes despite the Commission de Surveillance du Secteur Financier, the Luxembourg regulator, acknowledging that the bond fund – run by Belgian broker Petercam – had breached the jurisdiction’s fund rules.

In a letter, the CSSF said that the fund’s investments in perpetual bonds were “not permissible” as the fund’s managers said they would invest only in bonds of a limited duration. The prospectus of the fund in question, according to the CSSF, also did not comply with Luxembourg’s laws. Petercam declined to comment.

Investors are now on a campaign to highlight what they call the “lax and selective” supervision of funds listed in Luxembourg.

The campaign comes amid wider claims that investors in the grand duchy are less protected than in other EU countries. This issue took root after the 2008 Bernard Madoff fraud in which several Luxembourg-based Ucits funds funnelled money into the Ponzi scheme.

Amin Rajan, chief executive of Create Research, the fund consultancy, believes regulatory lapses are on the rise in Luxembourg due to its fierce rivalry with Dublin.

“There is a race among regulators to attract fund managers,” Mr Rajan told FTfm. “As a result of that, regulations on paper in Luxembourg are different than what is enforced.”

Luxembourg and Dublin have been competing furiously and “these regulatory lapses in Luxembourg are inevitable”, he says.

In its defence the CSSF says “it does not ignore claims made to it, but investigates them and acts as it sees fit”.

Camille Thommes, director-general of Alfi, the Luxembourg fund association, adds: “We cannot comment on this specific issue, but clearly it is important that investors have confidence in the regime of a domicile and investor protection is at the heart of fund regulation.”

Mr Thommes says that “contrary” to FTfm’s article, Luxembourg is considered to have a strong regulatory system. “Competition with any other domicile does not weaken this,” he says.

Albert Biebuyck, managing partner at Investor Protection Europe, the group representing disgruntled Petercam investors, believes otherwise. Earlier this month he sent a flurry of letters to influential industry players to complain about the regulator’s failure to offer compensation.

The list of recipients included Luc Frieden, Luxembourg’s minister of finance, Jean-Claude Juncker, the prime minister, and Steven Maijoor, chairman of the European Securities and Markets Authority.

Mr Biebuyck told FTfm: “If the [CSSF] applies the same lax and oblivious supervision approach to other Luxembourg-based funds, violations of fund investment rules will remain commonplace or even increase.”

His concerns are being heard in high places. Sven Giegold, the prominent German Green MEP promoting a plan to curtail bonuses for fund managers, recognises some of Mr Biebuyck’s criticisms: “This community is so small – much smaller than a city – and they all know each other. Even the investor protector organisations are not very critical of practises in the financial industry.”

At the time of going to press the CSSF took the unusual step of issuing a statement refuting claims that it failed to deal adequately with a Luxembourg fund that violated local regulations. Luxembourg has much to lose from not putting investors and the fund professionals on an equal footing and, unsurprisingly, the grand duchy has not taken long to act.