

# NARRATIVE REPORT ON LUXEMBOURG



## PART 1: NARRATIVE REPORT

### Overview and background

The Grand Duchy of Luxembourg is ranked sixth in our 2018 Financial Secrecy Index, based on a moderate secrecy score of 58 and a very large share of the market for offshore financial services, at over 12 percent of the global total. Its' position is largely unchanged since our 2015 index.

Sandwiched between Germany, France and Belgium at the heart of Europe, this tiny constitutional monarchy has a population of just over half a million, allowing its enormous financial sector to achieve a strong degree of 'capture' over the political system, media and culture of the entire Duchy. Criticism of the sector, and discussion about its relationship to society, used to be exceedingly rare, though the LuxLeaks revelations in 2014 are helping to change this.

As in Switzerland, the offshore financial sector has been underpinned by a history of political stability. This is bolstered by Luxembourg's position at the geographical heart of Europe, catering largely to its immediate neighbours – and also its role as a [founder member](#) of the European Union.<sup>1</sup> This latter factor has provided Luxembourg privileged access to the European market that other offshore centres cannot match; and Luxembourg also enjoys considerable political support from European economic élites who benefit from its offshore services. These factors have often protected it against being blacklisted or pressured to change.

Until recently we were calling Luxembourg the “Death Star” of financial secrecy in Europe, due to its highly aggressive stance in fighting European transparency initiatives. Between 2013 and 2015 Luxembourg has joined various international transparency initiatives and made significant improvements in its financial transparency. We attribute this *relative* change of heart above all to the evolving international climate on transparency, combined with high-profile global scandals that have cast the tax haven in a highly negative light. These changes also coincide with the departure of Prime Minister Jean-Claude Juncker, arguably the most important architect of the secretive modern tax haven. However, the improvements, noted on the publication of our 2015 Financial Secrecy Index, have not continued to 2018. (Indeed, Juncker's successor, Xavier Bettel, has [stated that](#) “I am fed up with being accused of being a defender of a tax haven and a hotbed of sin”.) Yet of course the tax haven was always nurtured and promoted by an élite consensus that goes far beyond Juncker, underlining the fact that external pressures are the core driver of change.

Despite these improvements, Luxembourg remains one of the world's most important secrecy jurisdictions, hosting a range of financial and other activities that foster illegality or abuses elsewhere – including a new high-security 'freeport' warehouse to store assets such as paintings, gold bars or bearer bonds, with ample opportunity for financial mischief.<sup>2</sup> A new unregulated investment fund for 'well-informed' investors ([Reserved Alternative Investment Fund](#),<sup>3</sup> or RAIF) has recently been launched which can be used to hold '[tangible assets such as art](#)<sup>4</sup> or to run [hedge funds that are not subject to regulatory approval](#).<sup>56</sup> Financial secrecy is based significantly on the privileged nature of professional lawyer-client relationships, rather than classic Swiss-styled banking secrecy. For instance, investors can hide behind

Rank: 6

Chart 1 - How Secretive?

58  
Secrecy Score

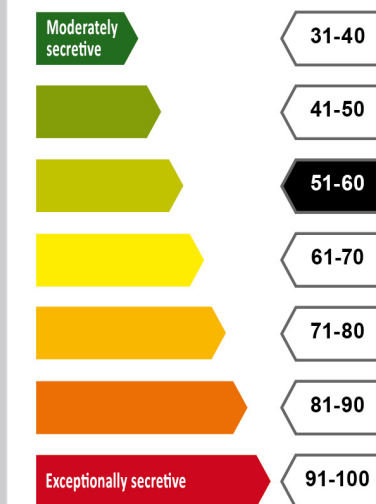
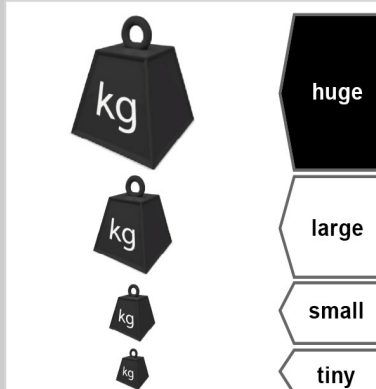


Chart 2 - How Big?



Luxembourg accounts for more than 10 per cent of the global market for offshore financial services, making it a huge player compared with other secrecy jurisdictions.

The ranking is based on a combination of its secrecy score and scale weighting.

Full data on Luxembourg is available here: [www.financialsecrecyindex.com/database](http://www.financialsecrecyindex.com/database).

To find out more about the Financial Secrecy Index, please visit [www.financialsecrecyindex.com](http://www.financialsecrecyindex.com).

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Luxembourg companies whose officers are bound by these relationships not to divulge details of who owns them. The Panama Papers mentioned [400 financial intermediaries in Luxembourg](#).<sup>7</sup>

‘Family offices’ manage private wealth across the generations, and since 2007 a specific entity has been available for private wealth management, the ‘[family wealth management company](#)’,<sup>8</sup> which is a passive investment vehicle for the acquisition, holding or sale of assets. As [Deloitte Luxembourg points out](#) to its clients,<sup>9</sup> it is free of all taxes (except a minuscule subscription tax) and there is ‘no access to tax treaties and European directives’.

Luxembourg is the [second largest home](#) of funds after the US.<sup>10</sup> A fund, if used by an individual or family, can potentially act as a wrapper to protect against being identified as the beneficial owner of the underlying assets and the income they produce. For example, if a fund is incorporated as a company and opens a bank account, under current insufficient beneficial ownership identification rules the bank collects ownership information - used for automatic tax information exchange with other countries under the new OECD Common Reporting Standard – based on a 25% ownership threshold. If nobody holds that much, which is simple to arrange, then they may not be identified and the information is not exchanged.

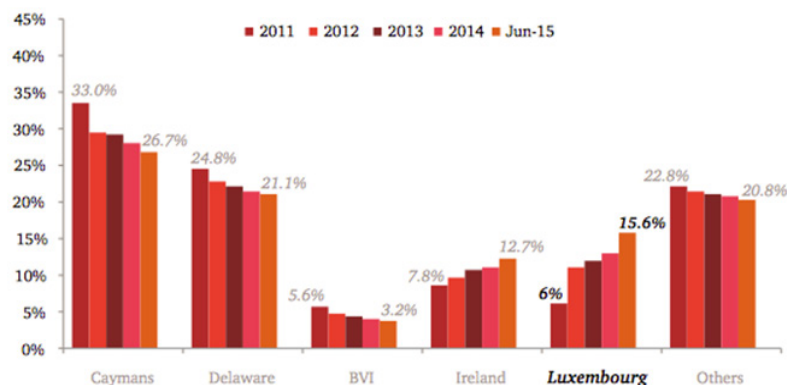
Luxembourg takes secrecy seriously: breaking professional secrecy [can result](#) in a prison sentence.<sup>11</sup> In January 2018 a welcome turn of events saw Antoine Deltour, one of the two the whistleblowers, who exposed the so-called “Luxleaks” scandal, have [his conviction overturned](#) while the conviction against his fellow whistleblower, Raphael Halet was upheld.<sup>12</sup> And while Luxembourg has taken action to

improve its previously poor track record on providing offshore secrecy, it has continued to expand its role providing letterbox companies to help multinational corporations avoid paying tax in other countries. It remains a centre of lax financial regulation, which potentially poses global financial stability risks. New initiatives to [diversify the economy into the information age](#),<sup>13</sup> develop itself as a centre for green and ‘[climate finance](#)’<sup>14</sup> and the exploitation of [outer space resources](#) (yes, really<sup>15</sup>) have yet to prove themselves.

More broadly, Luxembourg is also one of the world’s most important – and growing - financial centres, and its offerings go far beyond the provision of secrecy – though most of these sectors depend quite heavily on offering regulatory escape from other countries’ rules. Luxembourg is the most important private banking and wealth management centre in the Eurozone, with 143 banks holding [nearly 800 billion euros](#) in assets,<sup>16</sup> providing liquidity to their mostly foreign owners. Of these assets, 350 billion is in the secretive private banking sector (up from [300 billion](#) when we published the 2015 FSI<sup>17</sup>), and more than half of private banking assets are owned by ‘ultra high net worth individuals’ holding over 20m euros each. It is the world’s [second largest](#) investment fund centre after the United States<sup>18</sup> – and fund management, with assets under management worth nearly [3.8 trillion euros](#), is the most important part of the financial centre.<sup>19</sup>

Luxembourg also has a long history in hosting international bonds; it is a big player in insurance and reinsurance; and in structured finance and securitisation vehicles. It is the world’s [third largest centre](#) for the domicile of hedge funds,<sup>20</sup> after the Caymans and Delaware, and is growing fast at their expense, as [this graph](#) shows.<sup>21</sup>

**Evolution of the worldwide share of hedge funds by domicile**

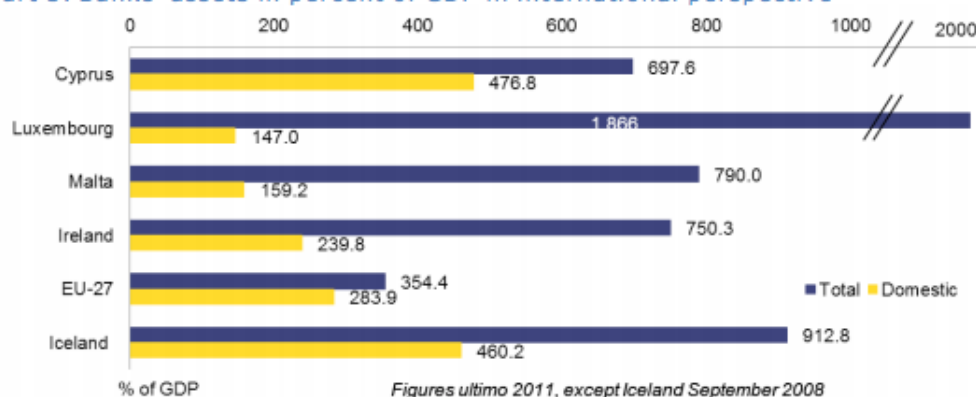


Source: HFR

Outside the traditionally-defined financial sector it also runs a lucrative line in hosting holding companies of transnational corporations, and facilitating the setting up of structures – notably its now infamous ‘tax rulings’ – to help them avoid and evade tax. It is strenuously seeking to build up an industry based on [Islamic finance](#)<sup>22</sup> and despite its historically European (particularly German) focus, it is actively courting offshore financial players in Asia, notably China. Luxembourg claims to be the second largest domicile for investment funds investing into mainland China, after Hong Kong (see p16 [here](#)).<sup>23</sup> Despite being landlocked, Luxembourg even has an offshore [shipping registry](#).<sup>24</sup>

The graph below, based on [end-2012 data](#) from the European Commission,<sup>25</sup> shows the extreme size of bank assets relative to the economy – another pointer to financial ‘capture.’

Chart 3: Banks' assets in percent of GDP in international perspective



Sources: ECB, Central Bank Iceland, Ameco

## History of Luxembourg's offshore financial centre

### Pre-history

Although Luxembourg today rivals Switzerland in size and scope as a European secrecy jurisdiction, the origins of its financial sector are far younger.

There is some dispute as to when Luxembourg emerged as a nation: it has been an autonomous political unit since the 10<sup>th</sup> Century and a long history of being a Duchy, owned over the centuries by successive European powers. The ancient Saxon name of its capital city Lucilinburhuc was “Little Fortress”, symbolising its strategic position astride major military (and trading) routes linking Germanic and Frankish territories. Interestingly, historical trading ‘nodes’ have often ended up as secrecy jurisdictions, as our reports on [Singapore](#),<sup>26</sup> [Hong Kong](#),<sup>27</sup> and [Dubai](#)<sup>28</sup> attest. Independence was

formally ratified in 1867, but even then it remained a possession of the Kings of Netherlands and only slowly did it gain true independence, eventually formally abandoning political neutrality and joining NATO after the Second World War.

The discovery of large iron ore deposits and the emergence of a strong iron and steel industry in the early years of the 20<sup>th</sup> Century, bolstered by policies that insisted on transforming the ore locally, underpinned an era of rapid growth.

Its history as a financial centre stems from three factors: first, tax-free and secrecy facilities for non-resident corporations, dating from 1929 (though only economically significant until much later); second, the emergence of offshore Eurobond activity in the early 1960s, particularly involving German banks wanting to take advantage of almost

non-existent banking regulation in Luxembourg; and third, banking secrecy which was *de facto* in place from the outset, but decisively strengthened and solidified with the [1981 Banking Act](#).<sup>29</sup>

Luxembourg has sought to create and 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 [explained](#).<sup>30</sup> Its high ranking on the Heritage Foundation’s [index](#)<sup>31</sup> for “investment freedom” is testament to this lax approach (although interestingly it has slipped from first place to sixth since our 2015 FSI, possibly due to the changes detailed below), and goes a long way towards explaining why Luxembourg has become so important in global investment funds today.

In an effort to diversify the economy away from its

overreliance on the financial sector, the government has launched a study and broad consultation process on the “[Third Industrial Revolution](#)”,<sup>32</sup> alongside its “[Digital Lëtzebuerg](#)” strategy<sup>33</sup> for investment in ICT infrastructure, as well as digital innovation and skills. While some of the endeavours, like the new-fangled [Space Resources](#) initiative,<sup>34</sup> look truly innovative on the surface, worries remain, however, that the [underlying motivation](#) remains the same as with past secrecy jurisdiction: the exploitation of Luxembourg’s most valuable resource, i.e. national sovereignty, for financial gain.<sup>35</sup>

## Offshore: early beginnings

Luxembourg’s first real steps as an offshore financial centre began in 1929 with a new legal regime for 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. European companies quickly noticed that such structures could be used to escape tax, in considerable secrecy. This was classic ‘offshore tax haven’ activity.

However, for many years this sector made a relatively modest contribution to Luxembourg GDP; it was only in the 1960s that the Luxembourg financial sector began to take off. The big milestone – a top Luxembourg financier [suggested](#)<sup>36</sup> 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. Until then, under the constraints of the Bretton Woods architecture which heavily restricted cross-border financial activities, bonds were largely domestic affairs: French investors would raise funds for French companies in French Francs, for example.

Though the nuts and bolts of the Autostrade deal itself were mostly hammered together in the City of London, the bond offering was listed on the Luxembourg stock exchange, at the suggestion of Edmond Israel, the deputy to City banker Siegmund Warburg. Luxembourg was chosen not just for its position in Europe but also for its lack of financial sector regulations: [there were, for example](#)<sup>37</sup> no stamp duties; no withholding taxes, and the bond issue [did not even](#) require a prospectus.<sup>38</sup>

The bond offering was a financial success and many others followed rapidly: by year’s end 1963 there were already 93 bonds listed in Luxembourg (and four decades later, that figure had grown to about 20,000.) 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.

Beth Krall, a banker who worked in a Luxembourg bank’s back office in the Eurodollar boom years, gives a flavour 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 [or, as [some called it](#),<sup>39</sup> the *train des fraudeurs*]. 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.” ([Treasure Islands p216](#))<sup>40</sup>

The launch of the Eurobond markets (and the wider “[Euromarkets](#)”,<sup>41</sup> which included currencies too) marked a new era in the globalisation of finance that would within a few years break apart the high-growth “golden age” Bretton Woods era and replace it with a new era of rapid financial expansion: an era also marked by greater volatility and frequent economic crises, mushrooming debt, lower growth and rising inequality.

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 ever more funding from Euromarket centres such as Luxembourg for their non-U.S. investments.<sup>42</sup> As European and U.S. corporates began to notice Luxembourg’s *laissez-faire*, see-no-evil approach to corporate business, bankers from these countries rapidly followed. Parallel to the Eurobond markets, Luxembourg widened its spectrum of activities to private banking and investment funds in particular, and kept expanding into new sectors with specific pieces of legislation designed to tempt the world’s hot money.

Less dramatically, the business of setting up secretive letter box companies in Luxembourg for foreign individuals and multinationals was quietly gathering pace. As early as 1973 France and Germany demanded a crackdown on these, but Luxembourg’s role as a European Union founder and member enabled it to lobby to head off any action: efforts [continue today](#).<sup>43</sup>

The collapse of Luxembourg iron ore mining from the 1970s – the last iron mine closed in 1981, and the

steel industry was by then a shadow of its former self – saw policy makers increasingly seeking to bolster the financial sector, which by 1981 was already the [dominant contributor](#) to GDP,<sup>44</sup> rapidly dwarfing all other sectors. The Banking Act of 1981 for the first time legally bound bankers to keep their client information secret, formalising practices that had long been in place.

Luxembourg's small size and incestuously connected élites have enabled the offshore financial sector to achieve and maintain a remarkable degree of 'political capture'. This capture explains why major political decisions relating to financial services can be taken quickly and with little or no democratic consultation or kerfuffle – ideal for the tumultuous and rapidly expanding offshore sector in a period of intense race-to-the-bottom dynamics. Already well embedded, the offshore model had become the unopposed centrepiece of national development strategy.

### Laxity is followed by . . . criminal activity

Luxembourg's regulatory laxity, tolerance of secrecy and tax-free benefits attracted large-scale criminality, of course. Much of this has undoubtedly been hidden from view by the secrecy, but many important cases have come to light.

One of the earliest concerned the global fraudster Bernie Cornfeld, who [established](#) his first mutual fund in Luxembourg in 1962.<sup>45</sup> It was aimed specifically at tax-evading people around the world. As Tom Naylor's account put it ([p19](#)<sup>46</sup>):

"When Bernie Cornfeld, the architect of the world's largest and most successful offshore mutual fund, bought his first airplane, the joke went around his Investors Overseas Services (IOS) that he was about to start "Capital Flight Airlines." It was only partly apocryphal. If Bernie Cornfeld did not invent the modern technology of capital flight, he did far more than most of his contemporaries to put it to work in an imaginative, systematic and profitable way."

Cornfeld's empire collapsed in the 1970s.

The [default in 1982](#) of Luxembourg-registered Banco Ambrosiano Holdings S.A.,<sup>47</sup> one of the largest in Europe's recent history, was at the core of another global scandal that erupted into world media with "God's Banker" Roberto Calvi hanging under Blackfriars Bridge in London. The tale, which involved allegations about the Italian Mafia, the Vatican, secret services and Masonic lodges, was never satisfactorily unravelled. Luxembourg's role in supplying the financial secrecy that enabled large-scale loans to

mysterious entities was rarely mentioned, other than in passing.

Later, the Bank of Credit and Commerce International (BCCI), widely regarded as the most criminal bank in history, incorporated itself jointly in Luxembourg and Cayman, with headquarters in London. Each financial centre provided the tax-free status and required lack of scrutiny – and this structure allowed each to point at the others when scandal hit. This model allowed BCCI to involve itself in the financing of terrorism, drugs smuggling, slavery, trafficking in nuclear materials, tax evasion, fraud, racketeering and much more, with – at least until Robert Morgenthau and (TJN Senior Adviser) Jack Blum [began probing](#) its U.S. activities in the late 1980s<sup>48</sup> -- no questions asked.

Luxembourg has also played a role in numerous European political scandals: for instance the giant "[Elf Affair](#)" that saw the international operations of France's Elf Aquitaine serve as a giant slush fund for the use of all major French political parties and intelligence services that became so extensive and corrupt that they destabilised the French state.<sup>49</sup> As the former head of Elf testified in court, by the 1990s the French intelligence services were so intertwined with this system that they had become, in his words ([p252](#)),<sup>50</sup> "a great brothel, where nobody knows any more who is doing what." Luxembourg, along with Switzerland and a few other mostly European tax havens, was a central node in the network of secret dirty money.

The role of Luxembourg in the more recent "[Karachi affair](#)," implicating such top French officials as Nicolas Sarkozy and Edouard Balladur, is testament to the Grand Duchy's ongoing involvement in French corruption at the highest levels of state.<sup>51</sup> Various other links to potentially destabilising European political scandals – including a [major emerging Mafia scandal](#) in Italy<sup>52</sup> – all add up to further evidence of Luxembourg's hellraising role in European politics and economics.

Overall, these scandals led to Luxembourg switching tack somewhat in the 1990s, along with the Cayman Islands and other jurisdictions, by effectively choosing to move upmarket. Sordid drug-dealing profits would henceforth be frowned upon; now it would be high finance: asset management, shadow banking and the like. These, of course, all carry their own risks, including infestation by criminal actors (not least tax evaders and avoiders, market riggers, Ponzi scheme operators, and so on) as subsequent years would show.

Nevertheless, scandals have continued to emerge. In March 2010, for instance, 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.”<sup>53</sup>

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

## The modern ‘captured state’ and its treatment of critics

As already noted, one of Luxembourg’s key selling points for the world’s mobile hot money has long been Luxembourg’s role as a state ‘captured’ by offshore financial services, which has effectively removed the possibility of democratic opposition to the sector. While lawmakers are not responsive to public pressure, they are extremely responsive to the wishes of offshore finance. As the Luxembourg Bankers’ Association (ABBL) boasts, one of Luxembourg’s core [strengths is](#) “easy access to decision-makers; limited red tape” – a testament to the fact that local democratic consultation is generally not allowed to intrude.

With commuters from across the border making up [nearly 45 percent](#) of the workforce,<sup>54</sup> and foreigners making up [over 70 percent](#) of the working population,<sup>55</sup> Luxembourg always had a strong international orientation, fitting its fast-developing ‘offshore’ character.

This stability for finance has been embedded in the dominance of the right-wing political party, the Chrëschtlesch Sozial Vollekspartei (CSV) which has strongly supported financial secrecy and the financial centre’s ‘offshore’ orientation – and which has been the largest political party in every election from 1919 to nearly the present day. Out of government in 2017, after it was defeated by a Liberal-Socialists-Greens coalition when snap elections were called in 2014, it is expected to prepare a comeback to power in the general elections planned for 2018. The current ruling coalition seems no less friendly to the financial sector than previous ones, though its leading figures have made a number of high profile statements to distance themselves from Luxembourg’s murky past.

But the ‘capture’ extends far beyond politics. Mike Mathias, a Green Party politician and former head of the Cercle, [stated](#) in 2014:

“The financial sector weighs on people’s minds, and they defend it without thinking. . . it’s very clear in every day talk: what is good for the financial sector is good for the country. . . Very few people dare to raise their voice to criticise the impact of this policy on the country. There is no political courage to face up to the heft of the financial lobby.”<sup>56</sup>

This has practical impacts: Luxembourg analyst Jérôme Turquey [has described](#):

“an insulated culture that systematically excludes any information that could contradict its reigning picture of reality . . . 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.”<sup>57</sup>

The rare internal critics of and challengers to the offshore financial sector can be dealt with rather harshly. For example, in October 2008 Arlette Chabot, information director for French TV station France 2, had to write a [craven apology](#)<sup>58</sup> 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 criticising Luxembourg’s status as a secrecy jurisdiction and pointing out the conflict with its foreign aid policies, the response was ferocious. Prime Minister Jean-Claude Juncker in a long [speech](#)<sup>59</sup> lambasted it as a ‘primitive study’ and told the NGOs that they should refrain from [criticising](#) the financial sector;<sup>60</sup> 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 study is available [here](#).)<sup>61</sup>

Another victim of the Luxembourg financial consensus 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>62</sup> and pursued for years afterwards.

The conflict between financial sector governance and wider political governance is consistent with a pattern common in offshore centres, particularly smaller ones,

where offshore financial actors can effectively tell the executive and even the judiciary how to behave: and for the executive, they are happy to do whatever brings revenue – so the financial sector actors don't generally need to exert much pressure to get what they want.

For instance, 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.”<sup>63</sup>

In early 2016, a new CSSF Director was appointed, who just so happened to be a former banker at HSBC Luxembourg and just so happened to have been involved in a number of offshore deals revealed in the Panama papers.<sup>64</sup> The outcry in the [press and parliament](#) and critical voices in civil society did not change the government's mind about this appointment.<sup>65</sup> A regulatory framework of this nature, anchored in an aim of drumming up as much business as possible, is directly at odds with the notion of proper supervision, and it accords with the classic offshore offering to capital owners that is crudely summarised, “we won't steal your money, but we will turn a blind eye if you want to steal someone else's.”

The conflicts of interest are legion. In September 2013, investor-protection group Protinvest complained to EU Commissioner Michel Barnier, highlighting conflicts of interest, [notably](#)<sup>66</sup> the appointment by Finance Minister Luc Frieden of his senior adviser Sarah Khabirpour to the board of the CSSF, while she also sits on the board of Banque Internationale a Luxembourg, one of the country's biggest banks, and is a director of the Luxembourg Stock Exchange – both institutions the CSSF regulates. As the *Financial Times* [summarised](#):

“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.”<sup>67</sup>

What may be still more striking is that Luxembourg's courts seem to have effectively been captured, so

that they will side with financial sector players – particularly large financial sector players – against smaller challengers, whether or not the law says they should.

A well-known case here involved the U.S.-based fraudster Bernie Madoff, who built up an international Ponzi scheme and defrauded investors of billions. Insolvency practitioners seeking redress for the defrauded investors have been particularly coruscating about Luxembourg because of the authorities' apparent determination to protect financial sector players at all costs – in violation of the law. In a series of searing public [letters](#),<sup>68</sup> [and [here](#)<sup>69</sup>] the insolvency practitioners Deminor, operating on behalf of 2,500 Madoff investors stated in 2011 that:

“Our clients and their financial advisors have relied on the safeguards in place in Luxembourg, an international financial centre that openly prides itself as having an efficient system aimed at the protection of investors. . . . none of these institutions has been held accountable to date . . . these courts have so far denied access to justice to the numerous investors who followed the CSSF's advice”

A May 2013 *Financial Times* [article](#) on the topic quoted a fund consultant as saying that regulatory lapses are on the rise in Luxembourg,<sup>70</sup> amid fierce competition in laxity with Dublin in particular (see more [here](#)).<sup>71</sup> By 2015, it seemed [Luxembourg's supreme court](#) denied the right of European investors to claim damages from Luxembourg-based custodian banks and auditors, apparently in violation of the law.

“European investors have been deprived of their rights by the Luxembourg courts to enforce claims derived from EU law, despite the blatant liability of service providers based in Luxembourg. . . financial institutions and other professionals in charge knowingly turned a blind eye on the risks in order to protect their commercial relationships and collect additional fees. . . the reality is that more than 6 years after the revelation of the fraud, [none] of these service providers have been held accountable by a court in Luxembourg.”<sup>72</sup>

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."

Meanwhile, the PR outfit for Luxembourg's financial centre has coined a delightful term for one aspect of what Tax Justice Network simply calls the finance curse: 'legislative agility'. As a [publication](#) promoting Luxembourg's charms as a hedge fund location neatly summarises, this is: 'a close working relationship between the business community, the Government and the legislator underpins the innovative legal framework of the Grand Duchy.'<sup>73</sup> Well, indeed.

## The Luxleaks scandal – and questions about Jean-Claude Juncker

Another huge global scandal, this time almost wholly centred on Luxembourg, goes by the name of "[Luxleaks](#)".<sup>74</sup> This exploded into international headlines in November 2014 when Luxembourg-based whistleblowers exposed a [huge trove of documents](#),<sup>75</sup> which were then publicised by the International Consortium of Investigative Journalists (ICIJ),<sup>76</sup> showing how the accounting giant PwC and others had helped multinationals from around the world – including IKEA, AIG, Deutsche Bank, Walt Disney Co., Pepsi and many other household names – slash their global tax bills using Luxembourg-based structures.

These featured 'tax rulings' (sometimes known as 'comfort letters') effectively amounting to rubber-stamp authorisation by the Luxembourg tax authorities for highly abusive and complex schemes to channel hundreds of billions of dollars to Luxembourg, in many cases cutting their effective tax rates to less than one percent of the profits that they had shuffled into Luxembourg. Although the cases do not primarily revolve around secrecy, it is telling that the only people to have been penalised or incriminated as a result of the exposure of these widespread abuses are the whistleblowers themselves. Their treatment suggests that despite the policy concessions – detailed below – which have emerged perhaps partly as a result of Luxleaks, Luxembourg is not ready to

relinquish its status as a secrecy haven.

Antoine Deltour, a junior auditor at PwC, [Raphaël Halet](#), who worked in the tax department at PwC scanning and archiving documents relating to multinationals' tax practices, and Edouard Perrin, the investigative journalist to whom they passed the documents, all found themselves on trial.<sup>77</sup>

Deltour was given a 12-month suspended sentence and fined 1500 €; Halet was sentenced to 9 months suspended and fined 1000 €.

In March 2017 an [appeal judge reduced](#) Deltour's sentence to six months suspended and removed Halet's sentence; the fines remained.<sup>78</sup> Perrin was acquitted for the second time. Deltour was acquitted of violation of professional secrecy and violation of trade secrets, but the court upheld his conviction for theft offenses, fraudulent maintenance of a database, and laundering of acquired data.

The message was fundamentally mixed: Deltour was in effect being acquitted of passing the information to a journalist – a recognition of his being a whistleblower, while remaining convicted of obtaining it in the first place. Deltour and Halet appealed again against their convictions. Deltour's conviction was quashed in [January 2018](#).<sup>79</sup> However, the court upheld a conviction against his fellow leaker, Raphaël Halet.

Jean-Claude Juncker, who had recently stepped down as Prime Minister amid a scandal over the secret services, roundly denied any involvement in Luxleaks. Yet the nature of his denials, and the history of Luxembourg, are instructive.

A graph of one aspect of this offshore activity points not only to Juncker's role, but also to the history of Luxembourg's involvement in offering corporate tax avoidance services, on the following page.

*(Graph Source: Gabriel Zucman, 2014; historical details added by David Walch, Attac-Austria. (Note, however, that Bermuda is not in the Caribbean)*

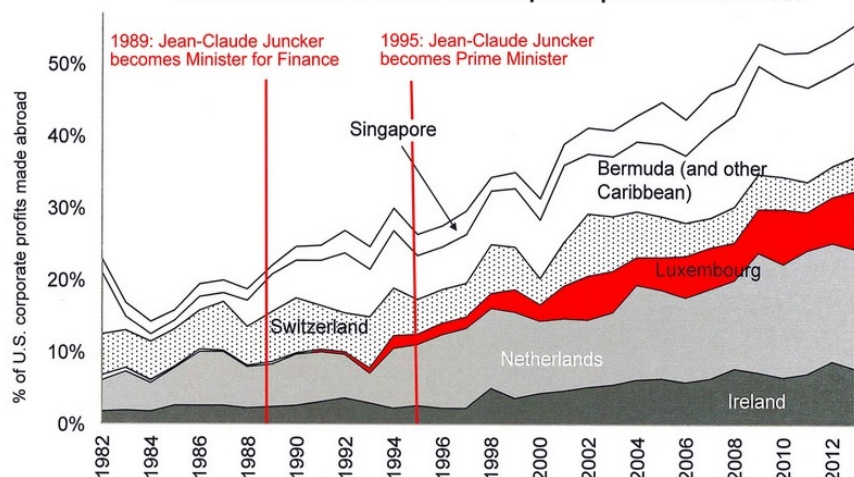
Juncker himself explicitly denied involvement in these activities that led up to Luxleaks:

"The Luxembourg tax authorities are very allergic to the idea of ministerial interference," he said. "I think you have (an) exaggerated idea of (the) power of the prime minister in this respect."

This is noteworthy in several respects. First, as already



The share of tax havens in U.S. corporate profits made abroad



Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S. DI abroad was about \$500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

explained, the offshore model involves reassuring flighty global capital by effectively ring-fencing the offshore sector against political interference: Juncker's words confirm this exactly. Second, Juncker's role was instead to sustain political support for the offshore model, rather than tinkering with its details. And this is confirmed by what [he said in 2007](#), after single-handedly torpedoing European efforts to tackle these abuses:

"We have not made ourselves extremely popular in Europe. . . . an essential interest of Luxembourg was at stake and therefore today I had no other possibility than to say no."<sup>80</sup>

This flatly contradicts his denials of responsibility for these abuses, which is also contradicted by a [recent article](#) in Luxembourg's leading daily newspaper, *Wort*, which reported that Juncker was alerted as early as 1997 that the special deals being negotiated by bureau 6 of the tax authorities may have been "questionable" and "should be accompanied by "a maximum of guarantees" to make sure they did not contradict tax law."<sup>81</sup>

However, we should also stress that the tax haven strategy was supported by the entire Luxembourg establishment. As the long-standing representative of that establishment, Juncker certainly carries a significant share of responsibility: but he did not stand alone.

### Secrecy in Luxembourg today

Juncker stepped down as Prime Minister in December 2013, and became President of the European Commission the following year. Given his

powerful role overseeing the construction of the Luxembourg secrecy jurisdiction there were questions about how he might use his new role. As the *Financial Times* reported:

The appointment . . . has sparked speculation that the Grand Duchy has won a powerful protector. Chris Lenon, former global head of tax at Rio Tinto, the mining group, says:

"This isn't a poacher turned gamekeeper, it looks more like the poacher in charge of the gamekeepers."

But following his departure, Luxembourg began to make major strides in improving its record on cooperating with other countries including the EU – at least in the area of secrecy. How instrumental his departure has been in unlocking these changes is a matter of debate, since the Luxleaks scandal a year later also had a significant effect, but the timing is intriguing.

In our Financial Secrecy Index in 2013 we had described Luxembourg as the "Death Star" of financial secrecy in Europe, on account of its intransigent role in opposing and seeking to undermine European transparency initiatives, as described below. The [assessment](#) of Luxembourg's anti-money laundering regime by the Financial Action Task Force in 2010<sup>82</sup> was devastating: of 49 assessed criteria, only one was rated as compliant, nine as largely compliant, 30 as partially compliant, and nine as non-compliant. Luxembourg was [peer reviewed in July 2013](#) by the OECD's Global Forum,<sup>83</sup> which not only reported a litany of problems, but also ranked Luxembourg as only one of three jurisdictions (out of 81 assessed) that were judged to be noncompliant. For instance, it [reports](#):

"Luxembourg has the legal framework and compulsory powers in place to access information under its updated and new agreements but has failed to use the powers in practice in a number of cases . . . information on the banking statements was partly unreadable, which prevented

the requesting jurisdiction from using the information, Luxembourg stated that the information had been blacked out directly by the banks and the Luxembourg tax authorities never accessed the original documents. When the banking statements were received by the Luxembourg tax authorities, partially unreadable, the Luxembourg tax authorities did not request the original documents, which means that the Luxembourg tax authorities accepted the decision of the banks on the relevance of the information without seeing the information. Luxembourg refused to provide the complete documents to the requesting jurisdiction on the basis that the information was not relevant for their investigations, without having seen the original documents.”<sup>84</sup>

The reports highlighted not only the scale of Luxembourg’s historical intransigence on secrecy, but it also once again illustrates the ‘captured state’ where tax authorities were unwilling or unable to carry out their expected role in requiring financial sector actors to obey the law.

Yet in a series of moves since Juncker’s departure and Luxleaks, some things have changed rapidly.

Luxembourg was among the first jurisdictions to commit to the OECD’s emerging global standard of information exchange, known as the **Common Reporting Standards**. It’s [one of 49 countries](#) beginning automatic exchange of information during 2017 (another 53 will begin during 2018).<sup>85</sup> However, information will only be exchanged with [63 selected jurisdictions \(as of 16 January 2018\)](#).<sup>86</sup>

Luxembourg is among 113 jurisdictions that [have engaged](#)<sup>87</sup> with the U.S. Foreign Account Tax Compliance Act (FATCA: see our [USA narrative report](#)<sup>88</sup>). This is primarily about the U.S. seeking information about its own taxpayers, though with some reciprocity. In July 2015 Luxembourg’s Intergovernmental Agreement (IGA – its mechanism to provide US taxpayer information to the US authorities under FATCA – came into force<sup>89</sup>).

For a long time, Luxembourg was one of two recalcitrants (alongside Austria) inside the European Union which refused to sign up to the automatic information exchange provisions of the EU’s Savings Tax Directive (EU-STD). Worse, it played the biggest blocking role when the European Commission was trying to push through powerful amendments to tighten up on loopholes and expand its scope. This position changed in [March 2014](#) when all 28 EU member states signed up to the amendments,

after Luxembourg and Austria finally dropped their opposition.<sup>90</sup> (However, the EU STD was repealed in November 2015, to be replaced by the Common Reporting Standard, which is implemented in the EU through the Directive on Administrative Cooperation, or DAC.)

A particularly worrying development that we had flagged in an earlier Luxembourg report was the introduction of a Private Foundations Law, which would have been a development of particular concern, creating an important new way for extremely wealthy people to escape scrutiny, tax and regulation. However, the threatened legislation was withdrawn in December 2014 and as of autumn 2017 has not re-emerged.

In January 2017 Luxembourg finally made [tax crimes a predicate offence](#) for money-laundering – as called for by the Financial Action Task Force, which oversees anti-money laundering regulations, for many years.<sup>91</sup> In theory, this should imply that bankers who accept money they have reason to know to be stemming from foreign tax evasion can be liable for money laundering (it remains to be seen what impact this may have in practice).

Luxembourg has [joined the OECD’s Inclusive Framework](#) on BEPS,<sup>92</sup> which commits it to implementing the [country-by-country reporting component](#) of the BEPS action plan.<sup>93</sup> It has [met the OECD requirement](#),<sup>94</sup> this standard is limited, however, to requiring country-by-country reports from a) large multinationals headquartered in a jurisdiction, and b) domestic branches of subsidiaries of large groups – but only subject to strict OECD conditions ([see KFSI 9](#)).<sup>95</sup> This is a much lower and less effective level of disclosure than full public reporting of this information would be.

Meanwhile – and perhaps more importantly, given the limitations of the BEPS standard on country-by-country reporting – there has been increased scrutiny by the EC of Luxembourg’s cosy tax arrangements with multinationals. Investigations have included Amazon, McDonalds, Fiat, and the French utility company Engie; in its most recent ruling the EC ordered Luxembourg to recover 250 million euros in taxes from Amazon, finding that the benefits extended to the company amounted to [illegal state aid](#).<sup>96</sup> Such moves may be making the country a less attractive low tax destination; McDonalds [jumped ship to the UK](#) at the end of 2016.<sup>97</sup>

Other things haven’t changed much. Luxembourg has not taken the step of putting beneficial ownership of companies on the public record as some countries are doing. However, on 26 April 2017 Luxembourg published the Bill of Law n.7128 to transpose the 4th AML Directive (EU) 2015/84 into national legislation. As

of 6 September 2017 the Bill had not been approved. All companies in Luxembourg need to register their legal ownership but they are always required to update details on all legal owners. Furthermore, while bearer shares are required to be recorded by private custodians, there is no requirement to register all owners of bearer shares in an official central register.

But the changes haven't just been in financial policy. The tone of public debate has started to shift too, which, given the web of connections and silent complicity that maintains the 'finance curse' in small secrecy jurisdictions, could start to become significant.

Just after Luxleaks broke, two Luxembourgish citizens, Luc Dockendorf and Benoît Majerus, launched an appeal "[For a new social contract for Luxembourg](#)".<sup>98</sup> In an op-ed published in Luxembourg's largest daily newspaper in November 2014, they argued that the time had come to urgently rethink Luxembourg's economic and social model, which required recognising that the offshore financial model was neither morally acceptable, not economically sustainable in the long term.

Then in January 2016, the "[Collectif Tax Justice Lëtzebuerg](#)" was launched as a civil society platform for a 'free, open, and constructive debate on offshore finance'.<sup>99</sup> A [Solidarity Committee](#) supporting the LuxLeaks whistleblowers facing trial was also founded,<sup>100</sup> organising protests at the trial and publishing articles calling for the recognition of their public service. (A draft law on the status of whistleblowers has yet to reach Parliament.)

Another positive outcome of the Luxleaks scandal has been a shift in the media attitude. Until 2014, the media was rarely critical, but the LuxLeaks revelations and the subsequent trial of its whistleblowers have changed this. A cadre of – mostly young – journalists across different newspapers and media groups has emerged to criticise the treatment of the whistleblowers and to shatter the taboo around offshore finance.

This rise in critical press coverage has come alongside artistic expressions of popular and intellectual resistance to the finance curse, such as the [independent arts collective "Richtung 22"](#),<sup>101</sup> which gives young Luxembourgish actors a platform to merrily and mercilessly lampoon the finance industry, political corruption, and hypocrisy.

Updated with the help of the [Collectif Tax Justice Lëtzebuerg](#).

### Secrecy and human rights

One interesting development has been the increasing scrutiny of the legal and moral legitimacy of tax

policies which uphold and support financial secrecy. One avenue through which this has been pursued is the Convention on the Elimination of All Forms of Discrimination Against Women ([CEDAW](#)) - the United Nations' international Bill of Rights for Women.<sup>102</sup>

In February 2018 the CEDAW Committee will meet at the 69th Session as part of its periodic and cyclical four year reporting process. At this session the Luxembourg Government will provide a State Party report to the Committee on their progress towards implementing CEDAW and the recommendations made by the CEDAW Committee in previous years. The Committee can look at the Luxembourg's domestic and extraterritorial tax policy and secrecy laws and how they impact on the UK's human rights obligations.

In 2016 the CEDAW Committee Sharply criticised [Switzerland](#) for the damage that its financial secrecy causes to human rights, and the protection of women's rights around the world.<sup>103</sup>

#### Read more:

Mediapart (in French): [Comment le Luxembourg s'est construit en trou noir de la finance mondiale](#) – a series in three parts, Dec 2013 and Jan 2014.<sup>104</sup>

OECD Global Forum, peer review for Luxembourg, July 2013

Luxembourg financial centre: facts and figures, [Luxembourg for Finance](#).<sup>105</sup>

The [Luxleaks files](#): International Consortium of Investigative Journalists (ICIJ).<sup>106</sup>

This 2007 [New York Times story](#),<sup>107</sup> 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](#).)<sup>108</sup>

[Fragen aus entwicklungspolitischer Sicht, Cercle de Coopération a.s.b.l., July 23, 2009](#)<sup>109</sup>

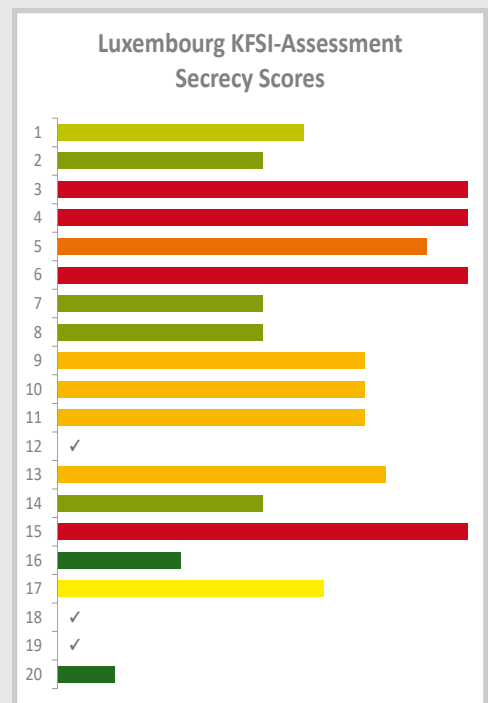
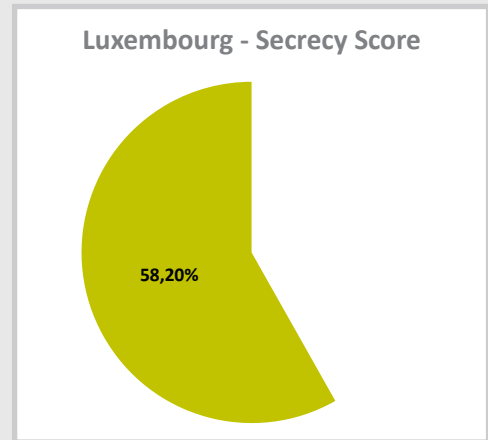
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- 63 <http://www.imf.org/external/pubs/ft/scr/2011/cr11148.pdf>; 25.01.2018.
- 64 His response was that his relationship with Mossack Fonseca while at HSBC was strictly professional and that he wasn't actually a director or shareholder of any of the companies set up by Mossack Fonseca: he was just a signatory for HSBC, 'consistent with market practice'. The full text of his explanation was [published](#) in the press.
- 65 <https://www.lequotidien.lu/a-la-une/claude-marx-directeur-de-la-cssf-tres-implique-dans-les-panama-papers/>; 25.01.2018.
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- 71 <http://treasureislands.org/luxembourg-versus-ireland-tax-havens-competing-to-be-more-rotten-than-each-other/>; 25.01.2018.
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- 74 <https://www.icij.org/investigations/luxembourg-leaks/>; 25.01.2018.
- 75 <https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/>; 25.01.2018.
- 76 The documents were exposed originally by Edouard Perrin, a French television journalist, but they only gained proper global traction when the ICIJ began working with a range of international media to publicise the scandal.
- 77 <https://www.politico.eu/article/silent-man-of-luxleaks-fights-back-raphael-halet/>; 25.01.2018.

- 78 <https://support-antoine.org/en/blog/2016/06/29/pr-verdict/>; 25.01.2018.
- 79 <https://www.taxjustice.net/2018/01/11/links-jan-11-2/>; 25.01.2018.
- 80 [http://www.nytimes.com/2007/06/05/business/world-business/05iht-eu.4.6011186.html?\\_r=0](http://www.nytimes.com/2007/06/05/business/world-business/05iht-eu.4.6011186.html?_r=0); 25.01.2018.
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PART 2: LUXEMBOURG'S SECRECY SCORE



Notes and Sources

The ranking is based on a combination of its secrecy score and scale weighting (click [here](#) to see our full methodology).

The secrecy score of 58 per cent has been computed as the average score of 20 Key Financial Secrecy Indicators (KFSI), listed on the left. Each KFSI is explained in more detail by clicking on the name of the indicators.

A grey tick indicates full compliance with the relevant indicator, meaning least secrecy; red indicates non-compliance (most secrecy); colours in between partial compliance.

This paper draws on data sources including regulatory reports, legislation, regulation and news available as of 30.09.2017.

Full data on Luxembourg is available here: [www.financialsecrecyindex.com/database](http://www.financialsecrecyindex.com/database).

To find out more about the Financial Secrecy Index, please visit [www.financialsecrecyindex.com](http://www.financialsecrecyindex.com).