

## Narrative Report on Luxembourg

Luxembourg is ranked at second position on the 2013 Financial Secrecy Index. This ranking is based on a combination of its secrecy score and a scale weighting based on its share of the global market for offshore financial services.

Luxembourg has been assessed with 67 secrecy points out of a potential 100, which places it in the mid-range of the secrecy scale (see chart 1).

Luxembourg accounts for slightly over 12 per cent of the global market for offshore financial services, making it a huge player compared with other secrecy jurisdictions (see chart 2).

### Part 1: Telling the story

30 September 2013

#### The Luxembourg financial centre: history and background

##### Overview

Luxembourg is one of the world's most important secrecy jurisdictions. Sandwiched between Germany, France and Belgium at the heart of Europe, this tiny constitutional monarchy has a population of just over half a million – making it relatively easy for the financial sector to exert a strong degree of 'capture' over the political system, the media and even the zeitgeist of the entire Duchy. With commuters from across the border making up [nearly 45 percent](#) of the workforce, and foreigners making up [over 70 percent](#) of the working population, Luxembourg always had a strong international orientation, which fits its fast-developing 'offshore' character.

Faced with European Union efforts to curtail tax evasion, Luxembourg works actively and aggressively to defend financial secrecy. Alongside its secrecy offerings it has many other 'offshore' offerings: it is a prolific source of tax loopholes for transnational corporations and wealthy individuals, and it offers a wide range of opportunities in the area of lax financial regulation.

Its history as a financial centre stems from three main developments: first, tax-free facilities for non-resident corporations, dating from 1929; second, the emergence of offshore Eurodollar and 'Eurobond' activity in the 1960s, attracted by Luxembourg's regulatory laxity

Chart 1 - How Secretive?

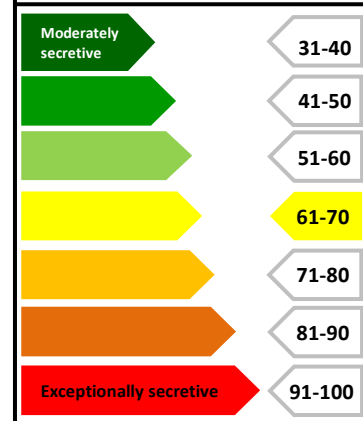


Chart 2 - How Big?



and tax-free status; and third, tight secrecy rules, first enshrined in the Banking Law of 1981. Breaking secrecy laws [can result](#) in a prison sentence. Luxembourg's secrecy score of 67 is fully deserved, indeed its role as an active political spoiler of European efforts to promote financial transparency – a role that is not reflected in our data – suggests that our index may underplay the damage inflicted on other countries by Luxembourg's financial sector.

Underpinning the financial sector, as with its competitor Switzerland and other financial centres, is the country's political stability, its neutrality, and its location at the heart of Europe, both geographically and politically: it was a [founder member](#) of the European Union. Its stability is bolstered further by the fact that politics has been dominated for the past half-century by a right-wing political party, the Chrëschtlesch Sozial Vollekspartei (CSV) which has strongly supported financial secrecy and the financial centre's 'offshore' orientation. Like Ireland, another competitor for global financial services, Luxembourg not only provides most of the offerings of 'traditional' tax havens like the Cayman Islands but its membership of the European Union and its wide range of [tax treaties](#) gives it better access to European and international markets than is available to more peripheral tax havens.

Luxembourg offers a wide range of international and offshore services, grouped into five '[strategic pillars](#)': wealth management; asset management & investment funds; international loans; insurance; and structured finance. Outside what might traditionally be regarded as the financial sector, it also runs a lucrative line in hosting holding companies of transnational corporations, principally to help them avoid (and evade) tax. It is also strenuously seeking to build up an industry based on [Islamic finance](#), and in October 2012 achieved a further fillip when a group of major Chinese banks [said they were departing](#) the (very lightly regulated) London markets in favour of the even less regulated Luxembourg.

In general terms, Luxembourg has sought to tailor specific legislation in sector after sector through a "light-touch", tax-light, rather secretive 'offshore' model, with a historically heavy emphasis on "keeping assets based in Luxembourg secret from national tax authorities," as a top Luxembourg regulator [explains](#). In this approach, Luxembourg has been highly successful: in the [words of Luxembourg for Finance](#), its promotional body, Luxembourg is the

"second largest investment fund centre in the world after the United States, the premier captive reinsurance market in the European Union and the premier private banking centre in the Eurozone."

It prides itself on being a fast mover in setting up new legislation: it claims to be the first country to define a clear legal framework for e-commerce, leading giants such as Amazon, Ebay and Skype to set up their European headquarters there, setting the stage for future tax avoidance controversies.

Luxembourg is home to alternative, specialised and venture capital investment funds, international pension funds, covered bond issuing banks, securitisation vehicles and many family wealth management companies; the country has a [six percent share](#) of the global

private banking industry, about a quarter the size of Switzerland's, boasting publicly of the sector's '[complete discretion](#)'. Its investment funds industry has assets under management worth [over \\$2.5 trillion](#), as well as 140 banks with some [\\$800 billion](#) in assets under management in 2011. The Luxembourg stock exchange is the [biggest](#) in Europe for the listing of international bonds, with over 40 percent of the total, and despite being landlocked, Luxembourg even has a [shipping registry](#).

Banking secrecy is based significantly on the privileged nature of professional lawyer-client relationships, rather than classic Swiss-styled banking secrecy; however other forms of secrecy are provided. In September 2013 Luxembourg was on the verge of approving a new Private Foundations law (see TJN's post [here](#)) that would create powerful new secrecy facilities for wealthy individuals – a move that has added three full points to Luxembourg's secrecy score. It is also [reportedly setting up](#) a major high-security warehouse to help clients store assets such as paintings, gold bars or bearer bonds with minimal or no disclosure to foreign tax authorities. Complementing all these offshore facilities, Luxembourg is also a major haven for transnational corporations, actively helping them carry out transfer pricing and other abuses through the provision of multiple and deliberately crafted tax loopholes.

Hosting large tax-evading and other criminal assets from around the world, Luxembourg has historically flown under the radar, attracting far less criticism than Switzerland. Luxembourg has a well resourced lobbying network that has actively sought to undermine criticism of its role as a secrecy jurisdiction, with repeated claims that it is 'not a tax haven' and sometimes somewhat repressive moves against its few domestic critics. TJN's director John Christensen has called Luxembourg the "Death Star" of financial secrecy inside Europe because of its [leading role](#), in close political partnership with Switzerland and Austria, in fighting against information-sharing schemes in Europe.

## History

Although Luxembourg today rivals Switzerland in size and scope as a European secrecy jurisdiction, the origins of its financial sector are far younger. Emerging as a neutral and partly independent (impoverished) nation only in 1867, Luxembourg did not gain its own independent ruling family until 1890. Rapid economic growth for much of the early part of the 20<sup>th</sup> Century was based on large iron ore deposits and the emergence of a strong iron and steel industry.

In 1929 Luxembourg took its first steps as an offshore financial centre with a new regime for holding companies, under which transnational corporations could establish 'holding company' subsidiaries in Luxembourg (set up purely to own assets elsewhere) that would be exempt from income and capital gains tax. Although justified as a way to help transnational corporations avoid getting taxed twice (once in their 'home' country and then again in the country where they were investing,) in reality they were used increasingly to achieve double *non*-taxation: that is, to escape tax in both countries.

In the 1960s, the Luxembourg financial industry began to take off properly. The big milestone – a top Luxembourg financier [suggested](#) this was Luxembourg’s financial “Big Bang” – was the launch in July 1963 of the world’s first ever offshore Eurobond (for the Italian motorways company Autostrade.) Though the deal itself was mostly hammered together in the City of London, it was listed on the Luxembourg stock exchange: partly for tax reasons, and partly due to Luxembourg’s regulatory laxity (for example, the bond issue [did not even](#) require a prospectus). By the year’s end there were already 93 bonds listed there (and four decades later, that figure had grown to about 20,000.) The Eurobond markets are a central pillar of the larger [Euromarkets](#) today.

Eurobonds were bearer bonds: classic tax evasion and secrecy instruments because no withholding tax was charged, and whoever physically held them in their hands was entitled to the income and capital. The Euromarkets got a large boost [in 1965](#) when U.S. President Johnson, worried about Vietnam-era deficits, tried to restrain U.S. companies from sending capital abroad to invest overseas: in response, U.S. corporate giants started seeking funding from Euromarket centres such as Luxembourg for their non-U.S. investments.

Meanwhile, Luxembourg banks enjoyed a growing stream of individual customers from neighbouring Germany, Belgium and France: a steady flow of middle-class or wealthier citizens from those countries who would present their bonds and attached coupons at local banks and be paid in cash, no questions asked. Beth Krall, a banker who worked in a Luxembourg bank’s back office in the Eurodollar boom years, gave a flavour ([Treasure Islands p216](#)) of those times:

‘We were dealing with those “Belgian dentists” who keep bonds under the mattresses,’ Krall remembers. ‘Sometimes they all came in at once – what we called the coupon bus would arrive. They came from Belgium, Germany, the Netherlands, filling the lobby, spilling out the door, getting angry, waving their coupons and getting their cheques.’ The vaults held, among other things, *enveloppes scellées* (sealed envelopes) relating to ‘Henwees’ – HNWI or high net worth individuals. ‘We didn’t know what the hell was in there,’ she said. ‘The private bankers and relationship managers put those things in there – we never had an inkling.’

Clients increasingly came from further afield too: American banks, along with German and Swedish ones (and others) rapidly moved in. Parallel to the Eurobond markets, Luxembourg widened its spectrum of activities to private banking and investment funds in particular.

Luxembourg’s regulatory laxity, tolerance of bearer bonds, secrecy and tax-free benefits has attracted significant criminality over the years. It was no coincidence that the global fraudster Bernie Cornfield [established](#) his first mutual fund in Luxembourg in 1962. Later, the Bank of Credit and Commerce International (BCCI), widely regarded as the most corrupt bank in history, incorporated itself jointly in Luxembourg and Cayman, (with headquarters in London.) Each centre provided the tax-free status and required lack of scrutiny – allowing

BCCI to get involved in the financing of terrorism, drugs smuggling, slavery, tax evasion, fraud, racketeering and much more. In March 2010, newspapers reported that Luxembourg hosted US\$4 billion in assets for North Korean leader Kim Jong-Il, which were shifted there after Swiss banks tightened up procedures. As the *Telegraph* newspaper [reported](#):

“Mr Kim’s operatives then withdrew the money - in cash, in order not to leave a paper trail - and transferred it to banks in Luxembourg. The money is the profits from impoverished North Korea selling its nuclear and missile technology, dealing in narcotics, insurance fraud, the use of forced labour in its vast gulag system, and the counterfeiting of foreign currency.”

*Luxembourg For Finance*, the financial industry’s lobbying arm, told TJN in an interview in 2011 that that particular report was entirely false.

Luxembourg’s financial regulator, the Commission de Surveillance du Secteur Financier (CSSF), is riddled with conflicts of interest. As the IMF [politely reported](#) in 2011,

“The current legal framework does not sufficiently guarantee the full operational independence of the CSSF; the CSSF is placed under the direct authority of the Minister; its missions include the “orderly expansion” of Luxembourg’s financial center; its general policy and budget are decided by a Board whose members are all appointed by the government upon proposals from supervised entities and the Minister.”

In September 2013, an investor-protection group called Protinvest sent a letter to EU Commissioner Michel Barnier, highlighting the conflicts of interest. As summarised by the [Financial Times](#):

"The head of ProtInvest, an investor-protection group, has sent a letter to Michel Barnier, an EU commissioner, in which he criticised Mr Frieden’s move to appoint his senior adviser Sarah Khabirpour to the board of the CSSF, the country’s financial regulator. The letter pointed out Ms Khabirpour also sits on the board of Banque International a Luxembourg, one of the country’s biggest banks, and is a director of the Luxembourg Stock Exchange – both institutions the CSSF regulates.

Ms Khabirpour’s multiple jobs showcase the cosy relationships that tie Luxembourg’s business community, which centres largely on fund management, to its regulators and political leaders."

Partly as a consequence of the financial sector’s heavy influence on supervision, Luxembourg has also been implicated in major global frauds, and its regulators are often assailed for apparently deliberately turning a blind eye to them, in an effort to attract funds. A searing [December 2011 letter](#) by Deminor, on behalf of 2,500 investors defrauded by Bernie Madoff, was coruscating in its attack on Luxembourg’s regulatory laxity, concluding that auditors had

turned a blind eye, the authorities had turned a blind eye, Luxembourg financial institutions had lent their credibility to fraudsters by serving as little more than ‘letter box companies’ – and that ‘none of these institutions has been held accountable to date.’ Later, a May 2013 *Financial Times* story entitled ‘[Lax’ Luxembourg fund rules attacked](#)’ reported that groups of investors were campaigning to highlight what they call the ‘lax and selective supervision of Luxembourg-listed funds’, and quotes a fund consultant as saying that regulatory lapses are on the rise in Luxembourg, amid fierce competition in laxity with Dublin in particular (see more [here](#)).

### Europe’s “Death Star” of financial secrecy

In contrast to the systemic global importance of Luxembourg's financial system, the [assessment of](#) Luxembourg's anti-money laundering regime by the Financial Action Task Force in 2010 was devastating. Out of 49 assessed criteria, only one has been rated as compliant, nine as largely compliant, 30 as partially compliant, and nine as non-compliant. Our [database report](#) has various other examples of failings in the Luxembourg’s supervisory apparatus: many of them deliberately crafted as part of the jurisdiction’s see-no-evil offshore model.

What is more, the European Union has for some years been trying to boost financial transparency through its Savings Tax Directive, under which member states (and other participants) automatically share information with each other on certain types of cross-border income, or withhold tax. The Directive is full of holes, but work is underway to plug them. Under the Directive, nearly all EU members have agreed to the gold standard of “automatic information exchange”, under the savings tax directive - but EU members Luxembourg and Austria have refused. Most importantly, the Directive is subject to a series of powerful Amendments, still awaiting approval, which will close the most egregious loopholes and would be expected to bring large amounts of income accruing to European taxpayers into the appropriate tax net. But Luxembourg – in alliance with Austria and Switzerland – is engaged in a [complex political dance](#) to sabotage progress on these Amendments: Switzerland says it will not yield on secrecy unless Luxembourg and others do; meanwhile Luxembourg has cited bilateral [Swiss deals](#) with the UK, which [politically undermine](#) the directive, as a reason for blocking further progress. Read more about this dance of the secrecy jurisdictions [here](#).

Luxembourg premier Jean-Claude Juncker has publicly [expressed](#) his preference for European financial policies to be conducted only in ‘secret, dark debates’. In discussions about progress in Europe on transparency, he has notably [said](#), in a testament to Luxembourg’s skilful use of delaying tactics to prevent transparency: “I look forward to many years of fascinating and fundamental discussions.”

### Mouldy political governance, repression of critics

Like many small secrecy jurisdictions, Luxembourg has poor political governance related to financial sector policies – even though broadly it is a social democratic state with fairly strong redistributive policies locally. The Luxembourg analyst Jérôme Turquey [describes](#) “an insulated culture that systematically excludes any information that could contradict its reigning picture of reality,” adding that “dishonest professionals fail to be pushed out of business, in large part because of Luxembourg’s small size where ‘everybody knows everyone else’ – and this creates conflicts of interest.” The conflict between financial sector governance and wider political governance is consistent with a pattern common in offshore centres, where financial actors require governance of the financial sector to be ring-fenced against domestic politics, and thus rather immune to appropriate reform, all under the financiers’ threat of ‘don’t tax or regulate us too much or we will run away to Geneva / London / Hong Kong.’ (This broad phenomenon of ‘country capture’ by financial services, common in many financially-dependent economies, is documented painstakingly in the e-book, [The Finance Curse](#).)

Luxembourg has at times proven to be quite harsh when its financial sector is criticised. The local media only rarely dares speak out against finance or financial secrecy, and numerous examples exist of the repression of alternative views. For example, in October 2008 Arlette Chabot, information director for French TV station France 2, had to write a [craven apology](#) to Luxembourg after airing a programme (which was admittedly rather short on specifics) critical of its financial secrecy. In July 2009, when a group of non-governmental organisations (NGOs), the [Cercle de Coopération](#), published a report in July 2009 critical of Luxembourg’s status as a secrecy jurisdiction, and pointing out a deep conflict with its foreign aid policies, the response was ferocious. Prime Minister Jean-Claude Juncker in a long [speech](#) lambasted it as a ‘primitive study’ and told the NGOs that they should refrain from criticising the financial sector; the Cercle was forced to withdraw the study within a week. (The Luxembourg Bankers’ Association cited ‘inaccuracies’ in the report yet has so far failed to offer correct statistics when challenged to do so.) The German NGO WEED has made the study available [here](#).

Perhaps the best known victim of Luxembourg’s approach is Denis Robert, a French journalist whose 2001 book *Revelation* about the Luxembourg-based clearing house Clearstream, alleging its role in facilitating money-laundering and flows of dirty money, led to him being subjected to almost sixty lawsuits in French, Belgian and Luxembourg courts.<sup>1</sup> Later, in August 2011, the Wall St. Journal [reported](#) that a group of nearly 1,000 U.S. victims of terrorism were suing Clearstream for helping Iran move money connected to the 1983 bombing of a U.S. Marine Corps barracks in Beirut.

In a testament to Luxembourg’s willingness to accommodate financial interests in whatever they want – a classic feature of any secrecy jurisdiction – the Luxembourg Bankers’

Association (ABBL) boasts that one of Luxembourg's core [strengths is](#) "easy access to decision-makers; limited red tape." The authoritative Progressive Tax Blog [added](#):

"It is well known jibe within the industry that favourable low-tax deals with the Luxembourg tax authorities can be reached over dinner (Michelin starred of course.)"

A Luxembourg-based correspondent added these striking words, sent to us by email:

"One very important aspect of the Luxembourg financial centre is the absolutely scandalous discrepancy between the texts of the law, and their application in everyday judicial life. . . . while international pressure managed to force Luxembourg to adapt stricter legal constraints to the financial activities under its jurisdiction, looking into the lack of judicial application of said constraints becomes even more important.

. . .

Unlike in larger countries, there is no such thing as an independent representation of any civil interests in a tiny country like Luxembourg. You just don't make it in this country unless you've proven your absolute loyalty to the system in place, including being ok (if not more) with all of its malpractices."

Other extraordinary allegations against Luxembourg's system are available, such as [this one](#), whose allegations we cannot verify but which do clearly raise uncomfortable questions.

All of this is, again, closely consistent with our [Finance Curse analysis](#).

#### Read more:

- This 2007 [New York Times story](#), looking at Luxembourg's lobbying in defence of special tax privileges enjoyed by the likes of iTunes, Skype, eBay, AOL, Amazon and other big Internet companies, provides an example of its role (and to see a photo of itunes' massive European holding company, illustrating its 'letter box' nature, click [here](#).)
- For a technical description of how Luxembourg is used to escape tax, see the Progressive Tax Blog's [exploration](#) of the UK's Vodafone case.
- [Fragen aus entwicklungspolitischer Sicht, Cercle de Coopération a.s.b.l., July 23, 2009](#)

#### Next steps for Luxembourg

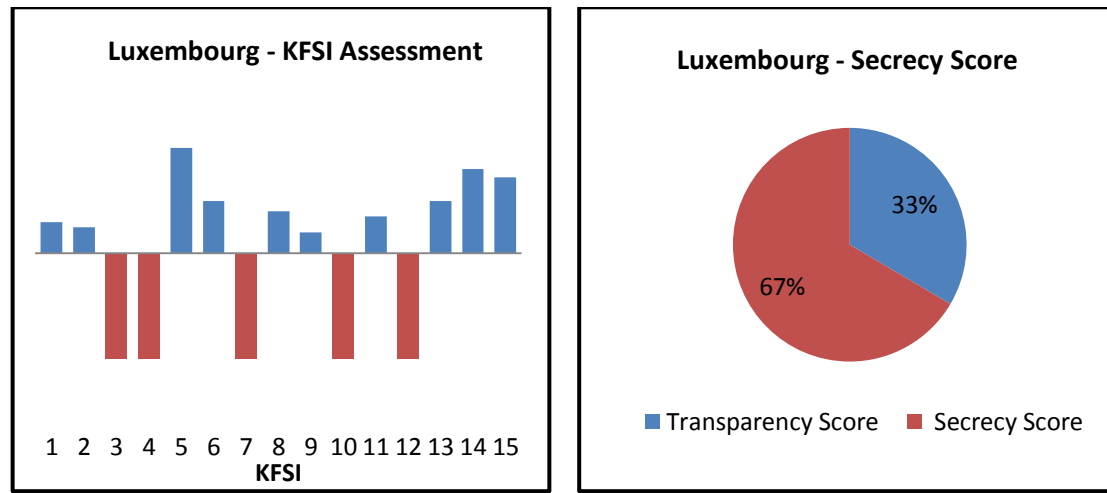
Luxembourg's 67 per cent secrecy score shows that it must still make major progress in offering satisfactory financial transparency. If it wishes to play a full part in the modern financial community and to impede and deter illicit financial flows, including flows originating from tax evasion, aggressive tax avoidance practices, corrupt practices and



criminal activities, it should take action on the points noted where it falls short of acceptable international standards. See part 2 below for details of Luxembourg's shortcomings on transparency. See this link <http://www.financialsecrecyindex.com/kfsi> for an overview of how each of these shortcomings can be fixed.

## Part 2: Secrecy Scores

The secrecy score of 67 per cent for Luxembourg has been computed by assessing the jurisdiction's performance on the 15 Key Financial Secrecy Indicators, listed below.



The numbers on the horizontal axis of the bar chart on the left refer to the Key Financial Secrecy Indicators (KFSI). The presence of a blue bar indicates a positive answer, as does blue text in the KFSI list below. The presence of a red bar indicates a negative answer, as does red text in the KFSI list. Where the jurisdiction's performance partly, but not fully complies with a Key Financial Secrecy Indicator, the text is coloured violet in the list below (combination of red and blue).

This paper draws on key data collected on Luxembourg. Our data sources include regulatory reports, legislation, regulation and news available at 31.12.2012<sup>2</sup>. The full data set is available [here](#)<sup>3</sup>. Our assessment is based on the 15 Key Financial Secrecy Indicators (KFSIs, below), reflecting the legal and financial arrangements of Luxembourg. Details of these indicators are noted in the following table and all background data can be found on the [Financial Secrecy Index website](#)<sup>4</sup>.

The Key Financial Secrecy Indicators and the performance of Luxembourg are:

<b>TRANSPARENCY OF BENEFICIAL OWNERSHIP – Luxembourg</b>	
1.	Banking Secrecy: Does the jurisdiction have banking secrecy?  <b>Luxembourg does not adequately curtail banking secrecy</b>
2.	Trust and Foundations Register: Is there a public register of trusts/foundations, or are trusts/foundations prevented?  <b>Luxembourg partly discloses or prevents trusts and private foundations</b>
3.	Recorded Company Ownership: Does the relevant authority obtain and keep updated details of the beneficial ownership of companies?  <b>Luxembourg does not maintain company ownership details in official records</b>
<b>KEY ASPECTS OF CORPORATE TRANSPARENCY REGULATION – Luxembourg</b>	
4.	Public Company Ownership: Does the relevant authority make details of ownership of companies available on public record online for less than US\$10/€10?  <b>Luxembourg does not require that company ownership details are publicly available online</b>
5.	Public Company Accounts: Does the relevant authority require that company accounts are made available for inspection by anyone for a fee of less than US\$10/€10?  <b>Luxembourg requires that company accounts be available on public record</b>
6.	Country-by-Country Reporting: Are all companies required to comply with country-by-country financial reporting?  <b>Luxembourg partly requires country-by-country financial reporting by some companies</b>
<b>EFFICIENCY OF TAX AND FINANCIAL REGULATION – Luxembourg</b>	
7.	Fit for Information Exchange: Are resident paying agents required to report to the domestic tax administration information on payments to non-residents?  <b>Luxembourg does not require resident paying agents to tell the domestic tax authorities about payments to non-residents</b>

8.	<p>Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information efficiently, and is there a large taxpayer unit?</p> <p><b>Luxembourg partly uses appropriate tools for efficiently analysing tax related information</b></p>
9.	<p>Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments?</p> <p><b>Luxembourg partly avoids promoting tax evasion via a tax credit system</b></p>
10.	<p>Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses?</p> <p><b>Luxembourg allows harmful legal vehicles</b></p>
<b>INTERNATIONAL STANDARDS AND COOPERATION – Luxembourg</b>	
11.	<p>Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations?</p> <p><b>Luxembourg does not comply with international anti-money laundering standards</b></p>
12.	<p>Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive?</p> <p><b>Luxembourg does not participate fully in Automatic Information Exchange</b></p>
13.	<p>Bilateral Treaties: Does the jurisdiction have at least 46 bilateral treaties providing for information exchange upon request, or is it part of the European Council/OECD convention?</p> <p><b>As of 31 May, 2012, Luxembourg had less than 46 tax information sharing agreements complying with basic OECD requirements</b></p>
14.	<p>International Transparency Commitments: Has the jurisdiction ratified the five most relevant international treaties relating to financial transparency?</p> <p><b>Luxembourg has partly ratified relevant international treaties relating to financial transparency</b></p>
15.	<p>International Judicial Cooperation: Does the jurisdiction cooperate with other states on money laundering and other criminal issues?</p> <p><b>Luxembourg partly cooperates with other states on money laundering and other criminal issues</b></p>

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<sup>1</sup> French courts in 2004 and 2008 ruled that he had failed to prove his allegations and that he should pay multiple damages; his French publisher estimated that the claims for damages exceeded its annual turnover. Important evidence that would have supported Robert's case was removed (and presumably destroyed) in Luxembourg police raids on the family homes and workplace of Regis Hempel, one of the key players in the affair. However, Robert won a final victory in the [French Court de Cassation](#) in February 2011 which [ruled that](#) he was protected by freedom of speech and of the press. (When Robert, fresh from his victory, staged an art exhibition in a Luxembourg shop, the owner [complained](#) that passersby had spat at his window.)

<sup>2</sup> With the exception of KFSI 13 for which the cut-off date is 31.05.2013. For more details, look at the endnote number 2 in the corresponding KFSI-paper here:

<http://www.financialsecrecyindex.com/PDF/13-Bilateral-Treaties.pdf>.

<sup>3</sup> That data is available here: <http://www.financialsecrecyindex.com/database/menu.xml>.

<sup>4</sup> <http://www.financialsecrecyindex.com>.