COMMISSION de SURVEILLANCE du SECTEUR FINANCIER

Annual Report 2006

Commission de Surveillance du Secteur Financier

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The year 2006 was an excellent year for the financial centre as a whole. Without wanting to be overenthusiastic, I deem it justified and appropriate to be optimistic as regards the future of our financial centre which, in my opinion, will continue to largely contribute to the prosperity of the national economy. The scepticism of the previous years must give way to confidence and I really encourage the youth to seek employment in the financial sector, which, more than ever, offers job opportunities for qualified experts.

I am certain that the financial centre, which developed over years, stands on sound grounds. Luxembourg must be proud thereof and should not have false modesty in this regard.

Over the last years, our financial centre was able to diversify by discovering and developing niche activities, thus giving it new impetus. No need, therefore, to fear for its future, even if some element was to change afterwards, notably due to decisions taken abroad. There is no "global risk" likely to shake our centre as a whole, because it is already diversified and because the products are diversified.

I would like to list four conditions that I deem essential to ensure that the financial centre will be as successful in the coming years.

Firstly, the financial centre must fulfil all the requirements discussed and decided at international level. There is no future for "unregulated islands".

Secondly, Luxembourg must more than ever take care of its financial centre, notably by supporting the creation of material infrastructures fostering its development and by adapting the legal and regulatory framework as needed.

Thirdly, professional training of all sorts must be continually improved, as well-trained staff is essential to assure that our financial centre remains competitive and attractive in the medium and long term. Substantial progress has been made recently with the creation and development of the University of Luxembourg and the Luxembourg School of Finance, which are major steps towards a high level of training and which reflect that Luxembourg recognised the challenges it must take up in this field.

Last but not least, the financial professionals must put the customers' interests at the centre of their concerns, because satisfied customers are the foundations of the centre.

Finally, I would also like to pay tribute to the CSSF's employees, who, ever more numerous (278 as at 1 March 2007), regularly arouse positive responses from the entities subject to the supervision of our Commission, which demonstrates a sound interaction between the supervised and the supervisors.

Jean-Nicolas SCHAUS

Director General

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Arthur PHILIPPE

Director

Jean-Nicolas SCHAUS

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Simone DELCOURT

Director

CORPORATE GOVERNING BODIES OF THE COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

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CHAPTER 1

1 SUPERVISION OF THE BANKING SECTOR

1. DEVELOPMENTS IN THE BANKING SECTOR IN 2006

1.1. Characteristics of the Luxembourg banking sector

The Luxembourg banking legislation provides for three types of banking licences, namely licences governing the activities of universal banks (152 institutions had this status on 31 December 2006), those governing the activities of banks issuing mortgage bonds (4 institutions had this status on 31 December 2006) and those governing the activities of banks issuing electronic means of payment (no institution had this status on 31 December 2006).

The universal banks comprise three categories according to their legal status and geographical origin:

- banks incorporated under Luxembourg law (114 on 31 December 2006);
- branches of banks originating from a Member State of the European Union or assimilated (34 on 31 December 2006);
- branches of banks originating from non-Member States of the European Union (8 on 31 December 2006).

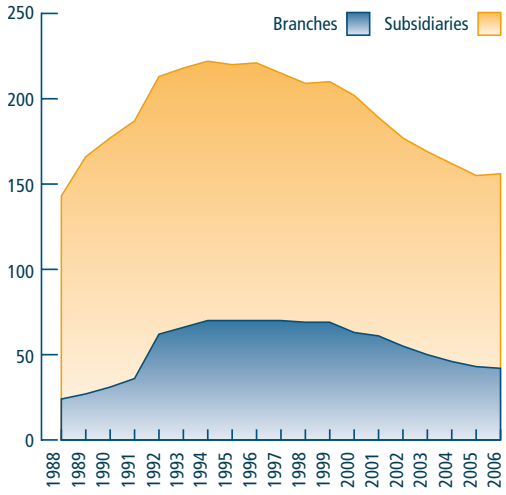
The *caisses rurales* (16 on 31 December 2006) and their central establishment, Banque Raiffeisen, which, according to the law on the financial sector, are to be considered as a single credit institution, constitute a special case.

1.2. Development in the number of credit institutions

The downward trend in the number of credit institutions established in Luxembourg that has been observed for several years did not continue in 2006. With 156 authorised banks at the end of 2006, their number has even increased by one entity compared to 31 December 2005 (155). Among these 156 entities, 114 are banks incorporated under Luxembourg law (2005: 112) and 42 are branches (2005: 43).

Development in the total number of banks established in Luxembourg

Year	Branches	Subsidiaries	Total
1988	24	119	143
1989	27	139	166
1990	31	146	177
1991	36	151	187
1992	62	151	213
1993	66	152	218
1994	70	152	222
1995	70	150	220
1996	70	151	221
1997	70	145	215
1998	69	140	209
1999	69	141	210
2000	63	139	202
2001	61	128	189
2002	55	122	177
2003	50	119	169
2004	46	116	162
2005	43	112	155
2006	42	114	156



The following events have influenced the development in the number of credit institutions.

- Four branches have ceased their activities, two banks went into liquidation and two banks have merged with other banks of the financial centre.
- Over the same period, nine banks have been granted a licence.

Eight banks were withdrawn from the official list during the year:

• Banque Nagelmackers 1747 (Luxembourg) S.A.	Merger with Banque Degroof Luxembourg S.A. on 1 January 2006
• Banque Colbert (Luxembourg) S.A.	Liquidation on 16 January 2006
• Hypo Public Finance Bank, succursale de Luxembourg	Cessation of activities on 31 March 2006
• Puilaetco Dewaay Private Bankers S.A., succursale de Luxembourg	Cessation of activities on 11 April 2006
• United European Bank (Luxembourg) S.A.	Merger with BNP Paribas Luxembourg on 30 April 2006
• Alcor Bank Luxembourg	Liquidation on 10 May 2006
• Deutsche Postbank AG, Niederlassung Luxembourg	Cessation of activities on 12 May 2006
• Merrill Lynch International Bank, succursale de Luxembourg	Cessation of activities on 30 September 2006

Nine new banks started their activities in 2006:

• RBC Dexia Investor Services Bank S.A.	2 January 2006
• EFG Bank (Luxembourg) S.A.	10 January 2006
• Advanzia Bank S.A.	11 January 2006
• NORD/LB COVERED FINANCE BANK S.A.	9 May 2006
• Alpha Credit S.A., succursale de Luxembourg	3 July 2006
• Commerzbank AG, Zweigniederlassung Luxemburg	1 August 2006
• Industrial and Commercial Bank of China Luxembourg S.A.	5 September 2006
• Citco Bank Nederland N.V., Luxembourg Branch	8 November 2006
• Compagnie de Banque Privée S.A., in abbreviated form “CBP”	13 December 2006

RBC Dexia Investor Services is the result of the combination of the business lines trust, custody and UCI administration of the Dexia and Royal Bank of Canada groups. The ultimate parent company of RBC Dexia Investor Services is a British holding company held by Dexia and RBC at 50%/50%. The British parent company holds two operational entities, namely RBC Dexia Investor Services Bank which encompasses the activities of the Dexia group brought to the joint venture and RBC Dexia Investor Services Trust (Canada) which groups the activities brought by the group Royal Bank of Canada to the joint venture.

EFG Bank (Luxembourg) S.A. is part of a group of banks specialised in private banking, the group head of which is located in Switzerland.

Advanzia Bank S.A., whose main shareholders are Norwegian investors active in diverse business sectors, is specialised in issuing credit cards in the European market.

Following the creation of NORD/LB COVERED FINANCE BANK S.A. belonging to the Norddeutsche Landesbank group, there are now four banks issuing mortgage bonds in the financial centre. The purpose of the bank is to finance the public sector by issuing public mortgages.

Alpha Credit S.A., succursale de Luxembourg, is a branch of a Belgian financial institution and grants consumer credits in co-operation with the Fortis group.

The German group Commerzbank has created the branch Commerzbank AG, Zweigniederlassung Luxemburg, in addition to its Luxembourg subsidiary.

In addition to its Luxembourg branch, Industrial and Commercial Bank of China created in 2006 the subsidiary Industrial and Commercial Bank of China Luxembourg S.A. that will allow it to use the European passport for its banking business in the European Union.

With the creation of Citco Bank Nederland N.V., Luxembourg Branch, this group already present in Luxembourg with a PFS authorised as distributor of units/shares of investment funds, plans to provide depositary bank services to its customers.

Compagnie de Banque Privée S.A., in abbreviated form "CBP", which is held in majority by Luxembourg private investors, purposes to be active as a private bank.

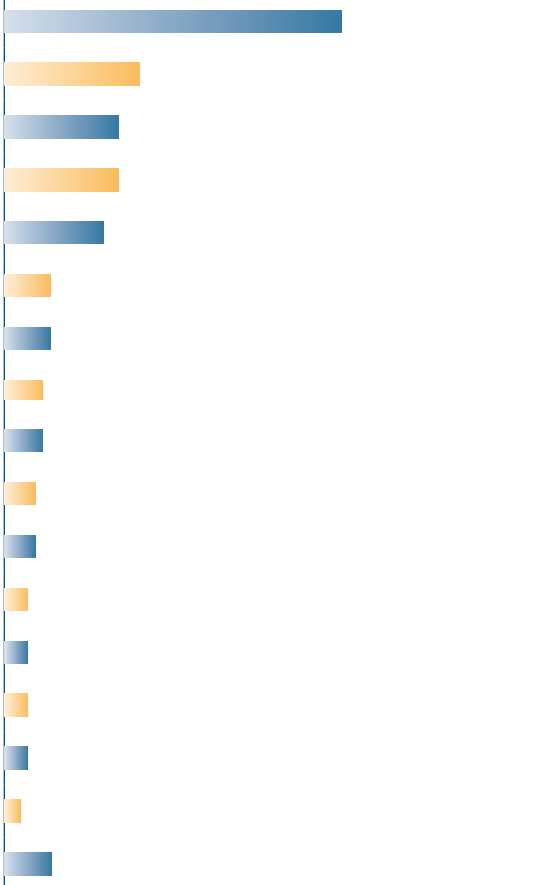
The following credit institutions have changed their corporate name in 2006:

Former corporate name	New corporate name (date of change)
• Bank of Tokyo-Mitsubishi (Luxembourg) S.A.	Bank of Tokyo-Mitsubishi UFJ (Luxembourg) S.A. (01.01.2006)
• LBB Landesbank Berlin – Girozentrale Niederlassung Luxemburg	Landesbank Berlin AG, Niederlassung Luxemburg (01.01.2006)
• Hypo Real Estate Bank International, succursale de Luxembourg	Hypo Public Finance Bank, succursale de Luxembourg (04.01.2006)
• Industrial and Commercial Bank of China, succursale de Luxembourg	Industrial and Commercial Bank of China Ltd., Luxembourg Branch (05.01.2006)
• Banque Ippa et Associés	Banque BI&A S.A. (16.01.2006)
• RBC Dexia Investor Services Bank	RBC Dexia Investor Services Bank S.A. (16.01.2006)
• Banque Puilaetco (Luxembourg) SA	Banque Puilaetco Dewaay Luxembourg S.A. (23.03.2006)
• WGZ-Bank Luxembourg S.A.	WGZ BANK Luxembourg S.A. (30.04.2006)
• Banca di Roma International S.A.	Capitalia Luxembourg S.A. (18.05.2006)
• ISB (Luxembourg) S.A.	Glitnir Bank Luxembourg S.A. (22.05.2006)
• SEB Private Bank S.A.	Skandinaviska Enskilda Banken S.A. (01.06.2006)
• Bankgesellschaft Berlin International S.A.	Landesbank Berlin International S.A. (01.09.2006)
• Swedbank (Luxembourg) S.A.	Swedbank S.A. (04.10.2006)
• Natexis Private Banking Luxembourg S.A.	Natixis Private Banking Luxembourg S.A. (21.12.2006)

The breakdown of the credit institutions according to their geographical origin has changed as follows (2005 figures between brackets). Banks of German origin remain the highest in number with 45 (43) entities, followed by Belgian and Luxembourg banks with 18 (16) entities. 15 (15) banks originate from France, 15 (15) from Italy, 13 (13) from Switzerland, 6 (6) from Sweden and 6 (6) from the United Kingdom.

Geographical origin of banks

Country	Number
Germany	45
Belgium / Luxembourg	18
France	15
Italy	15
Switzerland	13
Sweden	6
United Kingdom	6
Japan	5
USA	5
China	4
Netherlands	4
Brazil	3
Iceland	3
Israel	3
Portugal	3
Denmark	2
Others	6
Total	**156**



1.3. Development in the local branch network in Luxembourg

The downward trend in the branch networks since the 1990s also continued in 2006.

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Local branches	260	254	240	231	226	225	214	207	200	253*	246*	234*
Banks concerned	11	11	11	11	10	9	9	8	8	9	9	9

* including the Caisses Rurales Raiffeisen affiliated to Banque Raiffeisen and the local branches of these Caisses Rurales; the number of local branches, without those, totalled 198 in 2004, 193 in 2005 and 186 in 2006.

In order to better reflect the reality of the commercial presence of banks as perceived by the general public, the figures include since 2004 the Caisses Rurales Raiffeisen affiliated to Banque Raiffeisen, as well as the Caisses' local branches.

1.4. Development in banking employment

The total number of employees of Luxembourg credit institutions as at 31 December 2005 reached 23,227, which represented an increase of 673 employees (+3%) over a year. At the end of 2006, the total number of employees of Luxembourg credit institutions reached 24,752, which represents a further increase of 6.56% over a year.

Banking employment had strongly dropped in 2002 and 2003. The aggregate loss of about 1,300 jobs came in a difficult economic context, together with reorganisations of the production structure that led to the transfer of a substantial number of jobs to other entities of the financial sector, notably to PFS and management companies. The improvement in banking employment that took place in the favourable business climate of 2005 and even accelerated in 2006, suggests that the consolidation of banking staff before 2005 was to a large extent due to temporary, economic concerns.

The growth in banking employment in 2006 is particularly strong within recently incorporated credit institutions as well as within banks that are especially involved in the investment fund business. Among the credit institutions registered on the official list as at 31 December 2006, 74% have maintained, or even increased, their staff. This percentage was, for the same sample, 63% and 61% respectively in 2005 and 2004.

The breakdown of total employment shows that the share of executives within total employment continued to grow. It rose from 22.1% to 22.5% in 2006. The female employment rate remained unchanged (45.7%).

Breakdown of the number of employees per bank

	Number of banks					
Number of employees	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
> 1,000	4	4	4	4	4	5
500 to 1,000	5	6	4	2	6	7
400 to 500	4	3	4	6	4	3
300 to 400	4	7	6	8	7	8
200 to 300	12	9	11	8	7	10
100 to 200	16	18	19	19	20	18
50 to 100	26	23	21	21	18	18
< 50	118	105	100	94	89	87
TOTAL	**189**	**175**	**169**	**162**	**155**	**156**

Situation of employment in credit institutions

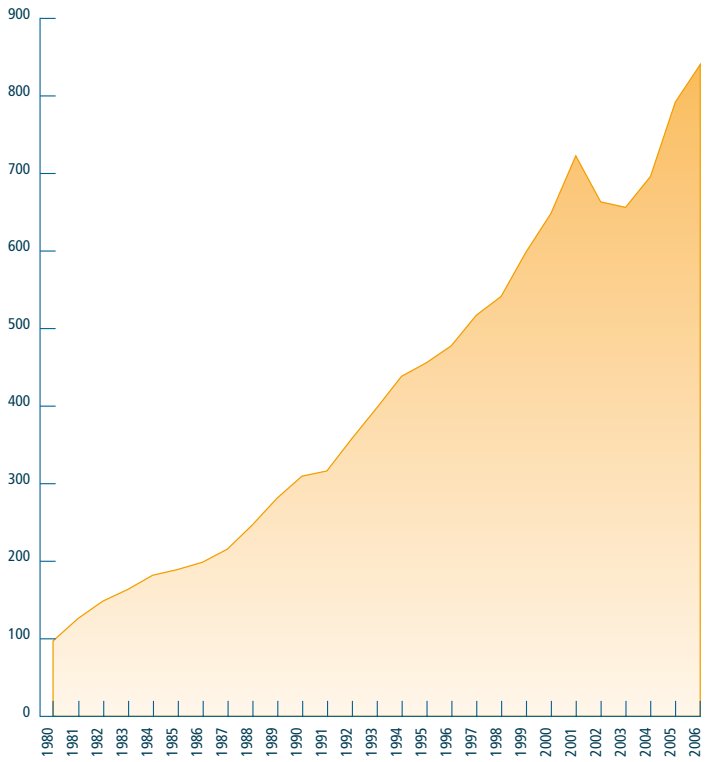
	Total		Management			Office staff			Technical staff			Total staff		
	Luxemb.	Foreigners	Men	Women	Total	Men	Women	Total	Men	Women	Total	Men	Women	Total
1995	8,170	10,113	2,533	451	2,984	7,318	7,813	15,131	49	119	168	9,900	8,383	18,283
1996	8,113	10,469	2,658	490	3,148	7,476	7,809	15,285	48	101	149	10,182	8,400	18,582
1997	8,003	11,086	2,765	547	3,312	7,631	8,013	15,644	44	89	133	10,440	8,649	19,089
1998	7,829	12,005	2,900	577	3,477	7,846	8,377	16,223	47	87	134	10,793	9,041	19,834
1999	7,797	13,400	3,119	670	3,789	8,362	8,961	17,323	34	51	85	11,515	9,682	21,197
2000	7,836	15,232	3,371	783	4,154	9,030	9,801	18,831	35	48	83	12,436	10,632	23,068
2001	7,713	16,148	3,581	917	4,498	9,222	10,046	19,268	33	62	95	12,836	11,025	23,861
2002	7,402	15,898	3,654	977	4,631	8,941	9,657	18,598	25	46	71	12,620	10,680	23,300
2003	7,117	15,412	3,720	1,049	4,769	8,486	9,211	17,691	23	40	63	12,229	10,300	22,529
2004	7,001	15,553	3,801	1,111	4,912	8,451	9,138	17,589	19	34	53	12,271	10,283	22,554
2005	6,822	16,405	3,948	1,183	5,131	8,641	9,397	18,038	20	38	58	12,609	10,618	23,227
2006	6,840	17,912	4,280	1,294	5,574	9,153	9,974	19,127	19	32	51	13,452	11,300	24,752
	Quota													
2002	31.8%	68.2%	78.9%	21.1%	19.9%	48.1%	51.9%	79.8%	35.2%	64.8%	0.3%	54.2%	45.8%	100.0%
2003	31.6%	68.4%	78.0%	22.0%	21.2%	48.0%	52.1%	78.5%	36.5%	63.5%	0.3%	54.3%	45.7%	100.0%
2004	31.0%	69.0%	77.4%	22.6%	21.8%	48.0%	52.0%	78.0%	35.8%	64.2%	0.2%	54.4%	45.6%	100.0%
2005	29.4%	70.6%	77.0%	23.1%	22.1%	47.9%	52.1%	77.7%	34.5%	65.5%	0.2%	54.3%	45.7%	100.0%
2006	27.6%	72.4%	76.8%	23.2%	22.5%	47.9%	52.1%	77.3%	37.3%	62.7%	0.2%	54.3%	45.7%	100.0%

1.5. Development in the balance sheets

The balance sheet total of credit institutions rose to EUR 839,574 million at the end of 2006 against EUR 791,250 million at the end of 2005, which represents a 6.1% increase during 2006. This increase reflects an overall business growth which affects all items.

Development in the balance sheet total of credit institutions – in billion EUR

1980	97.10
1981	125.95
1982	148.41
1983	163.41
1984	181.73
1985	189.09
1986	198.49
1987	215.32
1988	246.36
1989	281.04
1990	309.37
1991	316.09
1992	357.56
1993	397.15
1994	438.01
1995	455.47
1996	477.37
1997	516.59
1998	540.89
1999	598.01
2000	647.63
2001	721.98
2002	662.70
2003	655.60
2004	695.36
2005	791.25
2006	**839.57**



Aggregated balance sheet total – in million EUR

ASSETS	2005	2006[1]	Variation	LIABILITIES	2005	2006[1]	Variation
Loans and advances to credit institutions	399,437	409,719	2.6%	Amounts owed to credit institutions	384,366	384,145	-0.1%
Loans and advances to customers	146,506	159,439	8.8%	Amounts owed to customers	253,041	293,032	15.8%
Fixed-income securities	190,678	198,172	3.9%	Amounts owed represented by securities	84,932	85,497	0.7%
Variable-yield securities	5,124	16,368	219.4%	Various items	5,487	6,807	24.1%
Participating interests and shares in affiliated undertakings	8,797	9,693	10.2%	Permanent means*	63,423	70,093	10.5%
Fixed assets and other assets	40,708	46,182	13.4%	*of which profit for the year*	*3,498*	*5,685*	*62.5%*
Total	**791,250**	**839,574**	**6.1%**	**Total**	**791,250**	**839,574**	**6.1%**

[1] Preliminary figures for the end of 2006.

* Including share capital, reserves, subordinated liabilities and provisions.

- ***Assets***

As far as assets are concerned, the growth in the banks' balance sheet total is particularly strong with respect to loans and advances to customers and variable-yield securities.

The increase in **loans and advances to customers** is a trend that can be observed in the majority of banks. Given the diversity of activities performed in the financial centre, the reasons for this growth are manifold. The following elements can be singled out:

- The growth in UCI activity generates mechanically, for depositary banks, an increase in account overdrafts of these UCIs. These are not leveraged lending overdrafts, but rather advances in current account to provide for short-term liquidity needs, e.g. in the event of value date mismatches, repurchase requests for units/shares, etc. For banks, these overdrafts do not present risks as they are secured by UCI assets.
- The sound performance of stock markets also entails an increased demand from private customers for credits to finance securities portfolios. The risks for banks in this activity are generally weak, given the security margins applied. Risks are rather at operational and document level. However, the risks are high for customers using such credits and the banks are expected to make them aware thereof.
- A few banking groups have centralised their financing activity in 2006 within their Luxembourg subsidiaries.

On the other hand, the marked increase in **variable-yield securities** does only concern a few banks and results from structured operations. Trading activity of shares for own account remains marginal.

The share of **amounts owed to credit institutions** slightly fell to 48.8% of the balance sheet total. This figure bears witness to the lasting importance of interbank positions for the Luxembourg financial centre, which can be mainly explained by a group cash management logic and by the structure of the legal entities that take part in this management (notably the double presences of credit institutions in Luxembourg). Thus, 69% of the interbank assets and 60% of the interbank liabilities constitute transactions with banks of the group.

Qualitative breakdown of interbank assets

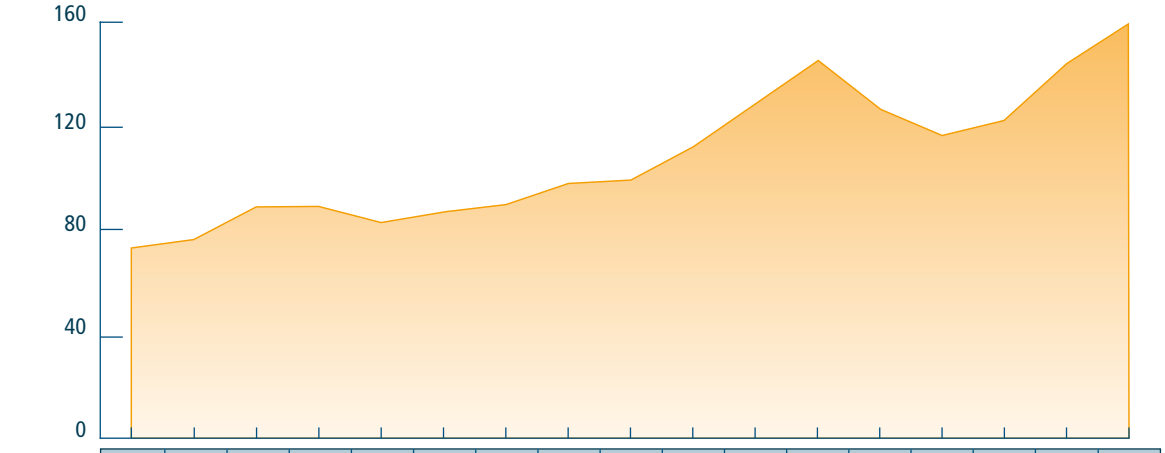
	2004	2005	2006
Central and multilateral banks	0.14%	0.08%	0.10%
Banks zone A[2]	98.39%	98.19%	98.05%
Banks zone B[3]	1.46%	1.73%	1.85%

This breakdown shows that the vast majority of loans and advances to credit institutions consist of commitments on zone A banks, i.e. banks of industrialised countries. The breakdown in relative terms remained relatively stable over the last three years.

[2] Countries zone A: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Saudi Arabia, Slovakia, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

[3] Countries zone B: all countries other than those of zone A.

Development in loans and advances to customers – in billion EUR



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Loans and advances to customers	74.1	77.1	88.3	88.5	80.7	86.0	88.1	96.8	98.2	117.1	128.5	145.3	127.5	117.5	121.1	146.5	159.4

Breakdown of loans and advances to customers

	2004	2005	2006
Public authorities zone A	8.63%	6.99%	6.08%
Public authorities zone B	0.09%	0.03%	0.11%
Private customers & Financial institutions	91.28%	92.97%	93.81%
of which: legal persons	*50.68%*	*48.66%*	*49.89%*
of which: natural persons	*24.18%*	*20.78%*	*19.79%*
of which: financial institutions	*25.08%*	*30.27%*	*30.27%*
of which: leasing	*0.06%*	*0.27%*	*0.06%*

The volume of loans and advances to legal persons grew by 12.9% in 2006; the volume of loans and advances to financial institutions increased by 10.1%. This development is attributable to the reasons mentioned above.

Qualitative breakdown of loans and advances to private customers and financial institutions

	2004	2005	2006
Secured by public authorities	2.98%	2.51%	2.22%
Secured by credit institutions	16.80%	14.94%	15.27%
Secured by real estate mortgages	15.04%	12.38%	11.68%
Secured by other tangible guarantees	31.50%	28.41%	28.11%
Unsecured	33.67%	41.76%	42.72%

The qualitative breakdown of loans and advances has hardly changed over the year 2006.

The portfolio of the **fixed-income securities** recorded a weak increase (+3.9%) in 2006, reaching EUR 198,172 million and representing 23.6% of the total balance sheet of 2006.

Qualitative breakdown of fixed-income securities

	2004	2005	2006
Public sector zone A	25.41%	29.88%	25.18%
Public sector zone B	0.31%	0.40%	0.24%
Credit institutions zone A	51.82%	43.58%	44.88%
Credit institutions zone B	0.83%	0.62%	0.49%
Other issuers zone A	17.76%	21.86%	25.43%
Other issuers zone B	3.87%	3.65%	3.78%

The volume of the portfolio of **variable-yield securities**, i.e. shares, remains marginal for Luxembourg banks (1.9% of the balance sheet total), even though this item has tripled in volume in 2006 to EUR 16,368 million at the end of the year. This improvement is attributable to a few material structured operations.

The item **participating interests and shares in affiliated undertakings** has grown even more to reach EUR 9,693 million in 2006 (+10.2%). A substantial part of this growth can be explained by the accounting effects of the contribution of Dexia Banque Internationale à Luxembourg of its UCI administration business line to the joint venture with the Royal Bank of Canada group.

The item **fixed assets and other assets** increased by 13.4% to EUR 46,182 million at the end of 2006.

- ***Liabilities***

As far as liabilities are concerned, amounts owed to customers have been particularly on the rise.

Amounts owed to credit institutions slightly decreased (-0.1%) to EUR 384,145 million. With 45.8% of liabilities (against 48.6% in 2005), the interbank market still remains the main item as regards refinancing, even if it loses ground compared to amounts owed to customers.

Amounts owed to customers, representing 34.9% of total liabilities, increased by 15.8% to EUR 293,032 million at the end of the 2006. Amounts owed to the public sector grew more substantially (+9.2%) than amounts owed to natural persons (+3.3%), while amounts owed to legal entities grew once again considerably by 20.2% (already +14.5% in 2005).

Breakdown of amounts owed to customers

	2004	2005	2006
Amounts owed to the public sector	3.46%	3.01%	2.83%
Amounts owed to legal persons	71.86%	75.23%	77.82%
Amounts owed to natural persons	24.68%	21.76%	19.35%

Amounts owed represented by securities remained stable (+0.7% in absolute terms) compared to 2005. With 10.2% of the balance sheet total, this refinancing mode remained interesting, notably for the banks issuing mortgage bonds.

Permanent means, which mainly encompass subscribed capital, reserves, provisions, subordinated debts and accruals, rose by 10.5% over the year to EUR 70,093 million at the end of 2006. This rise is mainly attributable to an increase in accruals and reserves, subordinated debts and the result for the financial year.

1.6. Development in the profit and loss account

Net profits of the Luxembourg banking sector in 2006 reached EUR 5,685 million, which represents a 62.5% growth as compared to the previous year.

The strong increase in the result for the financial year 2006 stemmed equally from current operating results and extraordinary non-recurring income. In a serene business environment, banking income improved by EUR 1,392 million to EUR 9,134 million. Other income grew by EUR 1,170 million. Other income includes extraordinary revenues that a limited number of credit institutions have realised on their securities portfolio and holdings portfolio.

Profit and loss accounts – in million EUR

	2004	Relative share	2005	Relative share	2006[4]	Relative share	Variation 05/06
Interest and dividends received	29,218		35,228		48,681		
Interest paid	25,306		31,323		43,864		
Interest-rate margin	**3,913**	**54%**	**3,905**	**50%**	**4,818**	**53%**	**23.4%**
Commission income	2,771	38%	3,209	41%	3,685	40%	14.8%
Income from financial operations	582	8%	628	8%	632	7%	0.6%
Banking operating income	**7,266**	**100%**	**7,742**	**100%**	**9,134**	**100%**	**18.0%**
General administrative expenses	3,174	44%	3,419	44%	3,752	41%	9.7%
of which: staff costs	*1,798*	*25%*	*1,945*	*25%*	*2,155*	*24%*	*10.8%*
of which: other administrative expenses	*1,375*	*19%*	*1,474*	*19%*	*1,597*	*17%*	*8.4%*
Depreciation	288	4%	274	4%	227	2%	-17.1%
Operating result before provisions	**3,805**	**52%**	**4,049**	**52%**	**5,155**	**56%**	**27.3%**
Other income	184	3%	548	7%	1,718	19%	213.5%
Creation of provisions	1,098	15%	1,142	15%	1,078	12%	-5.7%
Write-back of provisions	754	10%	846	11%	773	8%	-8.6%
Taxes	778	11%	803	10%	884	10%	10.0%
Result for the financial year	**2,866**	**39%**	**3,498**	**45%**	**5,685**	**62%**	**62.5%**

Interest-rate margin, which amounted to EUR 4,818 million as at 31 December 2006, increased by 23.4% as compared to the previous year. This growth results from two concurring developments: the rise in the pure interest-rate margin and the growth in holding income. The pure interest-rate margin, excluding income from dividends, increased by 15% in a context favourable to intermediation activities, as reflected by the rise in the aggregate balance sheet. Dividends received on holdings[5] increased by 70.7% over a year. Thus, a fifth of interest-rate margin is attributable to these dividends.

(in million EUR)	2004	2005	2006[6]
Dividends received on participating interests	643	578	986

[4] Preliminary figures for the end of 2006.

[5] Dividends relating to participating interests and interests in affiliated undertakings.

[6] Preliminary figures for the end of 2006.

The growth in stock valuation and the vigour of stock exchange operations, as well as the strength of intermediation activities are above all beneficial to commission income which increased by 14.8% over a year. The growth in **commission income** is particularly strong with respect to portfolio management commissions (+25.6%) and commissions on intermediation transactions (+30.1%). In 2006, banks in the financial centre thus earned EUR 3,685 million in commission income.

As far as market activities are concerned, net results totalled EUR 632 million as at 31 December 2006. This figure reflects a stagnation in **income from financial operations** year-on-year.

As far as expenses are concerned, **general administrative expenses** increased substantially. This growth concerns especially staff costs (+10.8%), which increase under the effect of wage adjustments and the rise in banking employment. The sharper growth in income as compared to costs entailed a strong increase of 27.3% in **gross result before provisions**.

The year 2006 has been particularly beneficial for a handful of banks of the financial centre that have realised substantial capital gains on their securities portfolios and their holding portfolios. Thus, **other income** has grown considerably by EUR 1,170 million over a year, reflecting in particular two important transactions on holdings.

Net creation of provisions increased slightly (+2.8%) as compared to its 2005 level. However, this increase is not attributable to new creation of provisions, but to lesser write-back of provisions year-on-year. **Tax** charges increased by 10% over a year.

Taking into account other income, creation of provisions and taxes, the result for the financial year 2006 reached EUR 5,685 million (+62.5%).

Structural ratios	2004	2005	2006
Cost / income ratio	46.5%	47.7%	43.6%
Profit before taxes / average assets	0.52%	0.54%	0.78%
Profit before taxes / risk-weighted assets	22.8%	26.9%	38.2%
Profit before taxes / tier-1 capital	15.4%	15.9%	22.2%
Income excluding interest / banking income	47.5%	49.6%	47.3%
Creation of provisions for loans and advances to customers[7]	0.73%	0.54%	0.39%
Creation of provisions for participations and shares in affiliated undertakings[8]	16.94%	12.90%	12.68%

Luxembourg credit institutions used the year 2006 to consolidate their profitability. Thus, the cost / income ratio fell back far below the 45% mark, after having been close to 48% in December 2005. Moreover, all the indicators of net unit profitability, whether they measure return on assets, risk-weighted assets or tier-1 capital, are increasing. This development took place in a context of an expanding tax base as average assets increased by 11.3%, risk-weighted assets by 14% and tier-1 capital by 9.8%.

[7] As a % of the gross amount.

[8] As a % of the gross amount.

In a favourable economic context, creation of provisions for loans and advances to customers decreased by 21.9% year-on-year. With 8.8% growth in volume of loans and advances to customers, the item creation of provisions thus decreased to 0.39% of the gross amount. Participations and shares in affiliated undertakings recorded a similar trend. Nevertheless, for the latter, both the outstanding amounts (+10.2%) and relating provisions (+8.3%) are on the rise.

Development of certain indicators of the profit and loss account by employee

(in million EUR)	2004	2005	2006
Banking income / employee	0.330	0.333	0.369
Staff costs / employee	0.080	0.084	0.087

The strong growth in banking income entails a noticeable rise in the banking income/employee ratio. The same is true, to a lesser extent, as regards the ratio staff costs/employee.

1.7. Off-balance sheet items and financial derivatives

The banks of the financial centre used derivatives for a total nominal amount of EUR 1,020.6 billion in 2006 against EUR 947.7 billion in 2005. The use of derivatives thus increased by 7.7% as compared to 2005.

The increased use of derivatives mainly concerned forward foreign exchange transactions (+33.8%), while interest rate derivative instruments slightly decreased (-2.1%). Interest rate swaps, used mainly within the scope of the management of assets/liabilities, remained the predominant derivative. They totalled EUR 589 billion, i.e. 57.7% of the total volume. Financial derivatives were mainly based on underlyings of interest rates (64.2% of the total volume) and of exchange rates (33.5% of the total volume). Derivative exposures to title deeds remained minor (2.2% of the total volume).

The ratio of the volume of derivatives compared to the balance sheet total reached 121.6% against 119.8% in 2005.

Instruments dealt over the counter remained the most used products (92.6% of the total nominal amount in 2006 against 94.7% in 2005). They reached a volume of EUR 945.5 billion against EUR 897.4 billion in 2005.

Use of financial derivatives by credit institutions

	2005		2006[9]	
	in billion EUR	*as a % of balance sheet total*	*in billion EUR*	*as a % of balance sheet total*
Interest rate swaps	609.4	77.0%	589.0	70.2%
Futures (interest) or forward rate agreements	60.0	7.6%	64.1	7.6%
of which: over the counter	*27.1*	*3.4%*	*23.4*	*2.8%*
of which: regulated market	*32.9*	*4.2%*	*40.7*	*4.8%*
Forward exchange	236.8	29.9%	317.0	37.8%
of which: over the counter	*236.7*	*29.9%*	*316.8*	*37.7%*
Futures (other rates)	7.0	0.9%	13.7	1.6%
Options (currencies, interests, other rates)	34.4	4.3%	36.9	4.4%
of which: over the counter	*24.2*	*3.1%*	*16.4*	*2.0%*
of which: regulated market	*10.2*	*1.3%*	*20.5*	*2.4%*

[9] Preliminary figures for the end of 2006.

Long-term development of profit and loss accounts – in million EUR

	1999	2000	2001	2002	2003	2004	2005	2006*	Variation 2005/2006
Interests and dividends received	35,943	47,996	51,942	41,257	34,071	29,218	35,228	48,681	38.2%
Interests paid	32,664	44,467	47,560	37,116	29,991	25,306	31,323	43,864	40.0%
Interest-rate margin	**3,279**	**3,529**	**4,382**	**4,141**	**4,080**	**3,913**	**3,905**	**4,818**	23.4%
Commission income	2,338	3,035	2,792	2,615	2,533	2,771	3,209	3,685	14.8%
Income from financial operations	563	488	355	261	481	582	628	632	0.6%
Banking income	**6,180**	**7,052**	**7,529**	**7,017**	**7,094**	**7,266**	**7,742**	**9,134**	18.0%
General administrative expenses	2,627	3,016	3,227	3,182	3,095	3,174	3,419	3,752	9.7%
of which: staff costs	*1,444*	*1,588*	*1,758*	*1,809*	*1,752*	*1,798*	*1,945*	*2,155*	*10.8%*
of which: other administrative expenses	*1,183*	*1,393*	*1,470*	*1,373*	*1,342*	*1,375*	*1,474*	*1,597*	*8.4%*
Depreciation	283	306	396	308	290	288	274	227	-17.1%
Result before provisions	**3,270**	**3,730**	**3,906**	**3,528**	**3,709**	**3,805**	**4,049**	**5,155**	27.3%
Other income	255	465	410	1,044	496	184	548	1,718	213.5%
Creation of provisions	1,095	1,520	1,261	1,824	1,389	1,098	1,142	1,078	-5.7%
Write-back of provisions	577	767	725	658	751	754	846	773	-8.6%
Taxes	977	1,013	920	685	694	778	803	884	10.0%
Result for the financial year	**2,030**	**2,429**	**2,861**	**2,720**	**2,874**	**2,866**	**3,498**	**5,685**	62.5%
Net creation of provisions	518	753	536	1,166	638	345	296	304	2.8%
Dividends relating to participating interests and interests in affiliated undertakings	226	433	652	499	628	643	578	986	70.7%

* preliminary figures

In 2003, the CSSF refined the reporting of third-party assets held by banks[10]. While this category previously comprised all the securities deposits of professional and non-professional customers, this amount is now broken down into the following categories:

- assets deposited by UCIs;
- assets deposited by clearing or settlement institutions;
- assets deposited by other professionals acting in the financial markets;
- other deposited assets.

The CSSF had not published the amount of securities deposits before 2003, as this figure was difficult to interpret. Indeed, the technical functioning of the securities deposits in the banking system implies that the same securities can be deposited and sub-deposited with several professionals, entailing that the same securities are counted twice or even more times, which can lead to wrong interpretations of the total amount of securities deposits.

This risk is now diminished, although not completely eliminated, for the deposits of the non-bank customers, UCIs and clearing or settlement institutions. It remains however for assets deposited by other professionals acting in the financial markets.

(in billion EUR)	**2005**	**2006**[11]	**Variation**
Assets deposited by UCIs	1,424.5	1,966.7	38.1%
Assets deposited by clearing or settlement institutions	421.8	417.6	-1%
Assets deposited by other professionals acting in the financial markets	4,456.7	5,495.7	23.3%
Other deposited assets	480.8	434.8	-9.6%

The rise in assets deposited by UCIs reflects the strong growth in these activities. It should also be noted that in 2006, a bank has re-categorised about EUR 100 billion from the item "Other deposited assets" to the item "Assets deposited by other professionals acting in the financial markets". Without this re-categorisation, the other deposited assets would have increased by 14% and the assets deposited by other professionals acting in the financial markets would have grown by 20.6%.

1.8. Development in own funds and in the solvency ratio

1.8.1. Number of banks required to meet a solvency ratio

As at 31 December 2006, the number of banks required to meet a non-consolidated solvency ratio stood at 115, including 114 banks incorporated under Luxembourg law and one branch of non-EU origin. 93 banks carry out limited trading activities, and are therefore authorised to calculate a simplified ratio. Actual trading activities remain confined to a limited number of banks. Among the 30 banks that also calculate a consolidated solvency ratio, fourteen are required to calculate an integrated ratio.

[10] For credit institutions under Luxembourg law and branches originating from third countries; branches originating from a Member State of the European Union are subject to a simplified reporting.

[11] Preliminary figures for the end of 2006.

Number of banks required to meet a solvency ratio	Integrated ratio		Simplified ratio		Total	
	2005	2006	2005	2006	2005	2006
Non-consolidated	24	22	89	93	113	115
Consolidated	14	14	14	16	28[12]	30

1.8.2. Development in the solvency ratio

The figures below are based on consolidated figures for banks required to meet a consolidated solvency ratio.

Although having dropped for the second consecutive year, the capital adequacy ratio remained high in 2006. The significant increase in capital requirements has only been partly offset by the growth in the base of eligible own funds. The solvency ratio itself reached 14.7%, easily exceeding the minimum threshold of 8% required under the existing prudential regulations. Taking into account core capital (Tier 1) only, the aggregate ratio for the financial centre decreased from 12.1% at the end of 2005 to 11.6% at year-end 2006.

Capital requirements for credit risk grew strongly in 2006 (+13.7%), reflecting a revival in lending operations. Besides, lending operations alone continue to make up the bulk of capital requirements. Capital requirements for the banks' trading portfolios, negligible in terms of volume, grew by 26%. Capital requirements for foreign exchange risk remain marginal, although their marked downward trend between 2000 and 2004 has been interrupted since 2005, which has been confirmed in 2006.

Eligible own funds continued their positive development of the previous years (+9.9%). Core capital, which represents 82.5% of total eligible own funds, grew by 9.8% due to the rise of the item "Paid-up capital" and "Reserves". As in the previous years, the banks hoarded a large part of their profits. Additional own funds (after capping) did not confirm their downward trend as in the previous year, but recorded a provisional volume of EUR 7,578 million as at 31 December 2006, i.e. 13.4% more than in the previous year. The marginal use of sub-additional own funds, as in the two previous years, also needs to be noted. Finally, items to be deducted from own funds have been on the rise since 2003 and recorded a volume of EUR 1,341 million in 2006 (against EUR 1,035 million in 2005), owing to the growth in the item participating interests in other credit and financial institutions exceeding 10% of the capital of the institutions under supervision. The impact on the solvency ratio denominator is significant as the participations concerned are to be fully deducted from eligible own funds.

[12] Banks whose participating interests are deducted from own funds on an individual basis are not required to calculate a consolidated ratio.

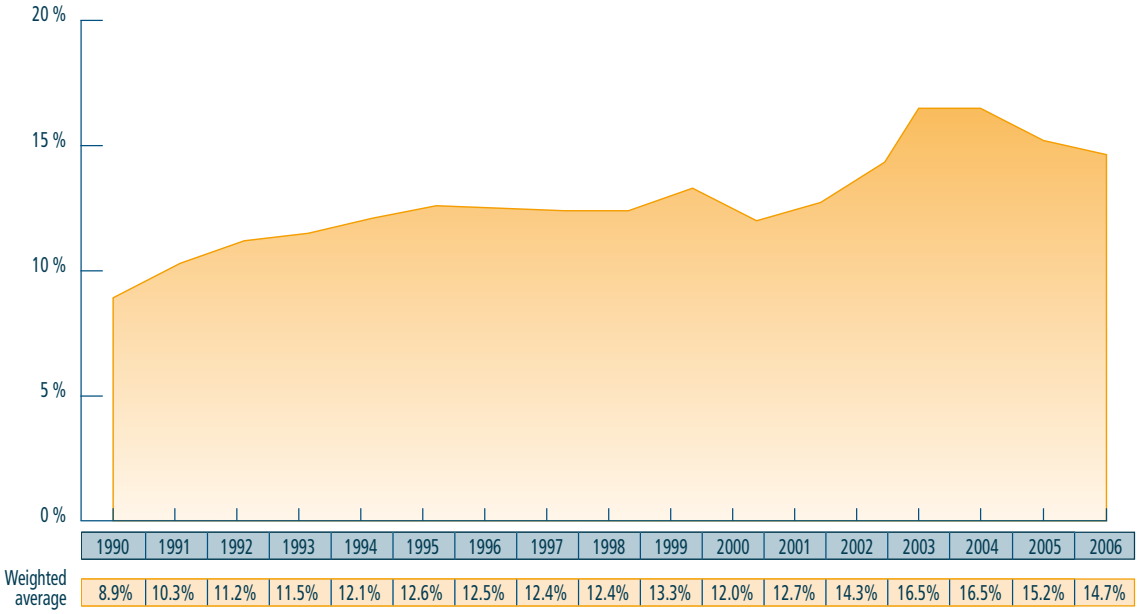
(in million EUR)

Numerator	2005 consolidated	2006 consolidated (provisional)
Original own funds before deductions	***27,593***	***30,651***
Paid-up capital	8,936	10,022
Silent participation ("Stille Beteiligung")	2,646	2,320
Share premium account, reserves and profits brought forward	13,321	15,680
Funds for general banking risks	1,907	1,315
Profits for the financial year	470	1,019
Specific consolidation items	313	294
Items to be deducted from original own funds	***-612***	***-1,024***
Own shares	0	-35
Intangible assets	-96	-444
Losses brought forward and loss for the financial year	-27	-112
Specific consolidation items	-489	-433
ORIGINAL OWN FUNDS (TIER 1)	**26,981**	**29,627**
Additional own funds before capping	***6,688***	***7,579***
Upper TIER 2	3,013	3,957
of which : cumulative preference shares with no fixed maturity	*29*	*29*
of which: subordinated upper TIER 2 debt instruments	*2,127*	*2,879*
Lower TIER 2	3,675	3,622
Lower TIER 2 subordinated debt instruments and cumulative preference shares with fixed maturity	*3,675*	*3,622*
ADDITIONAL OWN FUNDS AFTER CAPPING (TIER 2)	**6,683**	**7,578**
Sub-additional own funds before capping	***20***	***30***
SUB-ADDITIONAL OWN FUNDS AFTER CAPPING (TIER 3)	**20**	**30**
OWN FUNDS BEFORE DEDUCTIONS (T1+T2+T3)	**33,684**	**37,235**
ITEMS TO BE DEDUCTED FROM OWN FUNDS	**1,035**	**1,341**
Items of share capital in other credit and financial institutions in which the bank owns interests exceeding 10% of their share capital	917	1,164
Items of share capital in other credit and financial institutions in which the bank owns interests less or equal to 10% of their share capital	118	177
ELIGIBLE OWN FUNDS	**32,649**	**35,895**
Denominator		
TOTAL CAPITAL ADEQUACY REQUIREMENT	**17,183**	**19,587**
of which: to cover credit risk	16,794	19,094
of which: to cover foreign exchange risk	62	80
of which: to cover trading risk	327	413
Ratio		
SOLVENCY RATIO (base 8%)[13]	**15.2%**	**14.7%**
SOLVENCY RATIO (base 100%)	**190.0%**	**183.3%**

[13] Eligible own funds/(total capital adequacy requirement * 12.5)

The graph below plots the development of the solvency ratio (base 8%) since 1990. The weighted average is the ratio between total eligible own funds in the financial centre and total weighted risks. This average takes into account all credit institutions according to their business volume.

Development in the solvency ratio (base 8%)



1.8.3. Development in the solvency ratio distribution (base 8%)

In non-consolidated terms, the high solvency ratio in the financial centre includes a limited number of banks whose ratio is situated within the weak capitalisation bands, i.e. below 10%. For instance, as at 31 December 2006, the percentage of banks with a solvency ratio below this 10% threshold was only 11.3%. Conversely, more than 57% of credit institutions of the financial centre recorded a solvency ratio exceeding 15%.

	Numbers of banks		as % of total
Ratio	**2005**	**2006**	**2006**
<8%	0	0	0.0%
8%-9%	4	4	3.5%
9%-10%	5	9	7.8%
10%-11%	9	10	8.7%
11%-12%	5	9	7.8%
12%-13%	8	6	5.2%
13%-14%	5	5	4.3%
14%-15%	5	6	5.2%
15%-20%	19	20	17.4%
>20%	53	46	40.0%
Total	**113**	**115**	**100.0%**

1.9. International expansion of Luxembourg banks

In 2006, Luxembourg banks continued their prudent policy as regards the development of their activities abroad. External and organic growth strategies are only pursued on an isolated basis.

Five banks have expanded their international network in 2006, either by opening or acquiring banking or PFS subsidiaries abroad, namely:

• FORTIS BANQUE Luxembourg	Leasing activities extended through Fortis Lease Group
• Dresdner Bank Luxembourg S.A.	Creation of Dresdner Bank Monaco SAM
• DZ Bank International S.A.	Creation of DZ Bank International Singapore Ltd.
• Dexia Banque Internationale à Luxembourg S.A.	Creation of Dexia Private Financial Services SAM (Monaco)
• Crédit Agricole Luxembourg	Acquisition of CAGP (former CLGP) Belgium

Three banks have expanded their international network by opening branches abroad:

• Société Générale Bank & Trust	Opening of branches in Athens and Hong Kong
• RBC Dexia Investor Services Bank S.A.	Opening of branches in Zurich, Milan, Dublin and Hong Kong
• Commerzbank International S.A.	Opening of a branch in Brussels

One bank hived off a foreign subsidiary, namely:

• Kredietbank S.A. Luxembourgeoise	Sale of Banco Urquijo

The following branches abroad have been closed:

• Dexia Banque Internationale à Luxembourg S.A.	Closure of branches in Dublin, Milan and Hong Kong
• Banque BI&A S.A.	Closure of the branch in Lausanne
• EUROHYPO Europäische Hypothekenbank S.A.	Closure of the branch in Dublin

It should be noted that the business of the three branches closed by Dexia Banque International à Luxembourg S.A. has been transferred to the new branches created by RBC Dexia Investor Services Bank S.A.

Number of branches established in the EU/EEA as at 31 December 2006

Country	Luxembourg branches established in the EU/EEA	Branches of EU/EEA banks established in Luxembourg
Austria	1	-
Belgium	4	-
Finland	-	1
France	1	5
Germany	1	16
Greece	1	-
Ireland	3	-
Italy	1	2
Netherlands	-	2
Portugal	2	2
Spain	3	-
Sweden	1	1
United Kingdom	3	4
Total	**21**	**33**

Freedom to provide services within the EU/EEA as at 31 December 2006

Country	Luxembourg banks providing services in the EU/EEA	EU/EEA banks providing services in Luxembourg
Austria	24	18
Belgium	50	20
Cyprus	6	2
Czech Republic	6	-
Denmark	29	7
Estonia	7	-
Finland	24	5
France	50	61
Germany	49	41
[Gibraltar]	-	3
Greece	24	1
Hungary	6	2
Iceland	4	1
Ireland	23	31
Italy	40	6
Latvia	7	-
Liechtenstein	1	2
Lithuania	7	-
Malta	5	1
Netherlands	39	24
Norway	10	3
Poland	8	1
Portugal	27	8
Slovakia	6	1
Slovenia	6	-
Spain	41	5
Sweden	23	3
United Kingdom	40	79
Total number of notifications	**562**	**325**
Total number of banks concerned	**66**	**325**

1.10. Banks issuing mortgage bonds

The situation of banks issuing mortgage bonds has changed in 2006. Their number rose, their business has been diversified owing to the issue of the first mortgage bonds and, finally, the volume of the public mortgages issued has increased.

A new bank, namely NORD/LB COVERED FINANCE BANK S.A., subsidiary of Norddeutsche Landesbank Luxembourg S.A., has been created. It was authorised in 2006 and is in the progress of constituting its cover assets in order to launch its first public mortgage, probably in the second quarter of 2007.

Although the law on banks issuing mortgage bonds allows the banks issuing mortgage bonds to issue public bonds as well as mortgage bonds since its coming into force on 21 November 1997, the first mortgage bonds have been issued only in January 2006 by Erste Europäische Pfandbrief- und Kommunalkreditbank, Aktiengesellschaft in Luxembourg. The value of the cover assets of these mortgage bonds is made up exclusively of other mortgage covered bonds complying with the provisions of article 42(2) of the amended law of 30 March 1988 on UCIs and article 43(4) of the amended law of 20 December 2002 on UCIs. As at 31 December 2006, the total volume of mortgage bonds issued reached EUR 150 million; these bonds are guaranteed by cover assets worth EUR 183.9 million. Over-collateralisation (nominal value) represented EUR 33.9 million, while over-collateralisation according to the current value was EUR 33 million as at 31 December 2006.

In general, the banks issuing public mortgage bonds continued their positive development during 2006. Indeed, as at 31 December 2006, the balance sheet total of the four banks issuing mortgage bonds totalled EUR 42.9 billion and the total volume of public mortgage bonds issued (and in circulation) by the three issuing banks reached EUR 27.5 billion against EUR 23 billion at the end of 2005.

Issues of mortgage bonds are guaranteed by ordinary cover assets and by substitute cover assets. As at 31 December 2006, public mortgage bonds in circulation benefited from an over-collateralisation (nominal value) of EUR 3.8 billion. Over-collateralisation calculated according to the current value amounts to EUR 3.9 billion as at 31 December 2006.

The ordinary cover assets of public mortgage bonds for the three issuing banks break down as follows:

- claims on or guaranteed by public organisations: EUR 7.459 billion;
- bonds issued by public organisations: EUR 19.91 billion;
- public mortgage bonds of other issuers: EUR 1.199 billion;
- derivative transactions: EUR 901 million.

Besides these ordinary cover assets, the banks used substitute cover assets to cover their public mortgage bonds amounting to EUR 1.793 billion as at 31 December 2006.

Owing to the faultless quality of investments of the specialised banks and the scale of over-collateralisation in relation to the mortgage bonds issued, public sector mortgage bonds continue to receive an AAA rating from the rating agency Standard & Poor's. Moreover, the mortgage bonds issued by EUROHYPO Europäische Hypothekenbank S.A. also received an AAA rating from a second rating agency, namely FITCH IBCA.

Besides these positive developments regarding the volume of mortgage bonds, the need arose to adapt the law on banks issuing mortgage bonds on a certain number of points, and notably following the trends observed in the markets of financial instruments and the experience gained in the implementation of the existing provisions. In consultation with the players in the financial centre, the CSSF has thus drawn up a draft bill modernising the law of 21 November 1997 on banks issuing mortgage bonds.

2. PRUDENTIAL SUPERVISORY PRACTICE

2.1. Objectives of prudential supervision

Supervision of banks aims at the following:

- ensuring the security of the public's savings by monitoring the solvency and prudent management of individual banks;
- ensuring financial stability and proper functioning of the banking system as a whole;
- protecting the reputation of the financial sector by penalising ethically unacceptable conduct. In order to fulfil these objectives of public interest, the CSSF monitors the implementation by credit institutions of the laws and regulations relating to the financial sector.

2.2. Monitoring of quantitative standards

Quantitative standards, designed to ensure financial stability and risk spreading by credit institutions, relate to:

- evidence of minimum equity capital;
- a maximum ratio between own funds on the one hand and risk exposure on the other hand;
- limitation of the risk concentration on a single debtor or a group of associated debtors;
- liquidity ratio;
- limitation of qualified participating interests.

In the year under review, the CSSF had to intervene four times in writing with respect to own funds or the solvency ratio. In two instances, own funds were below the minimum level and in two other instances, the capital ratio was below the 8% threshold. Furthermore, the CSSF had to take measures twice on account of failure to meet the liquidity ratio.

In all instances of failure to meet a ratio, the CSSF required the institution concerned to provide information on the measures taken to remedy the situation. These situations have all been sorted out forthwith.

Within the scope of monitoring compliance with the requirements as regards large exposure limits, the CSSF intervened 38 times (24 in 2005), either to inform that the maximum level of large exposures had been exceeded and to request the bank concerned to provide information on the measures taken to bring back the commitments within the limits, or to request additional information on the guarantees and risk weights applied, or to require that certain commitments be combined. If such combinations resulted in an overrun of the large exposures limits, the bank concerned had to take appropriate measures once again to bring back these commitments within the regulatory limits. As regards credits secured by guarantees, the CSSF saw in particular to a sufficient diversification of the securities portfolios received as guarantees in order to avoid indirect risk concentrations.

2.3. Monitoring of qualitative standards

The CSSF relies on several instruments to assess the quality of the banks' organisation:

- analytical reports prepared by external auditors;
- management letters and similar reports prepared by external auditors;
- on-site inspections undertaken by CSSF agents;
- reports prepared by internal auditors of the banks.

These reports are all processed according to a methodology set out in the CSSF's internal procedures.

The response of the CSSF depends on the seriousness of the problem raised and whether it is repetitive in nature. It ranges from the simple monitoring of the problem on the basis of reports, drawing-up of deficiency letters, convening the bank's management, to on-site inspections undertaken by CSSF agents. Where necessary, the CSSF may use its formal powers of injunction and suspension of managers or activities.

In 2006, the CSSF has sent 145 (105 in 2005) deficiency letters to banks in relation with shortcomings relating to organisation; 72 of these letters relate to the review of the long form report, 31 to the review of internal audit reports and 16 to the on-site inspections carried out by the CSSF.

2.4. Analytical reports

The analytical report prepared by the external auditor is one of the most important instruments to assess the quality of the organisation and the exposure to different risks. The CSSF requires the preparation of an analytical report on a yearly basis for each Luxembourg credit institution as well as for the Luxembourg branches of non-EU credit institutions. Furthermore, credit institutions supervised on a consolidated basis are required to submit a yearly consolidated analytical report and individual analytical reports of each subsidiary included in the consolidation and carrying out an activity of the financial sector.

Analytical reports were made compulsory in 1989 through a circular, which was reformed in 2001 (circular CSSF 01/27) in order to reflect the development of the regulatory and prudential framework.

In 2006, the CSSF analysed 119 analytical reports (136 in 2005), 25 consolidated analytical reports (23 in 2005) and 80 analytical reports of subsidiaries of Luxembourg banks (77 in 2005).

2.5. Co-operation with external auditors

Article 54 of the law on the financial sector governs the relationship between the CSSF and the external auditors. This article confers upon the CSSF the power to establish the regulations relating to the scope of the audit mandate and the content of the audit report. The professionals supervised shall communicate all the reports issued by the external auditor within the course of the audit of the annual accounts to the CSSF.

Furthermore, the law requires external auditors to inform the CSSF immediately of any serious facts, defined more specifically under article 54(3) of the aforementioned law, which have come to their attention in the course of their duties.

The supervision of the CSSF is thus to a large extent based on the work of the external auditors and their reports. Since 2002, the CSSF holds annual meetings with the main audit firms in order to exchange opinions on specific issues encountered within banks. Discussions also deal with the quality of the reports produced and the results of the inspections.

2.6. On-site inspections

The programme of inspections to be carried out during the year is set up at the beginning of the year and is based on the assessment of the risk areas of the various credit institutions.

Since 2004, inspections focus on the internal governance of credit institutions, i.e. the functioning of the banks' bodies, the position of the bank within the group, as well as the efficiency of the control functions such as internal audit. Indeed, the verification of the proper operation of internal governance and control functions has proved to present the best means used/results ratio for the CSSF teams.

On the other hand, the missions to validate the internal models within the scope of the implementation of the Basel II framework continue to absorb an important part of the capacities (cf. point 2.7. below).

Inspections carried out by CSSF agents generally follow standard inspection procedures, in the form of discussions with the people responsible, assessment of procedures and verification of files and systems.

During the year under review, 36 inspections have been carried out, against 46 in 2005, 76 in 2004 and 62 in 2003. The reason for this decrease lies in the fact that the missions carried out under Basel II are no longer mentioned in this chapter, but in point 2.7. below and in Chapter XI on General Supervision and the involvement of the CSSF in international groups. Basel II missions included, the number of on-site controls and inspections amounted to 62 in 2006.

The controls and visits concentrated on the following topics:

- Ten missions concerned the functioning of the banks' bodies, notably the board of directors. During these inspections, the CSSF inspected the meeting frequency of the board of directors, the subjects mentioned, the frequency of the audits of the parent company and the decision-making process relating to the main counterparty risks and the business relationships in general. The CSSF observed that the banks inspected are in general well integrated in the decision-making process and control of the parent companies.
- Four missions focused on the function "head of group" and the supervision of the subsidiaries; three missions focused on the quality of the internal audit function. The main observations were that the audit plan and therefore the work of internal audit, did not cover all business areas of the bank and that the internal audit department only reported to part of the management instead of reporting to the management as a whole.

The other on-site inspections concerned different subjects such as credit activity, the organisation of private banking, money laundering and risk management. While the control of compliance with the anti-money laundering rules was a major focus of attention during the last years, with eleven inspections in 2004 and twenty in 2003, its relative importance, in numbers of inspections, decreased since 2005.

2.7. Basel II missions

Circular CSSF 06/273 of 22 December 2006 transposes the parts of Directives 2006/48/EC and 2006/49/EC (also known as "Basel II") that concern capital ratios into Luxembourg legislation. This new regime introduces a material change as the banks may opt to use internal models to estimate certain parameters that are included in the calculation of the capital requirement. These models must meet a large number of quantitative and qualitative criteria and be subject to a validation process of the supervisory authority.

The banks established in Luxembourg being very often subsidiaries of European groups, this validation process takes place in these cases in close consultation between the home and host authorities, in accordance with Directive 2006/48/EC.

In 2006, the CSSF took part in thirteen meetings abroad dealing with the validation process of internal models or meetings gathering home and host authorities. Five meetings took place in Luxembourg. In addition, validation missions were performed within eight banks.

2.8. Combating money laundering

Article 15 of the law of 12 November 2004 on the fight against money laundering and terrorist financing provides that the CSSF is the competent authority to ensure compliance with professional obligations as regards the fight against money laundering and terrorist financing by every person subject to its supervision. However, non-compliance with the professional obligations in full knowledge falls under the criminal law and relevant proceedings thus fall within the competence of the State Prosecutor's office.

Before the adoption of this law, non-compliance with professional obligations, even unintentional, was subject to criminal sanctions and the State Prosecutor's office was consequently responsible for prosecution.

The CSSF uses the following instruments to supervise compliance with these rules: reports of external auditors and those prepared by internal auditors, as well as the inspections carried out by CSSF agents.

During the year under review, the CSSF sent 50 letters to banks in relation with shortcomings concerning money laundering. These letters, based on on-site inspections and/or external or internal audit reports, listed the shortcomings identified and enquired about the corrective measures envisaged. Among the most frequently observed deficiencies are incomplete documentation of customer files, incomplete anti-money laundering procedures, lack of training sessions for employees, as well as lack of particular monitoring of politically exposed persons (PEPs). Furthermore, a significant number of accounts had not been blocked despite incomplete documentation or had been moved despite them being marked as blocked.

The yearly analytical report prepared by external auditors must specifically cover compliance with legal requirements and the adequate implementation of internal procedures concerning the prevention of money laundering. The main deficiencies observed are about the same as those observed by the CSSF.

The law of 12 November 2004 requires that banks with branches or subsidiaries abroad ensure that these entities comply with Luxembourg professional obligations, as far as these subsidiaries or branches are not subject to equivalent professional obligations provided for by the laws applicable at the place of their establishment. The CSSF verifies compliance with this requirement by means of analytical reports of external auditors to be prepared for each subsidiary carrying out an activity of the financial sector. Furthermore, the CSSF requires that the internal audit of the Luxembourg parent company periodically verify that subsidiaries and branches abroad comply with the group's anti-money laundering directives. The results of these inspections must be included in the summary report which has to be submitted to the CSSF on an annual basis.

2.9. Management letters

Management letters drawn up by external auditors for the attention of the banks' management are an important source of information as regards the quality of the credit institutions' organisation. In these reports, the external auditors point out weaknesses they observed in the internal control system in the course of their assignment. During 2006, the CSSF analysed 68 management letters and similar documents.

2.10. Meetings

The CSSF regularly holds meetings with bank executives to discuss business and any problems. It also requires prompt notification by the banks if a serious problem arises. In 2006, 156 meetings were held between CSSF representatives and bank executives.

2.11. Specific controls

Article 54(2) of the law of 5 April 1993 on the financial sector as amended allows the CSSF to require an external auditor to conduct a specific audit in a given institution. The CSSF did not make use of this power in 2006. However, it has invited six times (two in 2005) banks to appoint specifically their external auditor to audit specific business areas and to submit the results of these reviews to the CSSF.

2.12. Internal audit reports

The CSSF takes into account the work of the internal audit when assessing the quality of the organisation and risk management by analysing the summary report which the internal auditor must prepare every year. In 2006, the CSSF analysed 123 summary reports (141 in 2005). It also requested 66 specific internal audit reports (57 in 2005) in order to obtain more detailed information on particular subjects.

2.13. Supervision on a consolidated basis

As at 31 December 2006, 33 banks under Luxembourg law[14] (idem at the end of 2005), two financial holding companies under Luxembourg law[15] (one in 2005), as well as one financial holding company incorporated under foreign law[16] (none in 2005) were supervised by the CSSF on a consolidated basis.

The conditions governing submission to a consolidated supervision, the scope, content and methods of supervision on a consolidated basis are laid down in Part III, Chapter 3 of the law of 5 April 1993 on the financial sector as amended. The practical application of the rules governing supervision on a consolidated basis is explained in circular IML 96/125.

It has to be noted that the CSSF pays particular attention to the "group head" function set up at the Luxembourg establishment falling under its consolidated supervision. Thus, the CSSF sees more specifically to the way the Luxembourg parent company communicates its policies and strategies to its subsidiaries as well as to the controls set up at the Luxembourg parent company in order to monitor the organisation and activities of the subsidiaries, as well as their exposures.

The means the CSSF may use for its supervision on a consolidated basis are manifold:

- The CSSF requires periodic reports reflecting the financial situation and the consolidated risks of a group subject to its consolidated supervision.
- Another source of information are the reports prepared by the external auditors. Circular CSSF 01/27 defining the mission of the external auditor requires that a consolidated analytical report of a group subject to the consolidated supervision of the CSSF must be drawn up. The purpose of this consolidated report is to provide the CSSF with an overview of the group's situation and to inform on the risk management and structures of the group.

[14] ABN Amro Bank (Luxembourg) S.A., Banca Popolare di Verona e Novara (Luxembourg) S.A., Banque Carnegie Luxembourg S.A., Banque de Luxembourg S.A., Banque Degroof Luxembourg S.A., Banque Delen Luxembourg, Banque Safra-Luxembourg S.A., BHF-BANK International, BNP Paribas Luxembourg, CACEIS Bank Luxembourg, Crédit Agricole Luxembourg, DekaBank Deutsche Girozentrale Luxembourg S.A., Deutsche Bank Luxembourg S.A., Dexia Banque Internationale à Luxembourg, Dresdner Bank Luxembourg S.A., DZ Bank International S.A., Fideuram Bank (Luxembourg) S.A., FORTIS BANQUE LUXEMBOURG, HSH Nordbank Securities S.A., IKB International, ING Luxembourg S.A., John Deere Bank S.A., Kredietbank S.A. Luxembourgeoise, Mutuel Bank Luxembourg S.A., Natexis Luxembourg S.A., Natixis Private Banking Luxembourg S.A., Norddeutsche Landesbank Luxembourg S.A., Nordea Bank S.A., RBC Dexia Investor Services Bank S.A., Sanpaolo Bank S.A., Société Générale Bank & Trust, UBS (Luxembourg) S.A., West LB International S.A.

[15] Clearstream International S.A., EFG Investment (Luxembourg) S.à r.l.

[16] RBC DEXIA Investor Services Ltd, London.

- The CSSF requires an individual analytical report for each important subsidiary.
- By virtue of circular IML 98/143 on internal control, a summary report on the activities carried out by the internal audit department is to be communicated to the CSSF on an annual basis. The CSSF requires that the scope of intervention of the internal audit of the Luxembourg parent company be extended also to the subsidiaries in Luxembourg and abroad. This report must mention the controls carried out within the subsidiaries and the results thereof. The main observations made within the subsidiaries as regards the compliance function as defined in circular CSSF 04/155 shall also be mentioned therein.
- The CSSF's information is supplemented by contacts, exchange of letters and meetings with supervisory authorities of the subsidiaries' host countries. Within the scope of its supervision on a consolidated basis, the CSSF expects to systematically obtain, from the banks and financial holding companies subject to consolidated supervision, information on any interventions of the host country authorities with the subsidiaries, where these interventions concern non-compliance with domestic regulations and aspects regarding organisation or risks of these subsidiaries.
- As regards groups with an important network of subsidiaries, the CSSF follows the development of the financial situation and the risks of the subsidiaries included in the consolidated supervision by means of regular meetings with the management of the credit institution or of the financial holding company under consolidated supervision.
- The CSSF performs on-site inspections that focus, on the one hand, on the manner in which the parent company sets up its policies and implements its strategies within the subsidiaries and, on the other hand, on the follow-up applied to the subsidiaries.

Until now, the CSSF has not carried out itself any on-site inspection at the premises of foreign subsidiaries of Luxembourg banks.

The CSSF also investigates indirect participations of banks subject to its consolidated supervision in accordance with the terms of circular IML 96/125.

The law of 5 November 2006 on the supervision of financial conglomerates and amending the law of 5 April 1993 on the financial sector requires the CSSF to verify henceforth that Luxembourg credit institutions whose parent undertaking is a credit institution or a financial holding company having its head office in a third country, are subject to a consolidated supervision of the competent authority of that third country that is equivalent to the consolidated supervision performed by the CSSF on credit institutions and financial holding companies. If there is no equivalent consolidated supervision of the third country, the CSSF must perform a consolidated supervision of this group or apply another method in order to achieve the objectives of consolidated supervision.

The CSSF has thus to verify the equivalence of the consolidated supervision performed by the competent authority of the third country for five credit institutions belonging to banking groups of Swiss and Israeli origin. For one institution belonging to an US banking group, the CSSF concluded that the consolidated supervision performed by the US competent authority is equivalent to the supervision performed by the competent authorities of the Member States of the European Union.

2.14. Supplementary supervision of financial conglomerates

The law of 5 November 2006 on the supervision of financial conglomerates introduces a supplementary supervision on financial conglomerates into Luxembourg law. A financial conglomerate is a group that includes at least one important regulated entity within the banking or investment services sector and one important entity within the insurance sector.

The law requires the CSSF to perform a supplementary supervision of the financial conglomerates for which it exercises the role of coordinator of the supervision, the coordinator being the authority responsible for the coordination and supplementary supervision at the level of the financial conglomerate.

The CSSF's supplementary supervision of financial conglomerates does not affect at all the sectoral prudential supervision, both on the individual and consolidated level, by the relevant competent authorities.

The practical consequences of this law for Luxembourg credit institutions and investment firms are however limited as things stand at present. Indeed, the CSSF has not identified any financial conglomerate for which it should exercise the role of coordinator of this supplementary supervision at this stage.

2.15. International co-operation in matters of banking supervision

International co-operation, which has already been very comprehensive in the past, has been further strengthened by Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions. There are three types of co-operation:

- the traditional bilateral co-operation as performed since the beginning of the 1980s;
- the strengthened multilateral co-operation with respect to certain groups; and
- the co-operation as set out in article 129 of the said Directive.

2.15.1. Traditional bilateral co-operation

Following the implementation of the second banking Directive, the CSSF has concluded memoranda of understanding with the banking supervisory authorities of several Member States of the European Economic Area[17] in the 1990s, with a view to specify the terms of co-operation. These memoranda concern in particular the supervision of credit institutions involved in cross-border operations by way of the freedom to provide services or through the creation of branches.

Moreover, in accordance with the legal provisions in force, the CSSF co-operates and exchanges information on an informal basis with a number of other counterpart authorities.

In 2006, the CSSF held four bilateral meetings with banking supervisory authorities[18] in order to exchange prudential information on supervised institutions having a presence in both countries.

Alongside the consultations required under the European Directives, the CSSF informs the relevant authorities of all significant facts relating to supervision. In particular, it consults the relevant authorities regarding acquisitions of significant participating interests and restructurings of share ownerships.

2.15.2. Strengthened multilateral co-operation with respect to certain groups

The new structures of certain banking groups, introducing a decentralised organisation of operational management units and centres of competence, called for an adaptation of the prudential supervisory modes of the activities of these groups. In this context, the CSSF has signed specific co-operation agreements with:

[17] Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom.

[18] Bundesanstalt für Finanzdienstleistungsaufsicht (Germany), Commission bancaire, financière et des assurances (Belgium), Commission Bancaire (France), Commission fédérale des banques (Switzerland).

- the Belgian and French authorities for the supervision of the DEXIA group;
- the Belgian and Dutch authorities for the supervision of the FORTIS group;
- the German authority for the supervision of the Clearstream group.

The key objective of such specific co-operation agreements is to ensure that all banking activities of these groups are adequately supervised. To this end, the authorities ensure in particular that the various sets of regulations are applied in a harmonised manner in order to avoid any unbalanced treatment within the groups.

The co-operation between authorities is enacted on several levels:

- close consultation between the authorities in order to coordinate and align their prudential supervision;
- continuous and systematic exchange of information on any significant event likely to impact the group or its main constituent entities;
- regular consultation for the principal purpose of updating the list of points requiring the attention of the authorities within these groups, drafting of control plans and, finally, examining the appropriateness of on-site inspections to be carried out by the competent authority in close co-operation with the other relevant authorities.

Besides frequent exchanges of information between the persons directly responsible of the supervised entities in each authority, the CSSF attended twenty-five meetings within the framework of this specific co-operation. It should be noted that in 2006, a high number of these meetings between authorities exclusively concerned their co-operation with respect to the implementation of new models of risk management by various banking groups, in order to prepare for the Basel II regulations.

2.15.3. Co-operation in accordance with article 129 of Directive 2006/48/EC

Co-operation between European competent authorities assumes a new dimension in accordance with the requirements laid down in article 129 of Directive 2006/48/EC which requires intensive co-operation between the relevant competent authorities of cross-border banking groups and strives towards a more centralised supervision of these large cross-border groups at EU level.

The competent authority for the consolidated supervision of a European banking group shall henceforth plan and coordinate the prudential activities in co-operation with the other relevant competent authorities. In 2006, the CSSF participated in two meetings concerning each a large banking group and which laid within the context of strengthening the co-operation between European authorities for the purpose of consolidated supervision.

Similarly, for cross-border banking groups seeking to use advanced approaches for the calculation of capital requirements for credit risk or operational risk, European regulations require that the competent authorities co-operate closely to decide on authorising the use of these advanced approaches by the banking group. In the absence of a joint decision, the authority competent for the consolidated supervision of the banking group makes its own decision on the application. This decision shall be recognised by the other competent authorities as final and be applied by these authorities. In 2006, the CSSF took part in four meetings dealing exclusively with the implementation by various banking groups of these new models for risk management and calculation of capital requirements. Moreover, the CSSF closely co-operated with certain foreign authorities during the pre-validation and validation stages of the internal ratings-based approaches within the scope of the implementation of Basel II (cf. Chapter XI, point 1.2.)

2.16. Customer canvassing

Employees working as account managers changing employer often give rise to disputes between the banks concerned due to a subsequent migration of customers. Following numerous complaints of banks that have been the victims of customer canvassing performed by former employees, the CSSF had invited the professionals, by means of circular CSSF 2000/15 on the rules of conduct for the financial sector, to ensure that their employees refrain from using information from their former job in order to canvass customers of their former employer.

However, the number of banks that consider themselves harmed by the dealings of resigning employees that have joined competing institutions remains high. It is therefore necessary to provide further explanations and to propose guidance to resolve such conflicts.

The CSSF is faced with the following three difficulties when treating such cases:

- Private banking *per se* is a service activity where personal contact may play a major role. It is not uncommon that close relationships develop between account managers and customers and that the ties of the customers with their contact persons are stronger than those with the bank where they hold their account.

  Where account managers change employer, it is not surprising to note therefore that a certain number of customers follow the account manager with whom they were used to deal. This situation must be considered as normal.
- It is almost impossible in such a situation to determine whether the customer has taken the initiative to follow the account manager or if the account manager has contacted the customer to prompt him/her to join the new employer. Even if the initiative comes from the account manager, it is difficult, or even impossible, to demonstrate that the employer has encouraged or tolerated this active canvassing.
- It should be borne in mind that the CSSF does not have any procedures or sanctions available against individual account managers.

In general, the CSSF often has to shelve banks' complaints following the statements of the account managers. Account must also be taken of the fact that, according to jurisprudence, customer canvassing by a former employee *per se* is not an act of unfair competition as long as it is not performed by means that are contrary to fair trade practices, such as the use of denigrating information or misappropriation of lists. This explains why the CSSF does not dispose of any procedures, even if the act of canvassing is clearly established. Other means of resolving such conflicts shall thus be envisaged.

It is important that banks that lose one or several account managers take measures immediately to deter an erosion of business. It is thus recommended to contact the customers concerned and to propose a new contact person. According to the circumstances, the employer may exempt the resigning employee from the period of notice, and withdraw the means of communication that the bank had given him, such as mobile phones. Finally, direct contact between the management of both banks concerned sometimes allows to avoid an escalation of the conflict.

However, customers being harassed by a resigning employee to prompt them to change bank while they had no intention to do so is not tolerable. In such cases, the CSSF expects that the account manager is firmly called to order.

Agents hired in 2006 and 2007 – Departments "General Supervision", "Supervision of PFS", "Supervision of banks", "Supervision of securities markets", "Supervision of pension funds, SICARs and securitisation undertakings", "General Secretariat" and "Information technology"

First row, left to right: Carmela ANOBILE, Christine JUNG, Stéphanie NOTHUM, Mariette THILGES, Martine WEBER, Giang DANG, Micheline DE OLIVEIRA

Second row, left to right: Frank BRICKLER, Patrick HOMMEL, David DELTGEN, Cliff BUCHHOLTZ, Yves HANSEN

Absent: Paul ANGEL

CHAPTER 2

2 SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT

1. DEVELOPMENTS IN THE UCI SECTOR IN 2006

1.1. Major events in 2006

In 2006, the sector of undertakings for collective investment (UCIs) saw a substantial growth of 21% in the net assets managed and of 8.6% in the number of UCIs. 65.6% of the 2,238 UCIs registered on the official list as at 31 December 2006 were UCITS governed by Part I of the law of 30 March 1988 as amended and of the law of 20 December 2002 as amended.

In relation to the regulation applicable to UCITS with a European passport, the Committee of European Securities Regulators (CESR) issued in 2006 two documents of major importance, i.e. CESR document 06-005 dated 26 January 2006, defining the guidelines on the eligibility of different financial instruments and UCITS asset categories, and CESR document 06-120b of 29 June 2006 which defines the guidelines to simplify the notification procedure of these UCITS in Europe.

As a consequence of the requirements of the law of 20 December 2002 as amended on the management of UCITS covered by Directive 85/611/EEC, many management companies have adopted the status of management company in accordance with Chapter 13 of this law in 2006.

In 2006, the demand for Luxembourg UCIs has shifted, as compared to 2005, from fixed-income UCIs to UCIs with a diversified investment policy and UCIs investing in variable-yield transferable securities. In parallel, when considering supply, the launch of new entities with a diversified investment policy has experienced the most important growth as compared to other categories. Guarantee-type UCIs have also experienced a strong development in 2006.

Another point to highlight is that German, English and French promoters have strengthened their position in the Luxembourg financial centre.

Moreover, a stabilisation in the number of mergers and liquidations of UCIs and UCI sub-funds can be observed over the last three years.

1.2. Development in the UCI sector

The number of UCIs registered on the official list was of 2,238 UCIs as at 31 December 2006 against 2,060 UCIs at the end of 2005, representing an increase of 178 entities. The number of newly registered UCIs increased with 345 UCIs. The number of withdrawals reached 167 entities.

The performance of the main financial stock exchanges and the regular inflow of new capital led total net assets of Luxembourg UCIs to grow by EUR 319.6 billion in one year to reach a new record of EUR 1,844.8 billion on 31 December 2006. This 21% growth originates for 75.5% from the net issues and for 24.5% from the increase in stock exchanges. Net capital investment in Luxembourg undertakings for collective investment amounted to EUR 241.3 billion in 2006.

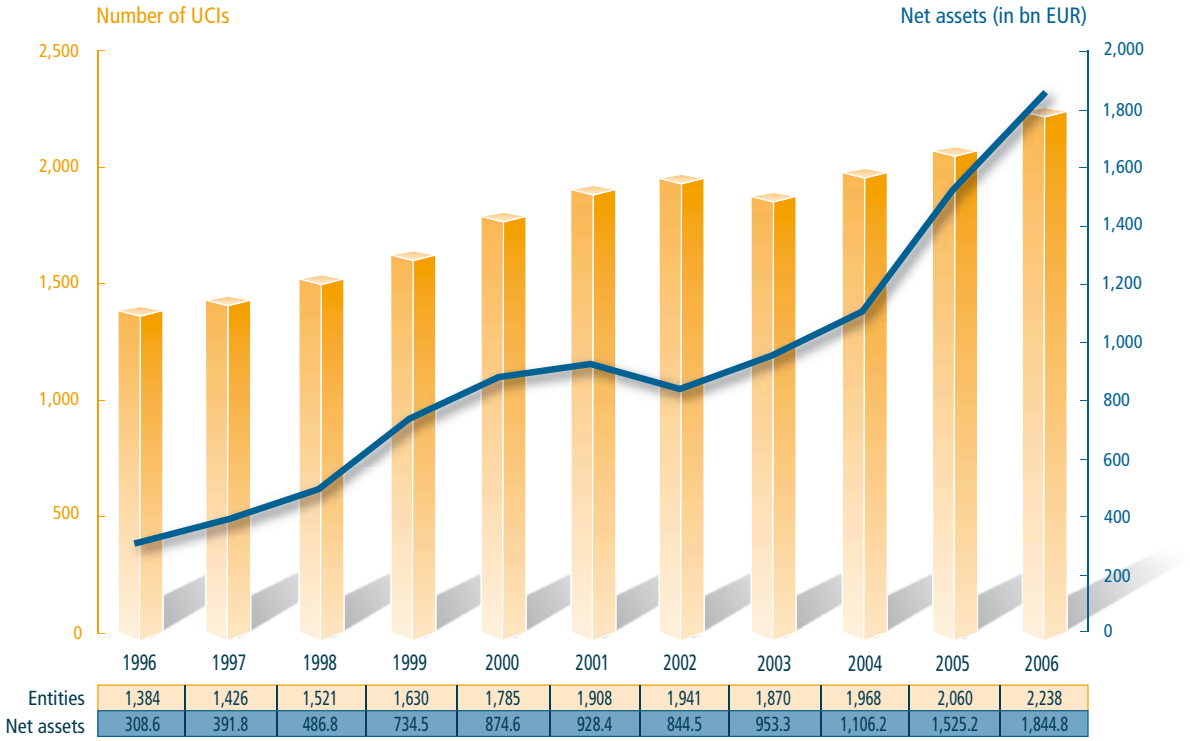
Development in the number and net assets of UCIs

	Number of UCIs	Regis-trations on the list	With-drawals from the list	Net variation	In %	Net assets *(in bn EUR)*	Net issues *(in bn EUR)*	Variation in net assets *(in bn EUR)*	In %	Average net assets per UCI *(in bn EUR)*
1996	1,384	182	127	55	4.1	308.6	22.5	46.8	17.9	0.223
1997	1,426	193	151	42	3.0	391.8	50.1	83.2	26.9	0.275
1998	1,521	234	139	95	6.7	486.8	84.1	95.0	24.3	0.320
1999	1,630	265	156	109	7.2	734.5	140.1	247.7	50.9	0.451
2000	1,785	278	123	155	9.5	874.6	168.1	140.1	19.1	0.490
2001	1,908	299	176	123	6.9	928.4	121.7	53.8	6.2	0.487
2002	1,941	222	189	33	1.7	844.5	57.3	-83.9	-9.0	0.435
2003	1,870	175	246	-71	-3.7	953.3	82.6	108.8	12.9	0.510
2004	1,968	202	104	98	5.2	1,106.2	113.7	152.9	16.0	0.562
2005	2,060	266	174	92	4.7	1,525.2	236.3	419.0	37.9	0.740
2006	2,238	345	167	178	8.6	1,844.8	241.3	319.6	21.0	0.824

Over the last ten years, the number of UCIs has grown by 854 entities to reach 2,238 entities in 2006, which corresponds to an average growth of 6.17% per year for the past ten years.

Net assets have increased over the past ten years by EUR 1,536 billion, representing an average growth of EUR 153.6 billion per year. It should however be pointed out that mainly 2005 and 2006 experienced a strong growth, with + EUR 419 billion for 2005 and + EUR 319.6 billion for 2006.

Development in the number and net assets of UCIs



The breakdown of UCIs across *fonds communs de placement* (FCP), *sociétés d'investissement à capital variable* (SICAV) and *sociétés d'investissement à capital fixe* (SICAF) reveals that at 31 December 2006, FCPs were still the prevailing legal form with 1,224 entities out of a total of 2,238 active UCIs, against 1,000 entities operating as SICAVs and 14 as SICAFs.

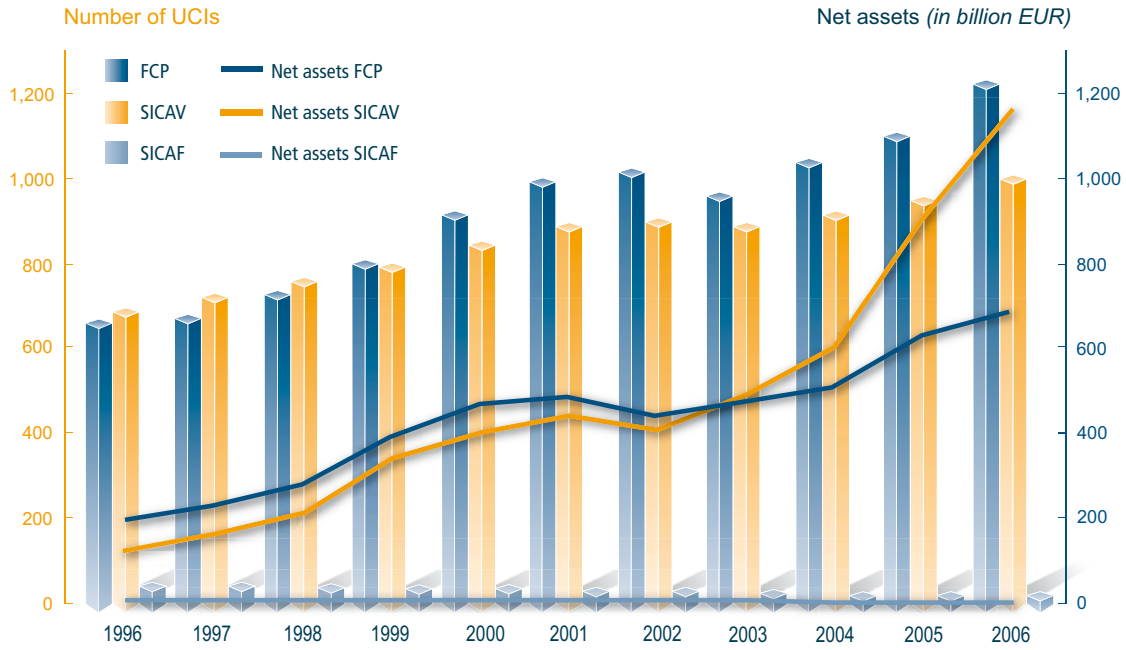
in billion EUR

	FCPs		SICAVs		SICAFs		Total	
	Number	Net assets	Number	Net assets	Number	Net assets	Number	Net assets
1996	656	187.4	688	117.9	40	3.3	1,384	308.6
1997	668	225.0	718	161.1	40	5.7	1,426	391.8
1998	727	270.8	758	210.3	36	5.7	1,521	486.8
1999	800	385.8	795	341.0	35	7.7	1,630	734.5
2000	914	462.8	840	404.0	31	7.8	1,785	874.6
2001	994	482.1	885	441.5	29	4.8	1,908	928.4
2002	1,017	435.8	896	405.5	28	3.2	1,941	844.5
2003	957	466.2	888	483.8	25	3.3	1,870	953.3
2004	1,036	504.0	913	600.3	19	1.9	1,968	1,106.2
2005	1,099	624.3	946	898.2	15	2.7	2,060	1,525.2
2006	1,224	681.3	1,000	1,161.1	14	2.4	2,238	1,844.8

FCPs' net assets increased to EUR 681.3 billion, representing 36.9% of the total net assets of UCIs as at 31 December 2006. SICAVs' net assets reached EUR 1,161.1 billion at the end of the year 2006, representing 62.9% of the UCIs' total net assets. SICAFs' net assets amounted to EUR 2.4 billion as at 31 December 2006.

In terms of net assets, SICAVs have strengthened their leading position with a growth rate of 29.3%.

Breakdown of UCIs by legal status



The following table illustrates the spread of UCIs depending on whether they fall within the scope of Part I of the laws of 30 March 1988 and 20 December 2002 as amended, Part II of the law of 20 December 2002 as amended or the law of 19 July 1991 concerning UCIs restricted to institutional investors.

Breakdown of UCIs according to Parts I and II of the law and institutional UCIs

in billion EUR

	Part I		Part II		Institutional UCIs	
	Number	Net assets	Number	Net assets	Number	Net assets
1996	988	209.2	353	96.2	43	3.2
1997	980	280.4	367	102.2	79	9.2
1998	1,008	360.2	400	111.0	113	15.6
1999	1,048	564.2	450	137.0	132	33.3
2000	1,119	682.0	513	153.3	153	39.3
2001	1,196	708.6	577	178.2	135	41.6
2002	1,206	628.9	602	171.6	133	44.0
2003	1,149	741.1	583	169.3	138	42.9
2004	1,303	929.3	516	131.2	149	45.7
2005	1,358	1,260.0	524	204.0	178	61.2
2006	1,469	1,516.5	552	249.9	217	78.4

UCIs that fall under Part I of the law of 30 March 1988 as amended and the law of 20 December 2002 as amended respectively are those which comply with the provisions of the EU Directive on UCITS and which can therefore benefit from the marketing facilities provided. Part II encompasses all the other UCIs which pool funds from the public, whereas institutional funds are UCIs whose securities are not intended to be placed with the public. In terms of regulatory provisions and especially restrictions applicable to their investment policies, they are nonetheless very similar to UCIs subject to Part II of the law of 20 December 2002 as amended.

Breakdown of UCIs and their assets according to legal status and law applicable

Situation as at 31 December 2006	Number of UCIs					Net assets *(in bn EUR)*				
	FCPs	SICAVs	Others	Total	In %	FCPs	SICAVs	Others	Total	In %
Part I	915	552	2	1,469	65.6	532.457	984.024	0.059	1,516.540	82.2
Part II	177	364	11	552	24.7	98.102	149.458	2.356	249.916	13.5
Institutional UCIs	132	84	1	217	9.7	50.778	27.577	0.039	78.394	4.3
Total	**1,224**	**1,000**	**14**	**2,238**	**100.0**	**681.337**	**1,161.059**	**2.454**	**1,844.850**	**100.0**

65.6% of UCIs registered on the official list as at 31 December 2006 were UCITS governed by Part I of the above-mentioned laws and 24.7% were other UCIs governed by Part II (non-coordinated UCIs). Institutional UCIs represented 9.7% of the 2,238 Luxembourg UCIs. UCIs under Part I, those under Part II and institutional UCIs recorded 82.2%, 13.5% and 4.3% respectively of total net assets.

The following table compares the development in 2006 of the number of UCIs and net assets according both to legal status and to the scope of the laws.

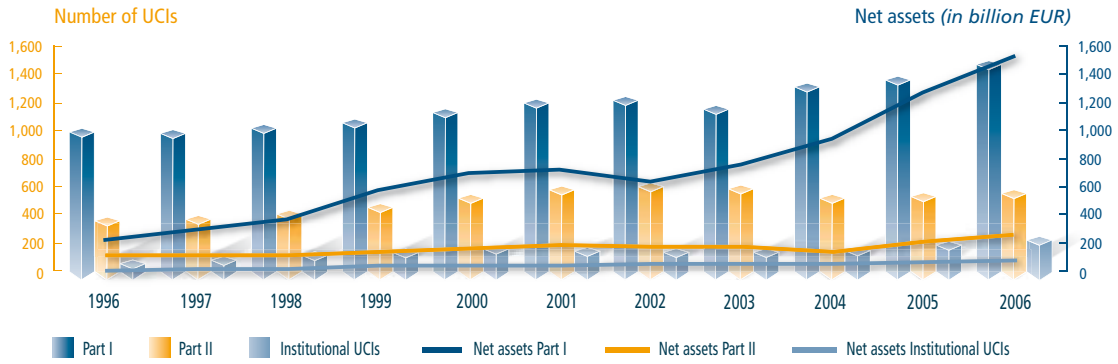
Breakdown of UCIs according to Parts I and II of the law and institutional UCIs

	2005				2006				Variation 2005/2006			
Number of UCIs	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total
Part I	814	541	3	1,358	915	552	2	1,469	12.41%	2.03%	-33.33%	8.17%
Part II	173	340	11	524	177	364	11	552	2.31%	7.06%	0.00%	5.34%
Institutional UCIs	112	65	1	178	132	84	1	217	17.86%	29.23%	0.00%	21.91%
Total	**1,099**	**946**	**15**	**2,060**	**1,224**	**1,000**	**14**	**2,238**	**11.37%**	**5.71%**	**-6.67%**	**8.64%**
Net assets *(in billion EUR)*	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total
Part I	495.844	764.031	0.135	1,260.010	532.457	984.024	0.059	1,516.540	7.38%	28.79%	-56.30%	20.36%
Part II	86.492	115.045	2.460	203.997	98.102	149.458	2.356	249.916	13.42%	29.91%	-4.23%	22.51%
Institutional UCIs	42.011	19.130	0.060	61.201	50.778	27.577	0.039	78.394	20.87%	44.16%	-35.00%	28.09%
Total	**624.347**	**898.206**	**2.655**	**1,525.208**	**681.337**	**1,161.059**	**2.454**	**1,844.850**	**9.13%**	**29.26%**	**-7.57%**	**20.96%**

As far as Part I is concerned, the number of UCIs rose by 8.2% as compared to the end of the previous year and net assets recorded an increase of 20.4%. The number and net assets of UCIs under Part II increased by 5.3% and 22.5% respectively.

As regards institutional funds, their number increased by 21.9% and their net assets by 28.1%. It should be borne in mind in this context that the law of 20 December 2002 as amended allows the creation of sub-funds and classes of units reserved to one or several institutional investors with respect to the UCIs under this law. However, the current reporting of UCIs does not allow to discern the institutional investors in Parts I and II of the law of 20 December 2002 as amended.

Breakdown of UCIs according to Parts I and II of the law and institutional UCIs



In 2006, UCIs under Part I of the law of 1988 or the law of 2002 (EU UCIs) recorded 76.4% of net issues, mainly attributable to UCIs in the form of SICAVs. UCIs under Part II showed net issues totalling EUR 44.56 billion, while net issues of institutional UCIs amounted to EUR 12.5 billion.

Breakdown of net issues according to Parts I and II of the law and institutional UCIs

(in million EUR)	FCPs	SICAVs	SICAFs	Total	In %
Part I	18,654	165,708	-60	184,302	76.4%
Part II	11,897	32,667	-9	44,555	18.4%
Institutional UCIs	7,364	5,140	-17	12,487	5.2%
Total	**37,915**	**203,515**	**-86**	**241,344**	**100.0%**

1.3. Developments in umbrella funds

In 2006, the number of umbrella funds increased by 89 entities. This structure, which brings together under the same legal entity several sub-funds centered on investment in a given currency, geographical region or economic sector, enables investors to re-focus their investment without having to switch to another investment fund. The promoters may thus offer, within a single entity, a whole range of sub-funds investing in equities, debt securities, money market securities or even sometimes warrants, thereby enabling investors to benefit from the best available returns. The structure of umbrella funds also enables promoters to create new sub-funds and to manage a collective pool of assets which were normally not large enough for a separate management in a traditionally structured fund.

Umbrella funds

	Total number of UCIs	Number of umbrella funds	As a % of total	Number of sub-funds	Average number of sub-funds per umbrella fund	Number of entities	Net assets of umbrella funds *(in bn EUR)*	As a % of total	Net assets per sub-fund *(in bn EUR)*
1996	1,384	632	45.7	3,187	5.04	3,939	222.0	71.9	0.070
1997	1,426	711	49.9	3,903	5.49	4,618	296.1	75.6	0.076
1998	1,521	797	52.4	4,454	5.59	5,178	384.3	78.9	0.086
1999	1,630	913	56.0	5,119	5.61	5,836	604.9	82.4	0.118
2000	1,785	1,028	57.6	6,238	6.07	6,995	739.1	84.5	0.118
2001	1,908	1,129	59.2	6,740	5.97	7,519	797.8	85.9	0.118
2002	1,941	1,190	61.3	7,055	5.93	7,806	724.8	85.9	0.103
2003	1,870	1,180	63.1	6,819	5.78	7,509	820.9	86.1	0.120
2004	1,968	1,226	62.3	7,134	5.82	7,876	962.8	87.0	0.135
2005	2,060	1,298	63.0	7,735	5.96	8,497	1,341.4	87.9	0.173
2006	2,238	1,387	62.0	8,622	6.22	9,473	1,639.6	88.9	0.190

The development of umbrella funds continued both as regards their number and their net assets managed.

As at 31 December 2006, 1,387 UCIs out of 2,238 had adopted a multiple sub-fund structure, representing an increase by 6.9% as compared to last year. The number of traditionally structured UCIs grew from 762 to 851. Moreover, the number of active sub-funds rose from 7,735 to 8,622, which represents an 11.5% growth as compared to the year 2005. Like the number of UCIs registered on the official list as at 31 December 2006, the number of active economic entities reached a record high with 9,473 entities at the same date.

The average number of sub-funds per umbrella fund increased slightly and reached 6.22 as at 31 December 2006. However, this figure conceals a wide dispersion between the smallest and largest UCIs.

As at 31 December 2006, umbrella fund net assets totalled EUR 1,639.6 billion, i.e. a substantial increase of 22.2% compared with the previous year-end. Net assets of traditionally structured UCIs have recorded an 11.7% increase over the same period.

The average net assets per traditional UCI amounted to EUR 241 million and thereby exceeded the average net assets per sub-fund of umbrella funds (EUR 190 million).

1.4. Valuation currencies used

As regards the valuation currencies used, the proportions in terms of entities remain the same as in 2005. Most entities (6,327 out of a total of 9,473) are denominated in euros, followed by those in US dollars (2,111) and those in Swiss francs (275). In terms of net assets, the entities denominated in euros encompass EUR 1,173.267 billion of a total EUR 1,844.850 billion, ahead of entities expressed in US dollars (EUR 492.655 billion), in Japanese yen (EUR 60.229 billion) and in Swiss francs (EUR 55.949 billion).

1.5. UCIs' investment policy

The table below describes the development in the number of UCIs and net assets according to their investment policy. It should be noted that UCIs investing in other assets include notably UCIs investing in venture capital and UCIs investing in insurance contracts or in debts.

Net assets and entities of UCIs according to their investment policy

	2005		2006		Variation in %	
	Number of entities	Net assets *(in bn EUR)*	Number of entities	Actifs nets *(in bn EUR)*	Number of entities	Net assets
Fixed-income TS[1]	2,815	683.447	3,019	743.461 [2]	7.25%	8.78%
Variable-yield TS	2,965	576.361	3,183	741.524 [3]	7.35%	28.66%
Mixed TS	1,100	113.963	1,437	171.920 [4]	30.64%	50.86%
Fund of funds	1,385	130.184	1,543	162.260	11.41%	24.64%
Cash	97	7.769	100	7.689	3.09%	-1.03%
Real estate	41	5.288	64	8.057	56.10%	52.36%
Futures, options, warrants	84	7.399	111	8.973	32.14%	21.27%
Others	10	0.797	16	0.966 [5]	60.00%	21.20%
Total	**8,497**	**1,525.208**	**9,473**	**1,844.850**	**11.49%**	**20.96%**

[1] Transferable securities.

[2] Including EUR 208.859 billion in money market instruments and other short-term securities.

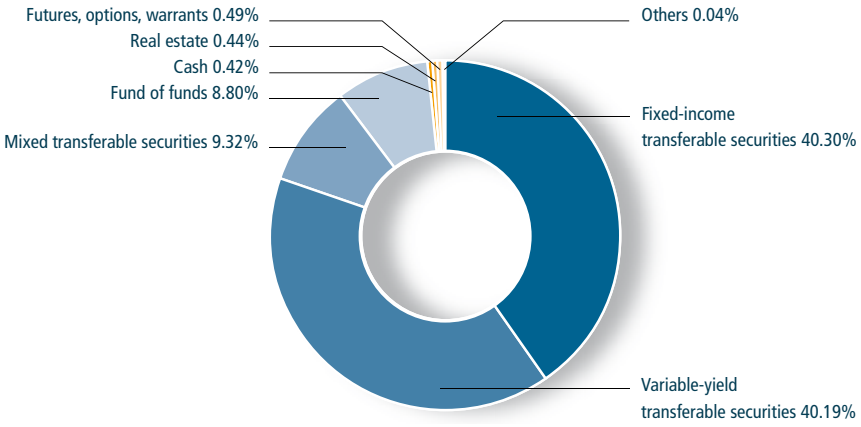
[3] Including EUR 2.787 billion in non-listed securities and EUR 0.421 billion in venture capital.

[4] Including EUR 0.598 billion in non-listed securities and EUR 0.314 billion in venture capital.

[5] Including EUR 0.045 billion in venture capital.

The following graph shows the breakdown of net assets of UCIs according to their investment policy as at 31 December 2006.

Breakdown of net assets of UCIs according to their investment policy



The following table illustrates, per quarter, the annual flow of subscriptions and redemptions divided into the main investment policies:

1 - Variable-yield transferable securities (equities)

2 - Fixed-income transferable securities (excluding money market instruments and other short-term securities)

3 - Mixed transferable securities

4 - Cash, money market instruments and other short-term securities

5 - Others

in million EUR

	1st quarter 2006			2nd quarter 2006			3rd quarter 2006			4th quarter 2006			Totals		
Pol.	subscr.	red.	n. iss.	subscr.	red.	n. iss.	subscr.	red.	n. iss.	subscr.	red.	n. iss.	subscr.	red.	n. iss..
1	147,893	95,395	52,498	109,479	104,633	4,846	92,964	84,629	8,335	131,538	113,125	18,413	481,874	397,782	84,092
2	100,380	74,290	26,090	80,401	72,757	7,644	57,695	58,451	-756	75,567	68,226	7,341	314,043	273,724	40,319
3	25,519	12,747	12,772	26,775	13,971	12,804	19,914	10,998	8,916	31,427	18,280	13,147	103,635	55,996	47,639
4	243,562	243,174	388	237,586	227,323	10,263	259,442	252,238	7,204	275,483	276,470	-987	1,016,073	999,205	16,868
5	30,773	15,952	14,821	30,436	18,997	11,439	24,013	14,840	9,173	37,297	20,304	16,993	122,519	70,093	52,426
Total	**548,127**	**441,558**	**106,569**	**484,677**	**437,681**	**46,996**	**454,028**	**421,156**	**32,872**	**551,312**	**496,405**	**54,907**	**2,038,144**	**1,796,800**	**241,344**

In 2006, net issues have experienced a slight increase as compared to net issues in 2005 (+2.14%). Substantial net issues have occurred mainly in the first quarter of 2006. UCIs investing in variable-yield transferable securities registered the main interest, followed by UCIs investing in mixed transferable securities.

UCIs' investment policy

Situation as at 31 December 2006	Number of entities	Net assets *(in bn EUR)*	Net assets *(in %)*
UCITS subject to Part I			
Fixed-income transferable securities[6]	2,376	652.338	35.4
Variable-yield transferable securities	2,871	688.714	37.3
Mixed transferable securities	1,102	142.986	7.8
Fund of funds	453	30.605	1.7
Cash	7	0.247	0.0
Futures and/or options	27	1.650	0.1
UCITS subject to Part II [7]			
Fixed-income transferable securities[8]	374	70.068	3.8
Variable-yield transferable securities	183	31.174	1.7
Mixed transferable securities	253	18.291	1.0
Fund of funds	875	107.405	5.8
Cash	93	7.442	0.4
UCITS subject to Part II[9]			
Non-listed transferable securities	20	2.552	0.1
Venture capital	11	0.516	0.0
Other UCIs subject to Part II			
Real estate	19	4.750	0.3
Futures, options, warrants	76	7.086	0.4
Others	6	0.632	0.0
Institutional UCIs			
Fixed-income transferable securities[10]	269	21.055	1.1
Variable-yield transferable securities	98	18.428	1.0
Mixed transferable securities	66	9.731	0.5
Non-listed transferable securities	11	0.833	0.1
Fund of funds	215	24.250	1.3
Venture capital	6	0.264	0.0
Real estate	45	3.307	0.2
Futures and/or options	8	0.237	0.0
Others	9	0.289	0.0
TOTAL	**9,473**	**1,844.850**	**100.0**

[6] Including EUR 177.502 billion in money market instruments and other short-term securities (287 entities).

[7] UCITS excluded from Part I of the law of 20 December 2002 as amended pursuant to article 3, points 1 to 3, i.e. UCITS disallowing any repurchase, not promoted in the EU or only sold to individuals in third-party countries outside the EU.

[8] Including EUR 30.176 billion in money market instruments and other short-term securities (115 entities).

[9] UCITS excluded from Part I of the law of 20 December 2002 as amended pursuant to article 3, point 4, i.e. UCITS under one of the categories set down by circular CSSF 03/88 owing to their investment and loan policy.

[10] Including EUR 1.470 billion in money market instruments and other short-term securities (12 entities).

1.6. Development in guarantee-type UCIs

Given the fluctuations inherent in financial markets, guarantee-type UCIs aim to offer investors greater security than that offered by traditional collective management products. According to the investment policy pursued by the funds concerned, the guarantee ensures that the subscriber is reimbursed either a proportion of the capital invested or is fully reimbursed his initial investment or even receives a return on his investment at the end of one or several pre-determined periods.

In 2006, the number of guarantee-type UCIs rose from 104 to 121 and the number of entities from 248 to 297. In terms of entities, the rise is attributable to the launch of 67 new entities, while the guarantee given came to maturity or has not been extended for 18 entities.

As at 31 December 2006, 297 entities comprised 28 entities guaranteeing investors only a proportion of the invested capital, 121 entities guaranteeing repayment in full of the invested capital (money-back guarantee) and 148 entities offering their investors a surplus as compared to the initial subscription price.

UCIs offering their investors a surplus compared to their initial investment remain thus dominant. These funds generally track a stock market index and, through the use of derivatives, enable investors to participate to some extent in the growth of this index.

Net assets of guarantee-type UCIs increased by EUR 7.87 billion to EUR 32.56 billion in 2006, i.e. an increase of 31.9%. It is also worth noting that guarantee-type UCIs created by German promoters alone accounted for 85.6% of the total net assets of guarantee-type UCIs.

Development in guarantee-type UCIs

	Number of UCIs	Number of economic entities	Net assets *(in bn EUR)*
1995	43	54	5.58
1996	52	67	7.08
1997	70	90	11.47
1998	86	99	15.00
1999	85	116	17.13
2000	79	119	14.30
2001	74	115	17.09
2002	75	151	17.40
2003	76	166	20.89
2004	90	207	21.41
2005	104	248	24.69
2006	121	297	32.56

1.7. Promoters of Luxembourg UCIs

The breakdown of Luxembourg UCIs according to geographic origin of their promoters highlights the multitude of countries represented in the financial centre. Promoters of Luxembourg UCIs spread over 41 countries.

The main countries actively promoting UCIs in Luxembourg are the United States, Switzerland, Germany, Great Britain and Italy.

Origin of promoters of Luxembourg UCIs

Situation as at 31 December 2006	Net assets *(in bn EUR)*	In %	Number of UCIs	In %	Number of entities	In %
United States	347.021	18.8%	116	5.2%	837	8.8%
Switzerland	343.750	18.6%	290	13.0%	1,757	18.5%
Germany	300.748	16.3%	934	41.7%	1,674	17.7%
Great Britain	203.904	11.1%	125	5.6%	735	7.8%
Italy	180.037	9.8%	85	3.8%	752	7.9%
Belgium	162.293	8.8%	145	6.5%	1,389	14.7%
France	133.400	7.2%	177	7.9%	879	9.3%
Netherlands	57.817	3.1%	47	2.1%	320	3.4%
Sweden	28.133	1.5%	57	2.5%	187	2.0%
Japan	25.036	1.4%	60	2.7%	154	1.6%
Others	62.711	3.4%	202	9.0%	789	8.3%
Total	**1,844.850**	**100.0%**	**2,238**	**100.0%**	**9,473**	**100.0%**

1.8. Marketing of Luxembourg UCIs and marketing of foreign UCIs in Luxembourg

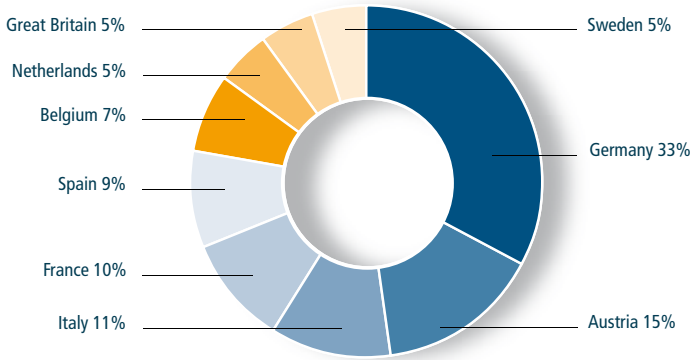
Owing to the small size of the domestic market, the vast majority of Luxembourg UCIs are marketed outside Luxembourg. To this end, UCIs governed by Part I of the laws of 1988 and 2002 respectively are authorised, based on a CSSF registration certificate, to market their units/shares in other EU countries without having to follow a further approval procedure with the competent authorities.

Until 31 December 2006, the CSSF had delivered a total of 3,958 Directive compliance certificates for registered UCITS, representing an increase of 336 units compared with 31 December 2005, and an increase of 637 units compared with 31 December 2004.

The certificates issued were intended for 1,314 different UCIs (2005: 1,209 UCIs, 2004: 1,165 UCIs), which means that 89.45% of UCIs under Part I of the laws of 1988 and 2002 had requested at least one certificate.

The main countries concerned, in decreasing order, were: Germany (1,037 certificates), Austria (483), Italy (363), France (325), Spain (302), Belgium (229), the Netherlands (173), Great Britain (172) and Sweden (168).

Compliance certificates issued in 2006 to Luxembourg UCIs marketing their units/shares in other EU countries



As regards foreign UCITS marketed in Luxembourg at the end of 2006, 178 foreign EU UCITS took advantage of the marketing facilities provided by the Directive to offer their units/shares in Luxembourg.

Finally, 14 foreign UCIs (8 from Germany and 6 from Switzerland) have been authorised to market their units/shares in Luxembourg in accordance with article 70 of the law of 30 March 1988 as amended and article 76 of the law of 20 December 2002 as amended respectively.

Marketing of foreign UCIs in Luxembourg

	2003	2004	2005	2006
EU UCITS				
Country of origin				
Germany	70	69	63	67
Ireland	22	31	33	41
France	26	27	28	35
Belgium	10	10	11	13
Great Britain	3	6	6	7
Norway	0	0	0	6
Sweden	0	0	0	5
Finland	0	0	0	4
Sub-total	**131**	**143**	**141**	**178**
Other foreign UCIs				
Country of origin				
Germany	16	9	9	8
Switzerland	15	9	6	6
Belgium	2	1	0	0
Sub-total	**33**	**19**	**15**	**14**
Total	**164**	**162**	**156**	**192**

2. NEWLY CREATED ENTITIES APPROVED IN 2006

2.1. General data

The number of newly approved entities[11] has been continuously rising since 2003. During 2006, 2,119 new entities have been granted approval, i.e. 313 more than in 2005 and even 685 entities more than in 2004. This positive development is most probably attributable to the favourable stock market situation. In relative terms, this accounts for a growth of 17.3% as compared to 2005 and of 47.8% as compared to 2004.

	2002	2003	2004	2005	2006
Newly approved entities	1,338	1,086	1,434	1,806	2,119
of which: launched in the same year	*881*	*637*	*961*	*1,022*	*1,263*
In %	65.8%	58.7%	67.0%	56.6%	59.6%

Although the number of approved entities has increased that much, only 1,263 out of the 2,119 entities approved, i.e. 59.6%, have been launched in the same year. Given that the lapse between the authorisation of a new entity and its effective launch can be explained, *inter alia*, by the period of time promoters have to wait between the notification to the host country's authority pursuant to European regulations and the effective marketing of units/shares in the host country, a high number of approved entities is expected to be launched during the first months of 2007.

2.2. Analysis of the investment policy of new entities

The proportion of entities that chose to invest in mixed transferable securities has increased by 4.7% and shows a positive variation of 162 entities in 2006. Similarly, the number of entities investing in variable-yield transferable securities increased by 94 entities as compared to 2005. The number of newly approved entities investing in other UCIs grew by 40 entities, despite the fact that in relative terms, the proportion of this category decreased slightly.

Although the majority of newly approved entities in 2006 planned to invest in fixed-income transferable securities, this part has experienced a substantial decrease of 4.8% as compared to 2005.

The number of entities whose investment policy provides for investment in cash, money market instruments and other short-term securities has recorded an important decrease of 22.7% in relative terms and of 30 entities in absolute terms.

The number of entities investing in derivative instruments has soared by 54 entities in absolute terms and by 2.9% in relative terms.

[11] The term "entity" refers both to traditional UCIs and to the sub-funds of umbrella funds. The number of new "entities" therefore means, from an economic point of view, the number of economic vehicles created.

Investment policy	2005		2006	
	Number of entities	As a % of total	Number of entities	As a % of total
Fixed-income transferable securities (excluding money market instruments and other short-term securities)	569	31.51%	566	26.71%
Variable-yield transferable securities	436	24.14%	530	25.01%
Mixed transferable securities	356	19.71%	518	24.45%
Fund of funds	295	16.33%	335	15.81%
Cash, money market instruments and other short-term securities	88	4.87%	58	2.74%
Futures, options, warrants	28	1.55%	82	3.87%
Others	34	1.88%	30	1.42%
Total	**1,806**	**100.00%**	**2,119**	**100.00%**

2.3. Origin of promoters of new entities

The analysis of the origin of promoters of newly created entities shows that:

- German and Swiss promoters remain top ranking, at first and second place, respectively.
- German, French and British promoters have strengthened their presence in the Luxembourg market. The number of British promoters has doubled, reaching 220 entities in 2006. With 288 approved entities (13.59% of the total of new entities), French promoters have strongly increased in number in 2006.
- The number of newly approved entities whose promoters are of American origin has decreased compared to 2005.

Origin of promoters of new entities

	2003		2004		2005		2006	
	Entities	In %	Entities	In %	Entities	In %	Entities	In %
Germany	160	14.73%	231	16.11%	294	16.28%	417	19.68%
Switzerland	176	16.21%	223	15.55%	353	19.55%	350	16.52%
France	99	9.12%	170	11.85%	156	8.64%	288	13.59%
Belgium	192	17.68%	306	21.34%	362	20.04%	280	13.21%
Great Britain	86	7.92%	108	7.53%	110	6.09%	220	10.38%
United States	76	7.00%	78	5.44%	213	11.79%	164	7.74%
Italy	127	11.69%	83	5.79%	108	5.98%	146	6.89%
Netherlands	36	3.31%	70	4.88%	76	4.21%	61	2.88%

3. CLOSED DOWN ENTITIES IN 2006

3.1. General data

The number of entities closed down in 2006 slightly decreased as compared to the previous year (-18 entities or -2.7%). The number of liquidated entities and matured entities decreased by 3.3% and 35.7% respectively. The number of merged entities on the other hand increased by 21 entities (+10.4%) as compared to 2005.

	2000	2001	2002	2003	2004	2005	2006
Liquidated entities	254	367	490	643	393	426	412
Matured entities	47	53	49	47	64	70	45
Merged entities	150	337	326	488	237	202	223
Total	**451**	**757**	**865**	**1,178**	**694**	**698**	**680**

3.2. Investment policy of the closed down entities

The distribution by investment policy of the entities closed down in 2006 shows that the fixed-income entities have increased significantly as compared to 2005. Most of the closed down entities had invested in variable-yield transferable securities, even though, in relative terms, this category has recorded a decrease of almost 1.7% compared to 2005.

Among the 250 closed down entities whose investment policy provides for investment in variable-yield transferable securities, 119 were liquidated, 128 merged and 3 matured. As regards the category of entities investing in fixed-income transferable securities, 127 entities were liquidated, 24 matured and 55 merged. In the category of entities investing in mixed transferable securities, 78 entities have been closed down, 5 matured and 21 merged.

Investment policy	2005		2006	
	Number of entities	As a % of total	Number of entities	As a % of total
Fixed-income transferable securities (excluding money market instruments and other short-term securities)	172	24.64%	206	30.29%
Variable-yield transferable securities	268	38.39%	250	36.76%
Mixed transferable securities	103	14.76%	104	15.29%
Fund of funds	101	14.47%	71	10.44%
Cash, money market instruments and other short-term securities	45	6.45%	44	6.47%
Derivative instruments	9	1.29%	5	0.74%
Total	**698**	**100.00%**	**680**	**100.00%**

4. DEVELOPMENTS REGARDING UCIS INVESTING PRINCIPALLY IN OTHER UCIS

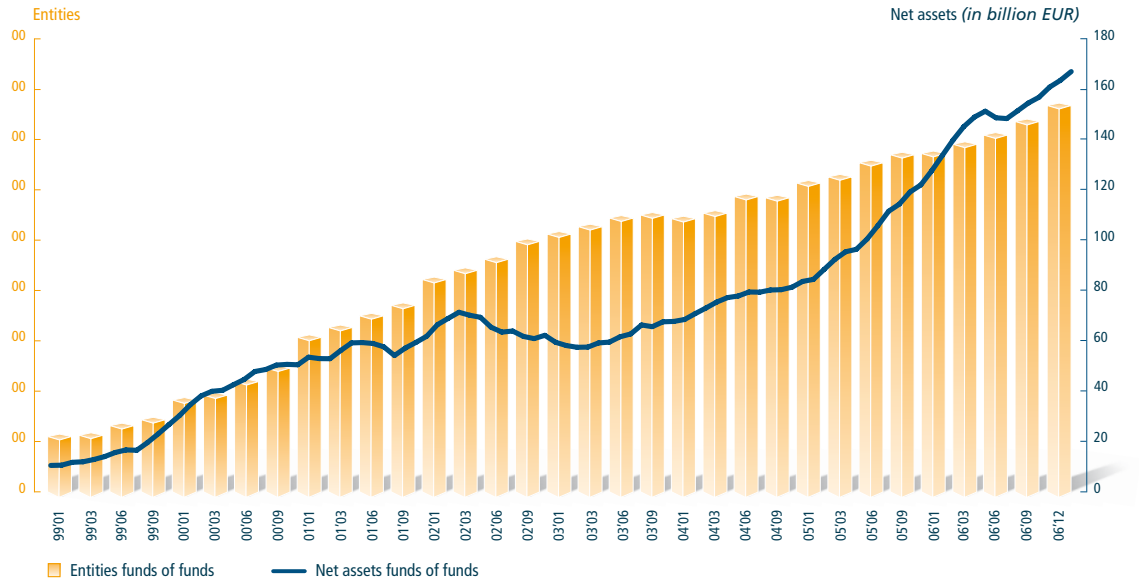
UCIs known as "funds of funds" (*fonds de fonds, Dachfonds*) are UCIs whose main investment policy provides for investment of the majority of net assets in other UCIs. Their portfolios therefore consist principally, if not exclusively, of shares of SICAVs or units of Luxembourg or foreign *fonds communs de placement.*

"Funds of funds" UCIs can fall under Part I or Part II of the law of 20 December 2002 as amended. They can also fall under the law of 19 July 1991 concerning funds reserved for institutional investors.

An analysis of the trends of previous years shows that the number of entities investing mainly in other UCIs has substantially grown between 1999 (213 entities) and 2005 (1,377 entities). This upward trend continued in 2006, the number of entities having grown by 166 entities, from 1,377 entities to 1,543 entities as at 31 December 2006, representing a record level since the analysis was first made in 1999. In 2006, the annual growth rate of funds of funds was of 12.06% in terms of entities.

Record figures have also been registered in terms of net assets. Net assets of funds of funds underwent a relative growth of 25% and an absolute growth of EUR 33.480 billion to reach EUR 167.426 billion as at 31 December 2006. This figure includes funds of hedge funds.

Development in the number of entities and net assets of funds of funds



5. DEVELOPMENTS REGARDING UCIS ADOPTING ALTERNATIVE INVESTMENT STRATEGIES

5.1. Regulatory framework

Circular CSSF 02/80 lays down a specific legal and regulatory framework for UCIs whose aim is to follow investment strategies similar to those pursued by hedge funds. Prior to this circular, investment restrictions applicable to UCIs adopting alternative strategies had been assessed by the CSSF on a case-by-case basis.

5.2. Main characteristics of alternative management UCIs

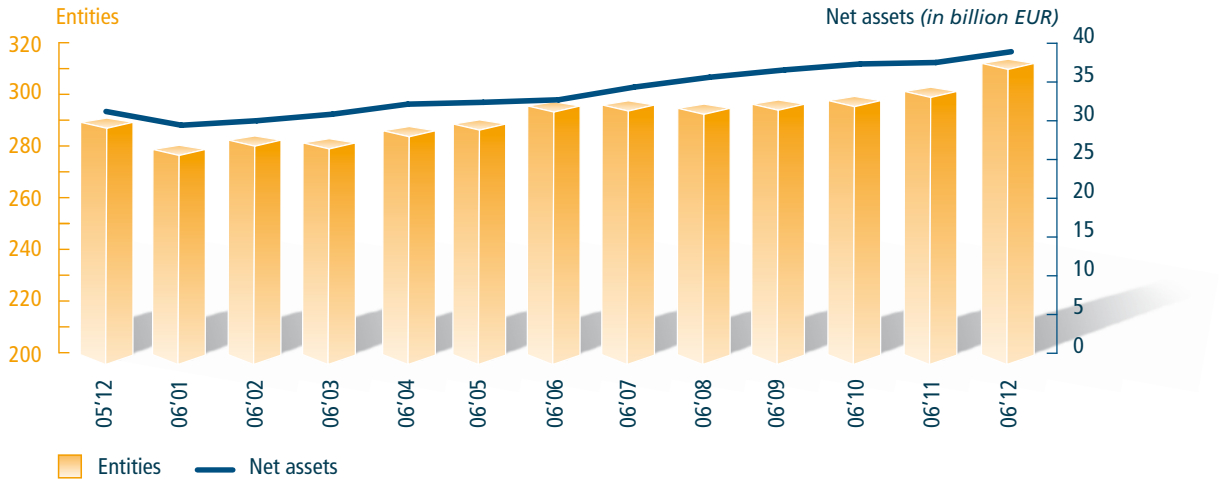
The main characteristics of alternative management UCIs include:

- alternative management UCIs follow absolute return strategies, i.e. the objective of these UCIs is to realise a performance which is independent from market trends;
- alternative management UCIs may follow different investment strategies, of which the most famous are arbitrage, directional and special situation strategies (for instance event-driven);
- alternative management UCIs may use specific investment techniques, such as short selling, leverage financing and an extensive usage of derivative instruments;
- alternative management UCIs may include an incentive fee structure, i.e. an additional management premium on the positive performance realised by the fund by applying a hurdle rate or a high water mark as defined in the prospectus.

5.3. Funds of hedge funds

As at 31 December 2006, 311 fund of hedge funds entities were authorised in Luxembourg for a total of EUR 39.085 billion. The number of funds of hedge funds thus increased by 22 entities during 2006 and the total net assets rose by EUR 7.74 billion during the same period.

Development of UCIs of the type funds of hedge funds



The main appeal for an investment in a fund of hedge funds as compared to a direct investment in a hedge fund is, among others, the diversification across the strategies and managers.

5.4. Hedge Funds according to circular CSSF 02/80

Since the introduction of circular CSSF 02/80 relating to the specific rules applicable to Luxembourg UCIs pursuing alternative investment strategies, a certain number of promoters have launched hedge funds in accordance with this circular. Circular CSSF 02/80 mainly defines:

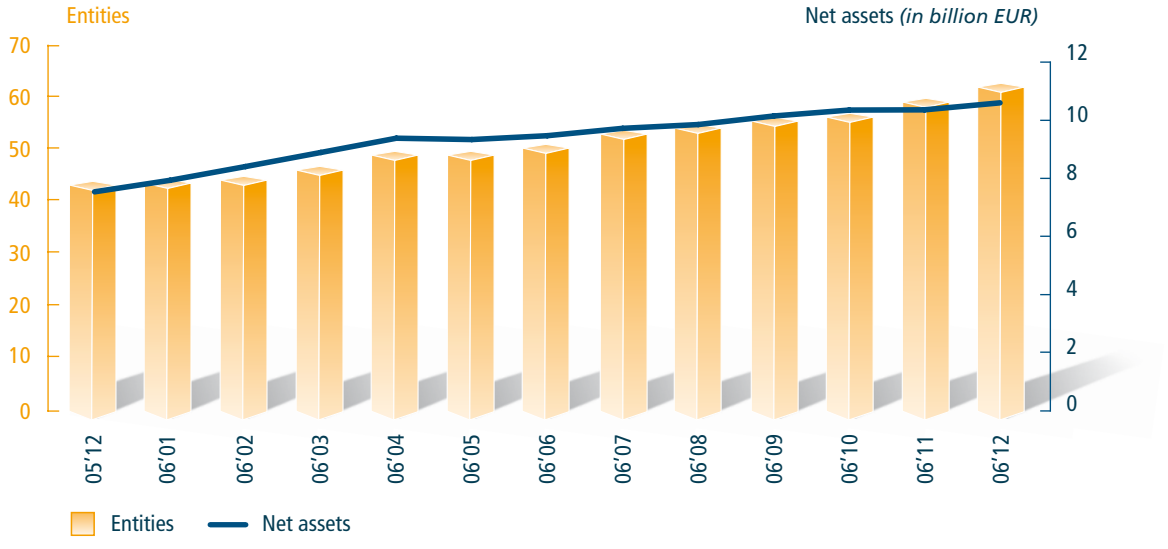
- short sales;
- borrowing limits;
- use of derivative instruments;
- rules for investment in other hedge funds.

The growing interest of both institutional and private investors in hedge funds can be explained by the fact that adding UCIs with alternative investment strategies to traditional investments gives investors the possibility, in terms of portfolio performance, to increase the risk/return ratio of their global investment.

This growing investor interest in alternative investment strategies is sustained by the statistical development of the number of hedge fund entities and assets under management over the past three years. Indeed, the number of hedge funds has increased from 45 entities in 2003 to a total number of 62 entities as at 31 December 2006. The assets under management have increased by EUR 9.921 billion since 2003 to reach a total of EUR 10.542 billion as at 31 December 2006. These figures correspond to a relative growth of 342.9% in terms of entities and of 1,597.6% in terms of managed assets over the past three years.

The number of hedge funds set up under the scope of circular CSSF 02/80 increased by 19 entities in 2006 and net assets grew by EUR 3.054 billion as compared to 2005.

Development of UCIs of the hedge fund type compliant with circular CSSF 02/80



As far as the legal structures are concerned, hedge funds may be set up in the form of a SICAV (*société d'investissement à capital variable*), SICAF (*société d'investissement à capital fixe*) and FCP (*fonds commun de placement*). As at 31 December 2006, hedge funds had adopted the following legal structures as per circular CSSF 02/80:

Legal structure as at 31 December 2006	**SICAVs**	**FCPs**	**Total**
Entities	45	17	62
Assets under management *(in bn EUR)*	6.935	3.607	10.542

6. DEVELOPMENTS REGARDING UCIS INVESTING PRINCIPALLY IN REAL ESTATE ASSETS

For the last few years, international promoters have shown a growing interest in the setting-up of Luxembourg UCIs the main object of which is investment in the real estate sector. The statistical data of the last four financial years show that this trend began in 2004 and has been strengthened in the following years.

	Number of real estate UCIs	of which active units	of which Part II	of which institutional	of which open-ended	of which closed-ended	Net issues *(in bn EUR)*	Net assets *(in bn EUR)*
2003	14	13	6	8	-	-	0.322	2.865
2004	23	22	7	16	-	-	0.173	3.130
2005	52	41	16	36	-	-	1.591	5.287
2006	76	64	22	54	25	51	2.653	8.057

In comparison with Luxembourg UCIs following "traditional" investment objectives, UCIs investing mainly in real estate used to represent only a marginal phenomenon in the Luxembourg financial centre for many years. However, this situation is noticeably changing with entities investing in this type of assets which nearly doubled as at 31 December 2004 as compared to the previous year. Indeed, their number increased from 14 entities as at 31 December 2003 to 23 entities as at 31 December 2004.

After this first rise, the number of approval requests for the setting-up of UCIs investing mainly in real property continued to grow at a sustained pace, in a way that 52 such entities were registered on the official list as at 31 December 2005, representing again a strong annual development of around 130%.

It is also worth noticing that the "relative" balance which existed until 2003 between UCIs under Part II of the law of 30 March 1988 and UCIs governed by the law of 19 July 1991 (institutional UCIs) has completely vanished at the advantage of the latter.

Already in 2004, sixteen entities were governed by the law of 19 July 1991 against only seven falling under Part II of the law of 30 March 1988 (i.e. a ratio of 70% against 30%). This positive trend for institutional UCIs has been confirmed in the following years. Thus, 36 entities out of the 52 investing in the real estate sector at the end of 2005 (i.e. 69%) were institutional undertakings, whereas sixteen entities (31%) were governed by Part II of the law of 30 March 1988.

As at 31 December 2006, the CSSF registered on the official list 76 entities investing in real estate assets, of which 64 were operating at the same date. In comparison with the previous financial year, this sector again experienced a progress of 46% for registered UCIs and of 56% for active UCIs.

Net assets of UCIs investing principally in real estate assets reached EUR 8.057 billion as at 31 December 2006, i.e. an increase of 52% as compared to 2005.

In 2006, the ratio between UCIs subject to Part II of the law of 30 March 1988 and institutional UCIs has stabilised, as compared to the previous year, with 54 entities governed by the law of 19 July 1991 (71%) against 22 entities under Part II (29%).

It should be noted as well that 51 out of the 76 authorised entities (i.e. 67%) are closed-ended.

7. PERFORMANCE ANALYSIS OF THE MAJOR LUXEMBOURG UCI CATEGORIES IN 2006

7.1. Objectives and methodology

The objective of this section is to analyse the performance distribution of several Luxembourg UCI categories in relation to the investment policy.

The UCI categories selected are the following:

Monetary UCIs	Bond UCIs	Equity UCIs
EURO	Europe	Europe
	Global	Global
	Emerging markets	Emerging markets

The category "European equity" only takes into account entities investing in standard European equity. Entities investing in Midcap and Smallcap shares have not been considered.

The category "EUR-denominated bonds" only takes into account entities investing in standard European bonds. Entities investing in High Yield bonds have not been considered.

For the analysis of the results, it is important to highlight that past performances do not presume future performances.

Methodological aspects:

- Base currency: to measure the performance of the various UCI categories, the Euro has been used as base currency.
- Population considered: the population considered is composed of a total of EUR 447.447 billion net assets and 1,424 entities. The entities with no performance over the last twelve months have not been taken into consideration.
- The average return and the average standard deviation per UCI category have been calculated with the weighting of the entities' average net assets.
- To compare the performances of the various investment policies, a risk-performance indicator is applied, i.e. the Sharpe ratio.

The Sharpe ratio was developed by William Sharpe, Nobel Laureate in Economics in 1990. The Sharpe ratio divides the difference between the return of a securities portfolio and a risk-free rate, i.e. a fixed-rate investment, by the portfolio standard deviation. It measures in this manner the excess return, realised per unit of risk taken into consideration. The Sharpe ratio is calculated as follows:

$$\text{Sharpe ratio} = \frac{\text{Portfolio return} - \text{Risk-free rate}}{\text{Portfolio standard deviation}}$$

The 12-month money market rate applicable beginning of January 2006 has been used as risk-free rate, i.e. 2.825%.

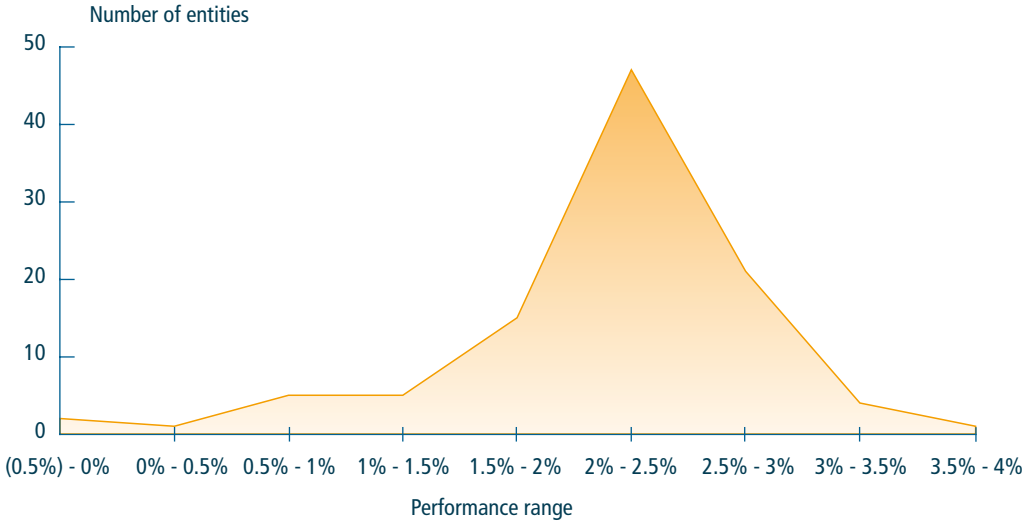
- Source of UCI data: CSSF database.
- For entities investing in equity, MSCI indices are used as benchmark.
- For entities investing in bonds, Lehman Brothers indices are used as benchmark.
- For the categories "international bonds" and "emerging market bonds", hedged indices are used in order to exclude the influence of currency movements on the performance of the benchmark.
- The term "entity" refers both to traditional UCIs and the sub-funds of umbrella funds.

7.2. Performance of the major Luxembourg UCI categories in 2006

7.2.1. Entities whose investment policy consists in investing in Euro money market instruments

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in Euro money market instruments.

Performance of entities investing in Euro money market instruments in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in money market instruments amounts to 2.15%. The variation range, i.e. the difference between the highest and the lowest performance, is of 3.92%. The standard deviation of the performance of these entities amounts to 0.67%.

Central values and dispersion characteristics

Average performance	2.15%
Maximum performance	3.73%
Minimum performance	-0.19%
Standard deviation of performance	0.67%
Performance spread	3.92%
Statistical population	101

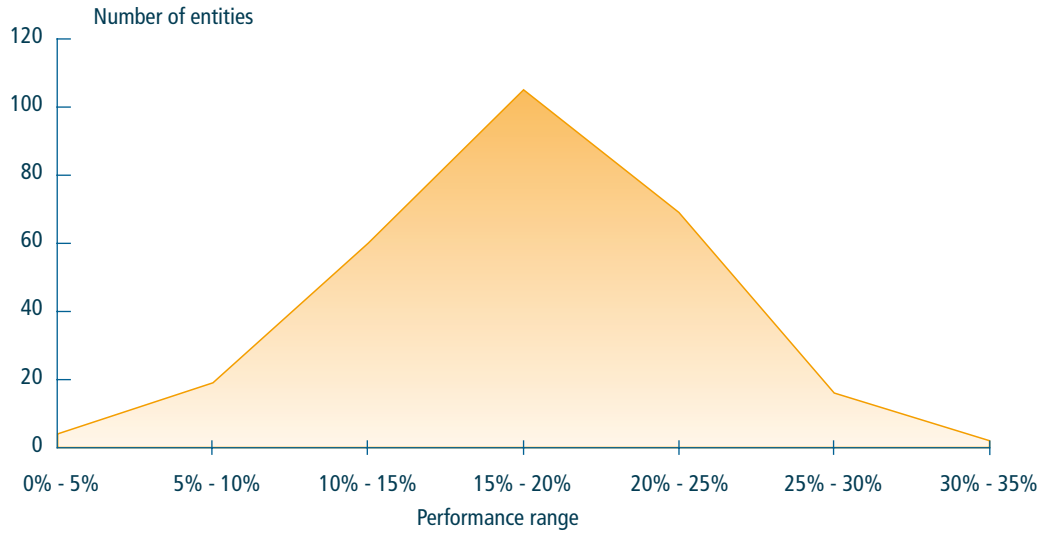
Statistical performance distribution of entities investing in money market instruments

Performance Return classes	**Number of entities** Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-0.5% to 0%	2	1.98%	2	1.98%
0% to 0.5%	1	0.99%	3	2.97%
0.5% to 1%	5	4.95%	8	7.92%
1% to 1.5%	5	4.95%	13	12.87%
1.5% to 2%	15	14.85%	28	27.72%
2% to 2.5%	47	46.53%	75	74.26%
2.5% to 3%	21	20.79%	96	95.05%
3% to 3.5%	4	3.96%	100	99.01%
3.5% to 4%	1	0.99%	101	100.00%
Total	**101**	**100.00%**		

7.2.2. Entities whose investment policy consists in investing in European equity

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in European equity. It should be noted that entities investing in European Smallcap and Midcap shares are not included in this category.

Performance of entities investing in European equity in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in European equity amounts to 18.38%. The variation range, i.e. the difference between the highest and the lowest performance, is of 31.27%. The standard deviation of the performance of these entities amounts to 5.33%.

Central values and dispersion characteristics

Average performance	18.38%
Maximum performance	35.47%
Minimum performance	4.20%
Standard deviation of performance	5.33%
Performance spread	31.27%
Statistical population	275

Statistical performance distribution of entities investing in European equity

Performance Return classes	**Number of entities** Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
0% to 5%	4	1.45%	4	1.45%
5% to 10%	19	6.91%	23	8.36%
10% to 15%	60	21.82%	83	30.18%
15% to 20%	105	38.18%	188	68.36%
20% to 25%	69	25.09%	257	93.45%
25% to 30%	16	5.82%	273	99.27%
30% to 35%	2	0.73%	275	100.00%
Total	**275**	**100.00%**		

The MSCI Europe Net Index (EUR), index which includes dividends, realised a performance of 19.61% in 2006. 93 entities investing in European equity, i.e. 33.82% of the total entities, have realised a higher performance than the MSCI Europe Net Index (EUR).

MSCI Europe Net Index (EUR) 2006

Source : MSCI Barra[12]

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For the average performance of 18.38% realised on the European equity market, the Sharpe ratio is of 1.65. The analysis for the investor is as follows: for 1% volatility considered, the investor could realise in average an additional return of 1.65%.

The following table gathers the performance results for the category of entities investing in European equity.

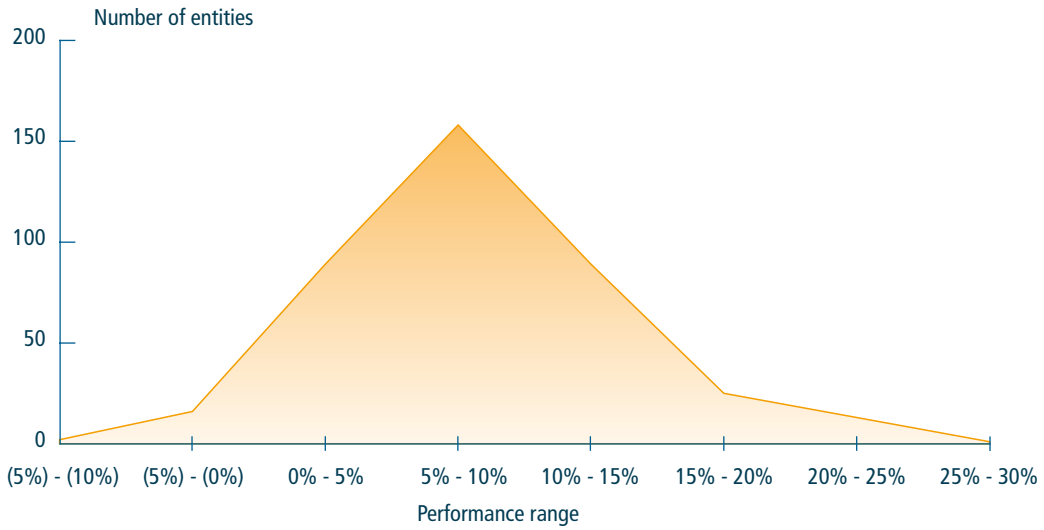
Summary table of the category of entities investing in European equity

Average performance	18.38%
Maximum performance	35.47%
Minimum performance	4.20%
Standard deviation of performance	5.33%
Performance spread	31.27%
Statistical population	275
MSCI Europe Net Index (EUR) performance	19.61%
Average volatility of performance	9.44%
Number of entities with higher performance than MSCI Europe Net Index (EUR)	93
Sharpe ratio – average performance	1.65
Sharpe ratio – maximum performance	1.69
Sharpe ratio – minimum performance	0.44

7.2.3. Entities whose investment policy consists in investing in international equity

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in international equity.

Performance of entities investing in international equity in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in international equity amounts to 8.71%. The variation range, i.e. the difference between the highest and the lowest performance, is of 33.93%. The standard deviation of the performance of these UCIs amounts to 5.30%.

Central values and dispersion characteristics

Average performance	8.71%
Maximum performance	26.26%
Minimum performance	-7.67%
Standard deviation of performance	5.30%
Performance spread	33.93%
Statistical population	393

Statistical performance distribution of entities investing in international equity

Performance	**Number of entities**			
Return classes	Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-10% to -5%	2	0.51%	2	0.51%
-5% to 0%	16	4.07%	18	4.58%
0% to 5%	89	22.65%	107	27.23%
5% to 10%	158	40.20%	265	67.43%
10% to 15%	89	22.65%	354	90.08%
15% to 20%	25	6.36%	379	96.44%
20% to 25%	13	3.31%	392	99.75%
25% to 30%	1	0.25%	393	100.00%
Total	**393**	**100.00%**		

The MSCI World Index Net (EUR), index which includes dividends, realised a performance of 7.40% in 2006. 208 entities investing in international equity, i.e. 52.93% of the total entities, have realised a higher performance than the MSCI World Index Net (EUR).

MSCI World Index Net (EUR) 2006

Source : MSCI Barra

For the average performance of 8.71% realised on the international equity market, the Sharpe ratio is of 0.66. The analysis for the investor is as follows: for 1% volatility considered, the investor could realise in average an additional return of 0.66%.

The following table gathers the performance results for the category of entities investing in international equity.

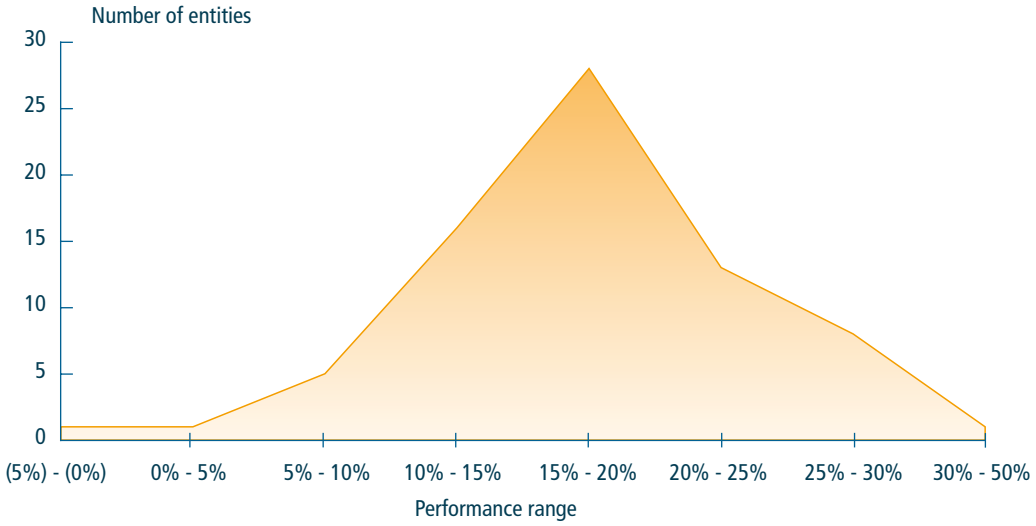
Summary table of the category of entities investing in international equity

Average performance	8.71 %
Maximum performance	26.26 %
Minimum performance	-7.67 %
Standard deviation of performance	5.30 %
Performance spread	33.93 %
Statistical population	393
MSCI World Index Net (EUR) performance	7.40 %
Average volatility of performance	8.84 %
Number of entities with higher performance than MSCI World Index Net (EUR)	208
Sharpe ratio – average performance	0.67
Sharpe ratio – maximum performance	1.71
Sharpe ratio – minimum performance	-0.49

7.2.4. Entities whose investment policy consists in investing in emerging market equity

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in emerging market equity.

Performance of entities investing in emerging market equity in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in emerging market equity amounts to 18.70%. The variation range, i.e. the difference between the highest and the lowest performance, is of 45.16%. The standard deviation of the performances of these entities amounts to 6.57%.

Central values and dispersion characteristics

Average performance	18.70%
Maximum performance	45.04%
Minimum performance	-0.12%
Standard deviation of performance	6.57%
Performance spread	45.16%
Statistical population	73

Statistical performance distribution of entities investing in emerging market equity

Performance	**Number of entities**			
Return classes	Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-5% to 0%	1	1.37%	1	1.37%
0% to 5%	1	1.37%	2	2.74%
5% to 10%	5	6.85%	7	9.59%
10% to 15%	16	21.92%	23	31.51%
15% to 20%	28	38.36%	51	69.86%
20% to 25%	13	17.81%	64	87.67%
25% to 30%	8	10.96%	72	98.63%
30% to 50%	1	1.37%	73	100.00%
Total	**73**	**100.00%**		

It should be noted that entities investing in BRIC countries (Brazil, Russia, India and China) are included in this category and have realised in 2006 the highest performance of entities investing in emerging markets.

The MSCI Emerging Markets Net Index (EUR), index which includes dividends, realised a performance of 18.23% in 2006. 27 UCIs investing in European equity, i.e. 36.99% of the total entities, have realised a higher performance than the MSCI Emerging Markets Net Index (EUR).

MSCI Emerging Markets Net Index (EUR) 2006

Source : MSCI Barra

For the average performance of 18.70% realised on the emerging countries' equity market, the Sharpe ratio is of 0.88. The analysis for the investor is as follows: for 1% volatility considered, the investor could realise in average an additional return of 0.88%.

The following table gathers the performance results for the category of entities investing in emerging market equity.

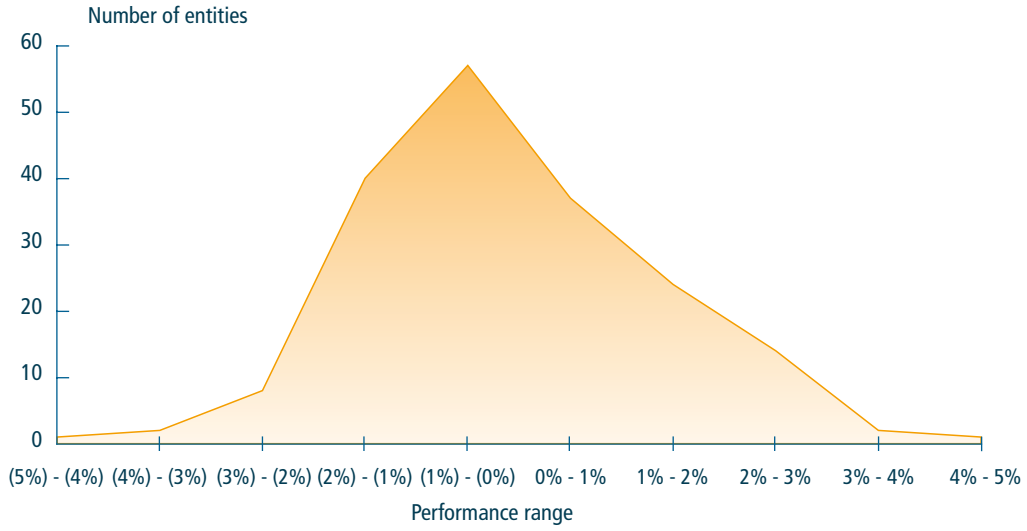
Summary table of the category of entities investing in emerging market equity

Average performance	18.70 %
Maximum performance	45.04 %
Minimum performance	-0.12 %
Standard deviation of performance	6.57 %
Performance spread	45.16 %
Statistical population	73
MSCI Emerging Markets Net Index (EUR) performance	18.23 %
Average volatility of performance	17.95 %
Number of entities with higher performance than MSCI Emerging Markets Net Index (EUR)	27
Sharpe ratio – average performance	0.88
Sharpe ratio – maximum performance	2.09
Sharpe ratio – minimum performance	-0.18

7.2.5. Entities whose investment policy consists in investing in EUR-denominated bonds

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in EUR-denominated bonds. It should be noted that entities investing in High Yield and Midcap bonds are not included in this category.

Performance of entities investing in EUR-denominated bonds in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in EUR-denominated bonds amounts to -0.06%. The variation range, i.e. the difference between the highest and the lowest performance, is of 9.10%. The standard deviation of the performance of these entities amounts to 1.42%.

Central values and dispersion characteristics

Average performance	-0.06 %
Maximum performance	4.85 %
Minimum performance	-4.25 %
Standard deviation of performance	1.42 %
Performance spread	9.10 %
Statistical population	186

Statistical performance distribution of entities investing in EUR-denominated bonds

Performance	**Number of entities**			
Return classes	Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-5% to -4%	1	0.54%	1	0.54%
-4% to -3%	2	1.08%	3	1.61%
-3% to -2%	8	4.30%	11	5.91%
-2% to -1%	40	21.51%	51	27.42%
-1% to 0%	57	30.65%	108	58.06%
0% to 1%	37	19.89%	145	77.96%
1% to 2%	24	12.90%	169	90.86%
2% to 3%	14	7.53%	183	98.39%
3% to 4%	2	1.08%	185	99.46%
4% to 5%	1	0.54%	186	100.00%
Total	**186**	**100.00%**		

The Lehman Brothers Euro-Aggregate - Index Level, EUR, Unhedged index realised a performance of -0.03% in 2006. 80 entities investing in European bonds, i.e. 43.01%, have realised a higher performance than the Lehman Brothers Euro-Aggregate - Index Level, EUR, Unhedged index.

Lehman Brothers Euro-Aggregate-Index Level, EUR, Unhedged, 2006

Source: Lehman Brothers

For the average performance of -0.06% realised on the EUR-denominated bond market, the Sharpe ratio is of -1.41.

The following table gathers the performance results for the category "EUR-denominated bonds".

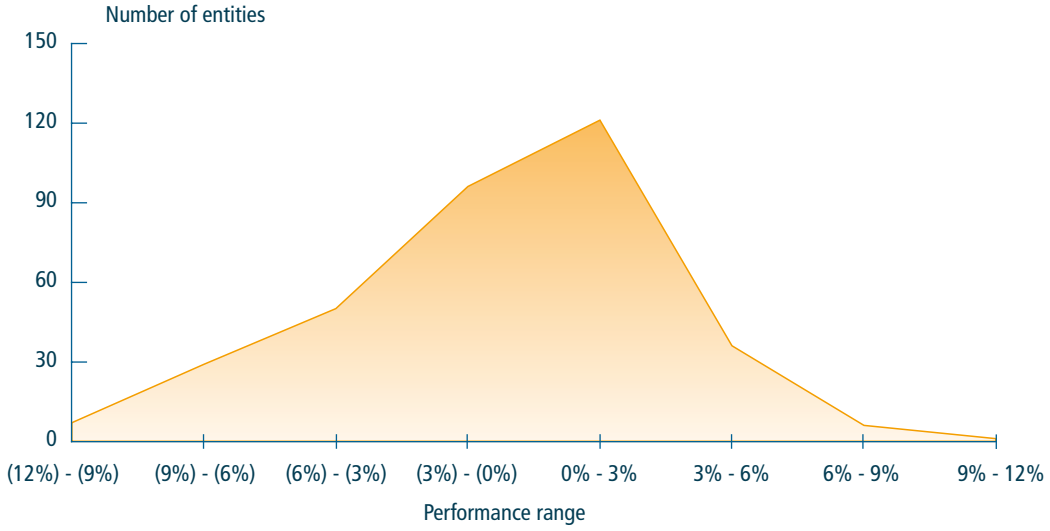
Summary table of the entities investing in EUR-denominated bonds

Average performance	-0.06 %
Maximum performance	4.85 %
Minimum performance	-4.25 %
Standard deviation of performance	1.42 %
Performance spread	9.10 %
Statistical population	186
Lehman Brothers Euro-Aggregate - Index Level, EUR, Unhedged performance	-0.03 %
Average volatility of performance	2.04 %
Number of entities with higher performance than Lehman Brothers Euro-Aggregate - Index Level, EUR, Unhedged	80
Sharpe ratio – average performance	-1.41
Sharpe ratio – maximum performance	0.76
Sharpe ratio – minimum performance	-1.46

7.2.6. Entities whose investment policy consists in investing in international bonds

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in international bonds.

Performance of entities investing in international bonds in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in international bonds amounts to 0.38%. The variation range, i.e. the difference between the highest and the lowest performance, is of 21.78%. The standard deviation of the performance of these entities amounts to 3.65%.

Central values and dispersion characteristics

Average performance	0.38 %
Maximum performance	10.97 %
Minimum performance	-10.81 %
Standard deviation of performance	3.65 %
Performance spread	21.78 %
Statistical population	347

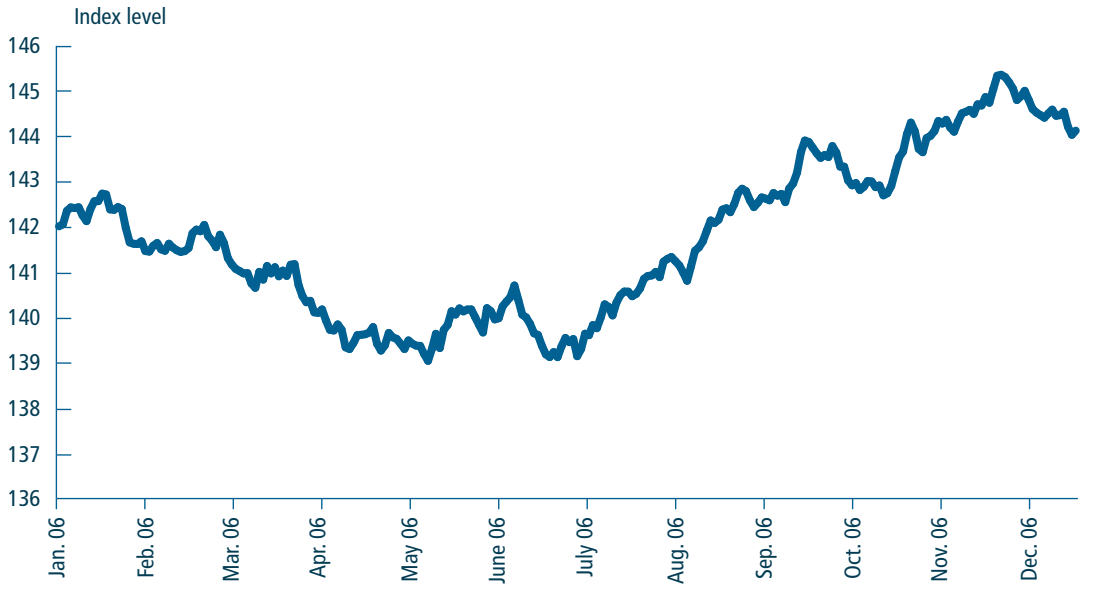
The maximum performance realised in 2006 by entities investing in international bonds amounts to 10.97%, whereas the minimum performance lies at -10.81%.

Statistical performance distribution of entities investing in international bonds

Performance	**Number of entities**			
Return classes	Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-12% to -9%	7	2.02%	7	2.02%
-9% to -6%	29	8.38%	36	10.40%
-6% to -3%	50	14.45%	86	24.86%
-3% to 0%	96	27.75%	182	52.60%
0% to 3%	121	34.97%	303	87.57%
3% to 6%	36	10.40%	339	97.98%
6% to 9%	6	1.73%	345	99.71%
9% to 12%	1	0.29%	346	100.00%
Total	**346**	**100.00%**		

The Lehman Brothers Global Aggregate - Index Level, EUR, Hedged index realised a performance of 1.48% in 2006. 94 entities investing in international bonds, i.e. 27.09%, have realised a higher performance than the Lehman Brothers Global Aggregate - Index Level, EUR, Hedged index.

Lehman Brothers Global Aggregate-Index Level, EUR, Hedged, 2006



Source : Lehman Brothers

For the average performance of 0.38% realised on the international bond market, the Sharpe ratio is of -0.84.

The following table gathers the performance results for the category "international bonds".

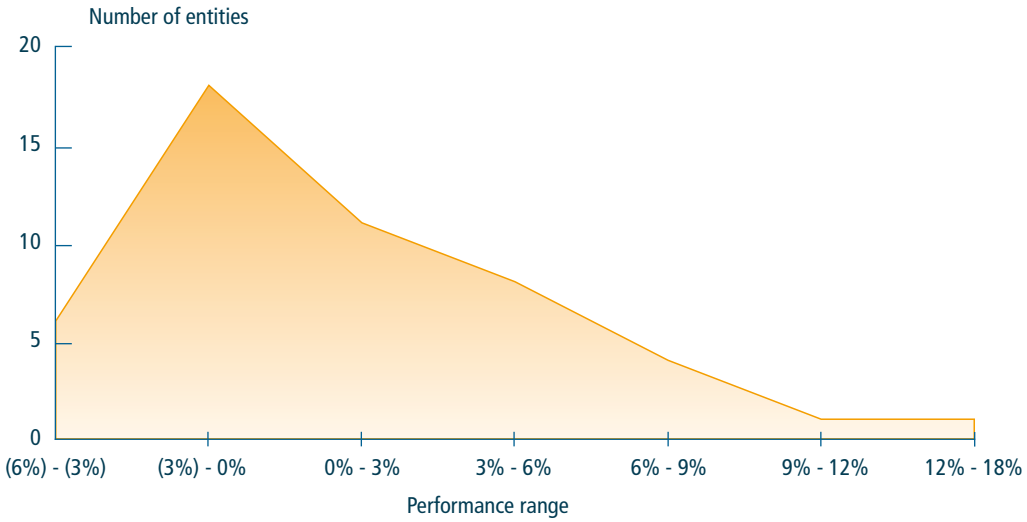
Summary table of the category of entities investing in international bonds

Average performance	0.38 %
Maximum performance	10.97 %
Minimum performance	-10.81 %
Standard deviation of performance	3.65 %
Performance spread	21.78 %
Statistical population	347
Lehman Brothers Global Aggregate - Index Level, EUR, Hedged performance	1.48 %
Average volatility of performance	2.90 %
Number of entities with higher performance than Lehman Brothers Global Aggregate - Index Level, EUR, Hedged	94
Sharpe ratio – average performance	-0.84
Sharpe ratio – maximum performance	2.56
Sharpe ratio – minimum performance	-3.69

7.2.7. Entities whose investment policy consists in investing in emerging market bonds

The following graph illustrates the performance distribution of entities whose investment policy consists in investing in emerging market bonds.

Performance of entities investing in emerging market bonds in 2006



The average performance realised in 2006 by entities whose investment policy consists in investing in emerging market bonds amounts to 3.26%. The variation range, i.e. the difference between the highest and the lowest performance, is of 21.94%. The standard deviation of the performance of these entities amounts to 4.38%.

Central values and dispersion characteristics

Average performance	3.26 %
Maximum performance	16.59 %
Minimum performance	-5.35 %
Standard deviation of performance	4.38 %
Performance spread	21.94 %
Statistical population	49

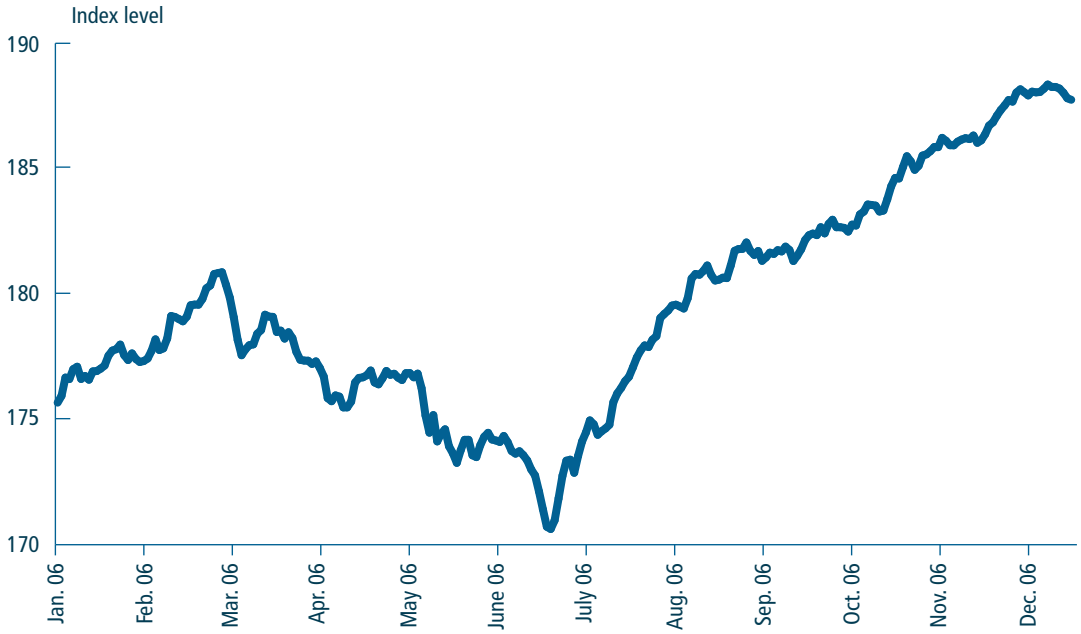
Statistical performance distribution of entities investing in emerging market bonds

Performance	**Number of entities**			
Return classes	Absolute frequency	Relative frequency	Cumulative absolute frequency	Cumulative relative frequency
-6% to -3%	6	12.24%	6	12.24%
-3% to 0%	18	36.73%	24	48.98%
0% to 3%	11	22.45%	35	71.43%
3% to 6%	8	16.33%	43	87.76%
6% to 9%	4	8.16%	47	95.92%
9% to 12%	1	2.04%	48	97.96%
12% to 18%	1	2.04%	49	100.00%
Total	**49**	**100.00%**		

Despite a 48.98% rate of negative performances in the number of entities, the weighting of the performance of entities investing in emerging market bonds through their net assets brings the average performance of these entities to 3.26%.

The Lehman Brothers Global Emerging Markets - Index Level, EUR, Hedged index realised a performance of 6.87% in 2006. Six entities investing in emerging market bonds, i.e. 12.24%, have realised a higher performance than the Lehman Brothers Global Emerging Markets - Index Level, EUR, Hedged index.

Lehman Brothers Global Emerging Markets-Index Level, EUR, Hedged, 2006



Source : Lehman Brothers

The average underperformance of the entities investing in emerging market bonds as compared to the Lehman Brothers Global Emerging Markets - Index Level, EUR, Hedged index can be explained by hedge of the index against exchange rate risk.

For the average performance of 3.26% realised on the market of emerging countries bonds, the Sharpe ratio is of 0.05.

The following table gathers the performance results for the category "emerging market bonds".

Summary table of the category of entities investing in emerging market bonds

Performance moyenne	3.26 %
Maximum performance	16.59 %
Minimum performance	-5.35 %
Standard deviation of performance	4.38 %
Performance spread	21.94 %
Statistical population	49
Lehman Brothers Global Emerging Markets - Index Level, EUR, Hedged performance	6.87 %
Average volatility of performance	8.27 %
Number of entities with higher performance than Lehman Brothers Global Emerging Markets - Index Level, EUR, Hedged	6
Sharpe ratio – average performance	0.05
Sharpe ratio – maximum performance	1.22
Sharpe ratio – minimum performance	-1.92

8. MANAGEMENT COMPANIES AND SELF-MANAGED INVESTMENT COMPANIES

8.1. Self-managed investment companies

In view of the deadline of 13 February 2007, date at which all investment companies that had not appointed a management company and falling under the scope of Directive 85/611/EEC had to be compliant with the provisions of Directives 2001/107/EC and 2001/108/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses, the number of approval requests for this type of companies has been very high.

Whereas at 31 December 2005 twenty investment companies qualified themselves as "self-managed investment company" (SMIC), their number increased to 102 as at 31 December 2006. These 102 SMIC represent 1,022 entities and their net assets amount to EUR 259 billion.

8.2. Management companies subject to the provisions of Chapter 13 of the law of 20 December 2002 as amended relating to undertakings for collective investment

8.2.1. Development in number

In 2006, the applications for authorisation as management company submitted to the CSSF continued at the same sustained pace than in 2005, which was predictable considering the transposition of the UCITS III Directive.

72 applications for authorisation as management company have thus been submitted to the CSSF in 2006 in view of their compliance with the provisions of Chapter 13 of the law of 20 December 2002 as amended. Since the entry into force of this law, a total of 190 applications for approval have been submitted to the CSSF.

These 72 files submitted can be divided as follows:

- 50 management companies under Chapter 14 of the law of 20 December 2002 as amended have decided to extend their authorisation to a management company subject to Chapter 13 of this law; one file has nevertheless been abandoned during the scrutiny process;
- fourteen projects for the setting-up of a new management company have been submitted, of which nine projects from promoters which were not yet established in Luxembourg;
- four institutions decided to give up their former status of professional of the financial sector (PFS) to take on that of management company governed by Chapter 13 of the above law;
- four companies that did not fall under the legislation relating to the financial sector chose to become a management company.

Considering the files opened in 2005 and finalised in 2006, 80 new entities have been registered in 2006 on the official list of management companies under Chapter 13 of the law of 2002 and benefiting from the European passport by way of free establishment or free provision of services in another EU Member State.

Following the withdrawal of four entities due to winding-up, the number of management companies authorised as at 31 December 2006 according to Chapter 13 of the law of 2002 amounted to 149 entities.

Development in the number of management companies under Chapter 13 of the law of 2002

	2003	2004	2005	2006
Number of registrations	3	23	47	80
Number of withdrawals	-	-	1	3
Total	**3**	**26**	**72**	**149**

Out of the 80 management companies newly registered in 2006, the authorisation for 72 entities exclusively covers the activity of collective management within the meaning of article 77(2) and the authorisation of eight entities covers, in addition to collective management, one or several services as referred to in article 77(3) of the law of 2002.

If taking into account the two management companies whose registration on the official list dates back to before 2006, but which have requested in 2006 the authorisation to widen their activities, the management companies that may benefit from a broader range of activities count ten entities.

Development in the number of management companies whose authorisation covers, in addition to the activity of collective management, one or several services referred to in article 77(3) of the law of 2002

	2003	2004	2005	2006
Number of registrations	2	6	5	10
Total	**2**	**8**	**13**	**23**

With a share of 15% in the total authorisations delivered so far, the number of management companies with a broadened field of activities remains relatively small since the entry into force of the law of 2002, even though this segment has experienced an important development in 2006.

8.2.2. Breakdown by geographical origin

The following table presents the breakdown of management companies under Chapter 13 of the law of 2002 according to their geographical origin.

Country	2004	2005	2006
Belgium	2	4	5
Denmark	1	2	3
France	3	5	14
Germany	8	15	39
Great Britain	3	6	7
Greece	/	/	1
Iceland	/	/	1
Italy	3	8	17
Japan	/	/	1
Liechtenstein	/	/	1
Luxembourg	/	1	8
Netherlands	2	3	3
Spain	/	1	2
Sweden	2	4	5
Switzerland	1	18	35
United States	1	5	7
Total	**26**	**72**	**149**

In 2006, management companies of German and Swiss origin remained predominant, followed by entities from Italy and France. It should be noted that management companies of French origin have developed their presence on the Luxembourg market to reach the fourth position as at 31 December 2006.

8.2.3. Assets managed

As at 31 December 2006, the total net assets of UCIs managed by management companies under Chapter 13 of the law of 2002 amounted to EUR 1,306 billion. Considering total net assets of EUR 1,844.8 billion invested as at 31 December 2006 in Luxembourg UCIs, more than two thirds of these total net assets are managed by management companies under Chapter 13 of the law of 2002.

Distribution of management companies in terms of assets under management as at 31 December 2006

Assets under management	Number of management companies
< 100 million EUR	15
100 - 500 million EUR	30
500 - 1.000 million EUR	13
1 - 5 billion EUR	34
5 - 10 billion EUR	23
10 - 20 billion EUR	16
> 20 billion EUR	18
Total	**149**

8.2.4. International expansion

Articles 88 and 89 of the law of 20 December 2002 as amended introduce the possibility for management companies authorised in accordance with Directive 85/611/EEC as amended to carry on cross-border activities. These articles indeed provide that a management company is allowed to carry on in an EU Member State other than its home Member State the activity for which it has been authorised in its home Member State, by means of a notification under the right of establishment or the freedom to provide services.

- ***Right of establishment***

In 2006, four management companies incorporated under Luxembourg law set up a branch in one or several EU Member States under the right of establishment:

- Camfunds S.A. set up a branch in Great Britain;
- Dexia Asset Management Luxembourg S.A. set up in Germany by means of a branch;
- JPMorgan Asset Management (Europe) S.à r.l set up a branch in Spain and in France.

The following management companies were represented, as at 31 December 2006, in one or several EU countries by means of a branch.

- Camfunds S.A.	Great Britain
- Dexia Asset Management Luxembourg S.A.	Germany, Spain, Italy, Netherlands, Sweden, Switzerland
- JPMorgan Asset Management (Europe) S. à r.l.	Germany, Austria, Spain, France, Italy, Netherlands, Sweden

As at 31 December 2006, one management company of another EU Member State, the French management company Société Générale Asset Management Alternative Investments, has introduced a notification of free establishment of a branch in Luxembourg. The opening of the branch is planned during the first quarter of 2007.

Concerning the expansion outside the EU, it should be noted that the management company Eurizon Capital S.A. incorporated under Luxembourg law opened a branch in Chile and in Singapore in 2006.

- ***Freedom to provide services***

Four management companies incorporated under Luxembourg law introduced a notification to carry on their activities in one or several countries of the European Union by way of free provision of services in 2006. These notifications mainly originated from management companies benefiting from a wider range of activities within the meaning of article 77(3) of the law of 2002.

The number of notifications to freely provide services in Luxembourg introduced by management companies from other EU Member States totalled ten in 2006 (thirteen in 2005).

- ***Representative offices***

In 2006, three management companies have opened representative offices abroad:

- Fortis Investment Management S.A.	Poland
- Dexia Asset Management Luxembourg S.A.	Bahrain
- Sparinvest S.A.	Germany, France

8.3. Supervisory practice

- ***Management company and domiciliation activities***

The issue of companies that can be domiciled with a management company has already been dealt with in Chapter II, point 5.4.2. of the CSSF Annual Report 2004. In this context, new interpretation questions have been submitted to the CSSF in 2006. Amongst the answers given by the CSSF to these questions, the following has had an impact on a certain number of files.

The CSSF considers that a management company may also domiciliate consultancy firms, provided that their object is limited to the provision of advice to one investment firm only and that the investment firm receiving the advice be also domiciled with this management company. Indeed, the aim was to avoid that a management company having domiciled consultancy firms should have to split up inter-linked activities forming a homogenous group of activities.

9. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

9.1. Circular CSSF 06/267 on the technical specifications regarding the communication to the CSSF, under the law on prospectuses for securities, of documents for the approval or for filing and of notices for offers to the public of units/shares of Luxembourg closed-end UCIs and admissions of units/shares of Luxembourg closed-end UCIs to trading on a regulated market

Circular CSSF 06/267 dated 22 November 2006 addresses Luxembourg closed-end UCIs whose units/shares are being offered to the public or admitted to trading on a regulated market within the meaning of the law of 10 July 2005 on prospectuses for securities.

The purpose of the circular is to specify the technical procedure and the practical elements regarding the communication to the CSSF, as referred to in the law of 10 July 2005, of documents for the approval or for filing and of notices for offers to the public and admissions to trading on a regulated market of units/shares of Luxembourg closed-end UCIs.

9.2. Circular CSSF 07/277 on the new notification procedure in line with the guidelines of the Committee of European Securities Regulators (CESR) regarding the simplification of the UCITS notification procedure

The purpose of circular CSSF 07/277 dated 9 January 2007 is to draw the attention of UCITS on the new notification procedure in line with CESR guidelines regarding the simplification of the UCITS notification procedure. CESR guidelines define the common approach that the EU host authorities shall adopt under the notification procedure.

The circular also aims at specifying the approach adopted by the CSSF as regards European passports for UCITS following the adoption of the new CESR guidelines. The circular describes, on the one hand, the notification procedures of Luxembourg UCITS that contemplate to market their units/shares in another EU Member State and, on the other hand, the notification specifications and marketing rules adopted by the CSSF for UCITS established in another EU Member State contemplating to market their units/shares in Luxembourg.

10. PRUDENTIAL SUPERVISORY PRACTICE

10.1. Prudential supervision

10.1.1. Standards to be observed by UCIs

One of the fundamental duties of the CSSF in the supervision of UCIs is to ensure application of the laws and regulations relating to UCIs. The aim of this supervision is to ensure adequate investor protection as well as stability and security in the UCI sector.

10.1.2. Instruments of prudential supervision

The CSSF's permanent supervision aims to ensure that UCIs subject to its supervision observe all legislative, regulatory and contractual provisions relating to the organisation and operation of UCIs, as well as to the distribution, investment or sale of their securities. This supervision is based in particular on:

- the examination of the periodic financial information which UCIs must submit to the CSSF on a monthly and annual basis;
- the analysis of annual and semi-annual reports which UCIs must publish for their investors;
- the analysis of the management letters issued by the external auditor, which must be communicated immediately to the CSSF;
- the analysis of the statements made in accordance with the circular relating to the protection of investors in the event of a NAV (net asset value) calculation error and correction for the consequences of non-compliance with investment rules applicable to UCIs;
- on-site inspections carried out by CSSF agents.

10.1.3. Means of control

- ***Audit of semi-annual and annual reports***

Scrutiny of semi-annual and annual reports carried out by the CSSF shows that these reports are in general drawn up in accordance with the applicable legal rules. During 2006, the CSSF had to intervene with several UCI service providers for the following reasons:

- non-compliance of the financial report with the fund's investment policy or lack of required information;
- omission to mention that the subscription can only be made on the basis of the UCI's prospectus;
- omission to mention the exchange rate applied;
- incorrect statement of the UCI's or sub-fund's denomination;
- breakdown of fee items;
- incorrect breakdown of the securities portfolio.

- ***Audit of financial information for the CSSF and STATEC***

In accordance with circular IML 97/136 and pursuant to article 118 of the law of 20 December 2002 as amended, the central administrations of Luxembourg UCIs must transmit financial information by electronic means to the CSSF, on a monthly (tables O 1.1.) and yearly (tables O 4.1. and O 4.2.) basis. The deadline to transmit the monthly financial information is twenty days following the reference date, which is in principle the last day of each month. As regards yearly financial information, the reference date is the date of the close of the financial year and the time limit is four months.

As far as monthly financial information is concerned, the CSSF considers that UCIs must, on the one hand, scrupulously observe the allocated deadline to submit table O1.1. and, on the other hand, pay due attention when drawing up this table so as to ensure that the format and content are correct. For information, the format and content of about 9,500 files, representing nearly 21,000 types of units/shares, are controlled every month.

- ***Surveys on Late Trading and Market Timing***

Following the publication of circular CSSF 04/146 concerning the protection of UCIs and their investors against Late Trading and Market Timing practices, three cases of potential Market Timing have been reported to the CSSF in 2006. The CSSF was able to close one case for which the investigation could not reveal the existence of transactions that could be qualified as Market Timing. For two cases submitted in 2006, investigations are still in progress.

- ***Meetings***

In 2006, 162 meetings were held between representatives of the CSSF and intermediaries of UCIs. These meetings concerned the presentation of new UCI projects, restructurings of UCIs, but also the application of the laws and regulations of UCIs.

10.2. Circular CSSF 02/77 on the protection of investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules

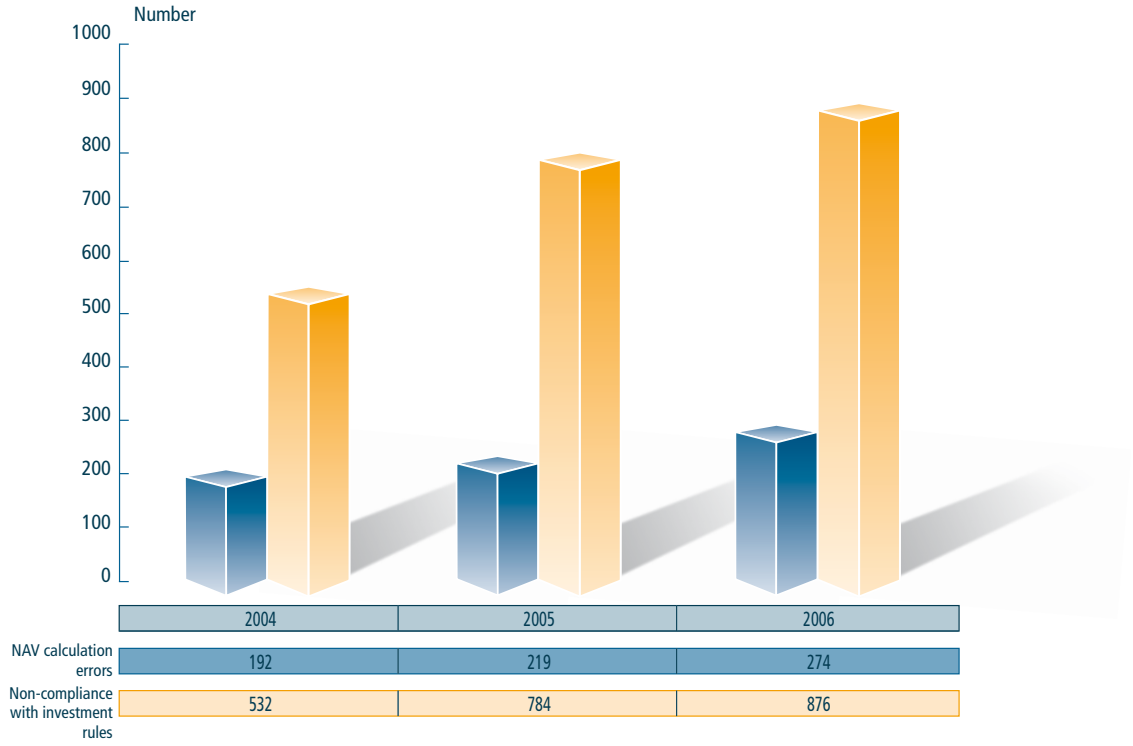
10.2.1. Reports made in 2006 on the basis of circular CSSF 02/77

In 2006, the CSSF received 1,150 reports based on circular CSSF 02/77, against 1,003 reports in 2005, representing an increase of 15%.

Among these reports, 274 cases (219 cases in 2005) concerned NAV calculation errors and 876 cases (784 in 2005) non-compliance with investment rules, including 217 cases (148 in 2005) of non-compliance with the investment policy.

The following graph shows the development of the number of NAV calculation errors and cases of non-compliance with investment rules which have been reported to the CSSF over the last three years.

Development in the number of NAV calculation errors and cases of non-compliance with investment rules over the last three years



While the number of NAV calculation errors tended to decrease until 2004, the rise which began in 2005 was confirmed in 2006. This growth should however also be seen in the light of the substantially increasing number of registered UCIs.

The number of instances of non-compliance with investment rules continued to grow, however only by 12% as compared to 2005. Indeed, the strong increase of 47% registered in 2005 was not repeated in 2006.

As regards more particularly the reports received in 2006, 92 out of the 274 cases of NAV calculation errors and 127 out of the 876 cases of non-compliance with investment rules could not be closed at 31 December 2006, as the CSSF was still awaiting either further information, or the report(s) of the external auditor or the management letter, or the report on the UCI's activity following the application of the simplified procedure as provided for by circular CSSF 02/77.

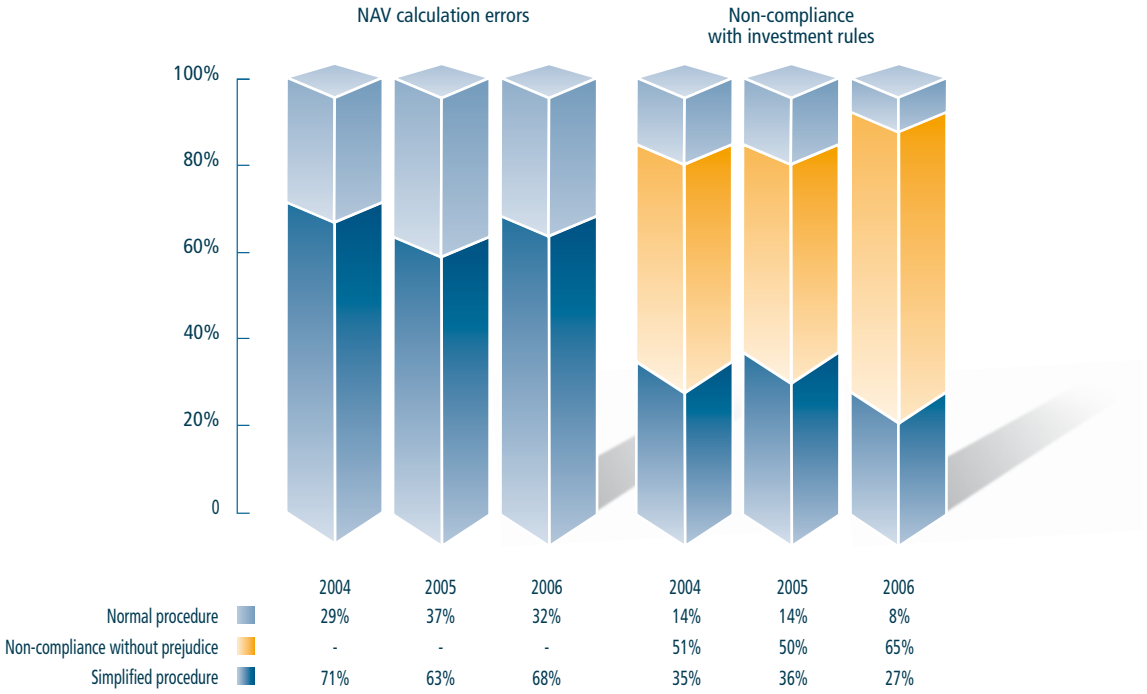
Indeed, circular CSSF 02/77 introduced a simplified procedure for cases of NAV calculation errors or non-compliance with investment rules that entail losses for the UCI, where the indemnification amount does not exceed EUR 25,000 and the amount to be reimbursed to an investor does not exceed EUR 2,500.

In this event, no corrective action plan needs to be submitted to the CSSF, but the central administration must notify the occurrence of the calculation error or non-compliance to the CSSF and take the measures necessary to correct the calculation error or non-compliance and arrange the indemnification of the damages occurred. The external auditor of the UCI must review the correction process and state in his annual audit report whether, in his opinion, the correction process is appropriate and reasonable.

In 2006, 185 out of 274 cases of NAV calculation errors fell within the scope of the simplified procedure (139 cases out of 219 in 2005). 237 out of 876 cases of non-compliance with investment rules have also applied this procedure (281 cases out of 784 in 2005).

The following graph plots the proportion of the cases of simplified procedure compared to the total number of reports received over the last three years.

Simplified procedure

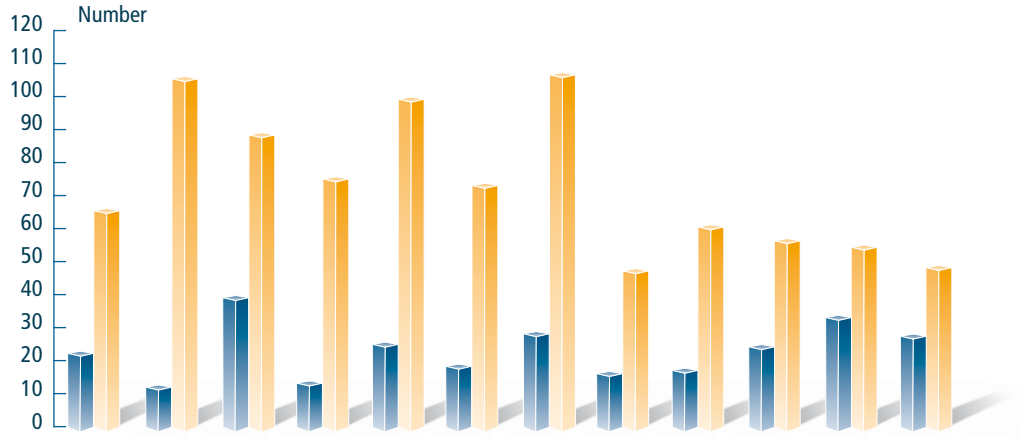


	2004	2005	2006	2004	2005	2006
Normal procedure	29%	37%	32%	14%	14%	8%
Non-compliance without prejudice	-	-	-	51%	50%	65%
Simplified procedure	71%	63%	68%	35%	36%	27%

Thus, 68% of the reports of NAV calculation errors fell within the scope of the simplified procedure (63% in 2005 and 71% in 2004). As regards the cases of non-compliance with investment rules, 27% of the cases met the criteria of the simplified procedure (36% in 2005 and 35% in 2004) and 65% of the cases could be regularised without harming neither the investors nor the UCIs (50% in 2005 and 51% in 2004).

The following graph sets out in detail the reports made during 2006.

Development in the errors and instances of non-compliance notified in 2006



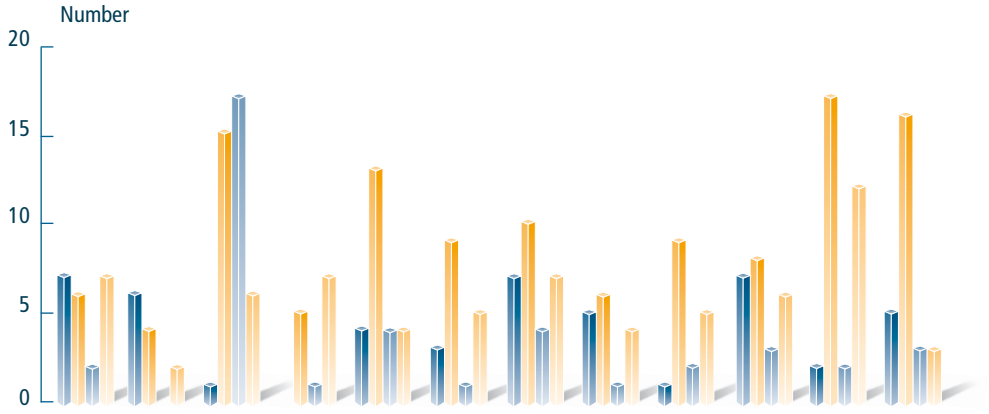
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
NAV calculation errors	22	12	39	13	25	18	28	16	17	24	33	27
Non-compliance with investment rules	65	105	88	75	99	73	106	47	60	56	54	48

73% of the reports have been made during the first six months of 2006. Moreover, 15% of the reports have been made during the month of July 2006, i.e. the month with the highest number of errors and non-compliance reported. This can be explained by the fact that the finalisation works for the financial year closing and for the UCI activity audit report start during this period and that the auditor detects only at that moment the NAV calculation errors or the instances of non-compliance with the investment restrictions that have not been previously identified.

NAV calculation errors may be linked to four different causes: pricing errors, booking errors, errors in the calculation of costs and accruals and other errors, for example in the valuation of swaps or futures.

The following graph plots the different causes of NAV calculation errors recorded in 2006.

Development of the causes for NAV calculation errors in 2006

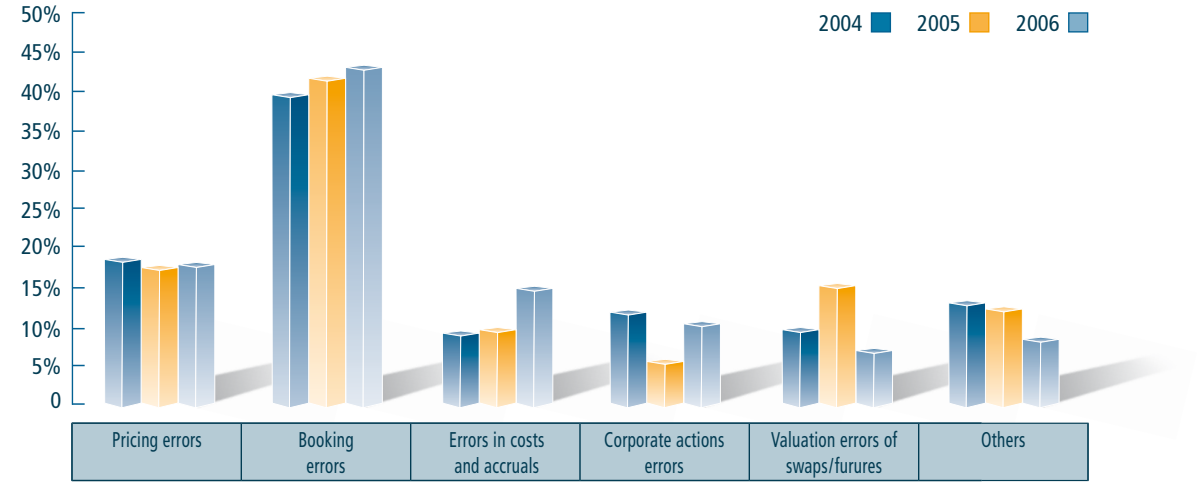


	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
Pricing errors	7	6	1	0	4	3	7	5	1	7	2	5
Booking errors	6	4	15	5	13	9	10	6	9	8	17	16
Calculation errors in costs and accruals	2	0	17	1	4	1	4	1	2	3	2	3
Others	7	2	6	7	4	5	7	4	5	6	12	3

In 2006, 18% of NAV calculation errors were due to pricing errors, 43% to booking errors and 15% to calculation errors in costs and accruals. Among the other causes of error, problems linked to corporate actions represent 10% of the cases reported and errors in the valuation of swaps and futures account for 7% of the NAV calculation errors.

The following table shows the development of the causes of NAV calculation errors recorded since 2004.

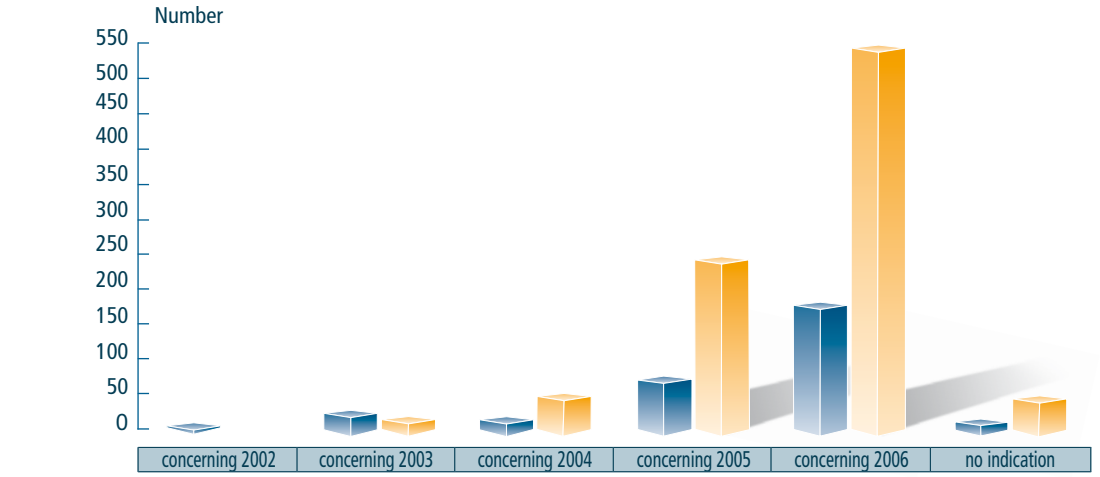
Development of the causes of NAV calculation errors over the last three years



Over the last three years, booking errors and errors in the valuation of securities held by UCIs were the main causes for NAV calculation errors. The number of errors relating to the valuation of swaps/futures decreased substantially as compared to 2005, whereas the errors originating from corporate actions have increased compared to 2005. Concerning the errors in costs and accruals, a significant increase can be noticed in 2006, whereas their number was constant in 2004 and 2005.

It should be noted that reports made during 2006 do not always refer to errors and instances of non-compliance that occurred during 2006. Indeed, they can also relate to errors or instances of non-compliance detected in 2006, but which relate to errors or instances of non-compliance that occurred previously, as shown in the graph below.

Reports made during 2006



	concerning 2002	concerning 2003	concerning 2004	concerning 2005	concerning 2006	no indication
NAV calculation errors	1	17	13	60	173	10
Non-compliance wit investment rules	0	12	45	239	540	40

Out of 1,150 reports made in 2006, 0.1% and 2.5% respectively were related to errors or instances of non-compliance that had already occurred in 2002 or 2003. 5% and 26% concerned errors or instances of non-compliance which occurred in 2004 and 2005, while 62% related to errors or instances of non-compliance that had actually occurred in 2006.

10.2.2. Compensation paid following regularisation of NAV calculation errors or instances of non-compliance with investment rules

The table below sets out the amounts of compensation notified in 2005 and 2006. It has to be noted that it is based on data available to the CSSF as at 31 December 2005 and 31 December 2006 respectively, while the amount of compensation had not yet been notified in certain cases.

Compensation paid following NAV calculation errors

	Investors		UCI/Sub-fund	
	2005	2006	2005	2006
EUR	746,162.82	3,628,317.75	2,313,212.89	4,039,577.26
USD	166,386.43	1,076,828.98	355,830.81	3,401,307.28
GBP	2,395.74	1,040.00	52,904.98	143.00
CHF	3,274.33	65,759.29	211.10	76,626.73
Other currencies*	46,729.59	145,719.45	17,584.09	17,780.20
Total *(in EUR**)*	**939,535.13**	**4,634,146.84**	**2,709,760.64**	**6,687,873.99**

Compensation paid following non-compliance with investment rules

	Investors		UCI/Sub-fund	
	2005	2006	2005	2006
EUR	170,696.62	1,449.26	1,323,945.11	1,781,131.53
USD	77,074.72	-	153,774.00	706,293.98
GBP	-	43.14	1,432.28	39,900.93
CHF	-	484.46	180,060.65	33,160.81
Other currencies*	-	-	3,241.92	185,579.98
Total *(in EUR**)*	**236,030.78**	**1,814.99**	**1,575,414.21**	**2,583,058.65**

* converted in EUR at the exchange rate applicable on 31 December 2006 and 31 December 2005 respectively.

** exchange rate as at 31 December 2006 and 31 December 2005 respectively.

566 out of the 876 instances of non-compliance with investment rules have been regularised resulting in a profit, while 246 regularisations led to a loss. In 64 instances of non-compliance, the amount realised in the context of regularising operations has not been communicated yet.

While compensation paid following instances of non-compliance with investment rules had fallen in recent years, followed by a sharp rise in 2005, it recorded in 2006 an increase only at the level of compensation paid to UCIs or sub-funds. Indeed, the amount of compensations paid to investors affected has considerably decreased. This can be explained by the fact that the losses incurred did not have any material impact on the NAV so that a recalculation of the NAV during the period of non-compliance was not necessary.

As regards the increase of the amounts paid out as a compensation following NAV calculation errors, it should be noted that the compensation amounts linked to only two NAV calculation errors represented 44% of the total amount paid out to investors and 62% of the total amount paid out to sub-funds.

10.2.3. Management letters

Chapter P of circular IML 91/75 of 21 January 1991 states that UCIs must automatically and immediately communicate to the CSSF the management letters issued by external auditors in the context of the audits which the latter are obliged to undertake pursuant to article 113 the law of 20 December 2002 as amended.

The analysis below is based on the data of the year 2005, since these are more pertinent. Indeed, most UCIs close their financial year on 31 December so that the data relating to 2005 are established by the CSSF in 2006.

As in previous years, many management letters, namely 77%, are management letters that contain no recommendations. i.e. the external auditor has not detected any irregularities in the management of the UCIs. 19% are management letters with recommendations by which the external auditors have reported irregularities of various types. 4% of the management letters have not been submitted yet.

With regard to management letters with recommendations, the irregularities pointed out by external auditors can be divided into four main categories: overstepping of statutory or regulatory limits, NAV calculation errors, non-compliance with investment policy and problems in the organisation of UCIs.

In 2005, the management letters described in their majority instances of overstepped investment limits and contained details required by the simplified procedure as provided for by circular CSSF 02/77.

10.3. Long form reports

Circular CSSF 02/81 of 6 December 2002 sets out the rules concerning the scope of the audit of the annual accounting documents and the content of the audit reports to be drawn up pursuant to the law on UCIs.

The circular, which applies to all Luxembourg UCIs, takes account of the fact that in practice, the role and function of the external auditor are one of the pillars of the prudential supervision of UCIs.

The purpose of the long form report introduced by circular CSSF 02/81 is to report on the findings of the auditor in the course of its audit concerning the financial and organisational aspects of the UCI comprising *inter alia* its relationship with the central administration, the depositary bank and other intermediaries (investment managers, transfer agents, distributors, etc.).

1,698 reports out of the 1,810 long form reports relating to the financial year ending 31 December 2005 were drawn up and submitted to the CSSF as at 31 December 2006.

The reports enable the CSSF to strengthen the supervision of UCIs as they provide detailed information on the organisation of UCIs and on their relationships with the central administration, the depositary bank or any other intermediary.

10.4. Enforcement of the legislation concerning UCIs

In January 2006, the Committee of European Securities Regulators (CESR) adopted guidelines relating to the eligible assets for investments of UCITS in the context of "CESR's Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS" (CESR's Advice), in order to harmonise, at European level, the interpretation of Article 19 of Directive 85/611/EEC as amended.

The CSSF, as a CESR member, applies the recommendations relating to the eligible assets of UCITS.

The CSSF has been contacted in order to give its opinion on a certain number of eligibility questions on the investment of UCITS. The following subjects can be pointed out.

10.4.1. Gold Bullion Securities

The CSSF had to give its opinion on the eligibility of Gold Bullion Securities for investment of UCITS subject to Part I of the law of 20 December 2002 as amended.

The CSSF considers that investments in Gold Bullion Securities, listed on the London and Paris Stock Exchanges, constitute eligible investment for an UCITS by virtue of article 41(1)a) of the law of 20 December 2002 as amended, arguing that the investments of an UCITS may be constituted by transferable securities and money market instruments listed or negotiated on a regulated market.

The CSSF has thus taken into account the recent restructuring of the Gold Bullion Securities in order to adapt its position published in its Annual Report 2004.

It should be pointed out that the above securities cannot result in a physical delivery of gold.

10.4.2. Transferable securities including an embedded derivative

The CSSF had to give its opinion on the eligibility of certain transferable securities, which invest in or will be linked to the performance of other assets, for investment of UCITS further to article 41(1)a)-d) of the law of 20 December 2002 as amended. In this context, an analysis of the relevant transferable securities should be performed in order to determine if the concerned security embeds a derivative within the meaning of CESR's advice on this subject (embedded derivative within the meaning of Box 11 of CESR's Advice).

It should first be noted that in order to be eligible under article 41(1)a)-d) of the law of 20 December 2002 as amended, the transferable securities must comply with the factors set out by CESR relating to the definition of transferable securities (Box 1 of CESR's Advice).

In order to define embedded derivatives in the context of transferable securities, two possibilities should be distinguished:

a) The analysis of the relevant transferable securities indicates that these are linked to the performance of other underlying assets by an embedded derivative.

   In this case, the look-through principle should be applied and the eligibility of underlying assets should be verified in relation to the recommendations on financial derivative instruments (Box 13 of CESR's Advice).

   If the underlying assets of the transferable securities are eligible, these transferable securities are eligible for investment of UCITS subject to Part I of the law of 20 December 2002 as amended. However, should the underlying assets of the transferable securities not qualify as eligible, these transferable securities are not eligible for investment of UCITS subject to Part I of the law of 20 December 2002 as amended.

b) The analysis of the relevant transferable securities indicates that these are not linked to the performance of other underlying assets by an embedded derivative.

   In this case, the eligibility analysis of these transferable securities is limited to article 41(1)a)-d) and to Box 1 of CESR's Advice, as for any other transferable security in the context of a UCITS subject to Part I of the law of 20 December 2002 as amended.

10.4.3. Investment companies in risk capital (SICAR)

The CSSF decided that investments in SICARs are eligible for UCITS subject to Part I of the law of 20 December 2002, by virtue of article 41(1) of this law, provided that the SICARs whose acquisition is considered are:

- closed-end funds;
- listed or admitted to trading on a regulated market in accordance with article 41(1)a)-d) of the law;
- in accordance with the criteria defining closed-end UCIs (Box 3 of CESR's Advice) and with the criteria set out by CESR relating to the definition of transferable securities (Box 1 of CESR's Advice).

SICARs whose acquisition is considered and which do not meet one or several of the above criteria, are eligible for investment of UCITS within the meaning of article 41(2)a) of the law of 20 December 2002 as amended, provided that the criteria applicable to the relevant article of CESR's Advice are respected (Box 2 of CESR's Advice).

10.4.4. Eligibility of warrants on transferable securities

The CSSF decided that warrants on transferable securities are to be considered as financial derivative instruments pursuant to article 41(1)g) of the law of 20 December 2002 as amended.

Consequently, warrants on transferable securities shall respect all legal provisions applicable to financial derivative instruments pursuant to articles 41(1)g), 42 and 43 of the above law and follow all recommendations on this subject included in CESR's Advice.

Concerning the application of articles 42 and 43 of the law in relation to warrants, the CSSF reminds of the following rules:

- the UCITS shall set up a risk management process that takes adequately account of the risks incurred;
- the UCITS shall determine the global risk linked to the financial derivative instruments, by adding market risk to counterparty risk;
- the UCITS shall respect the investment limits set under article 43, relating to diversification risk and counterparty risk linked to OTC derivatives.

The offering prospectus for a UCITS shall include a detailed description of the use of warrants on transferable securities in order to ensure comprehensive information to investors.

10.4.5. Eligibility of leveraged loans

The CSSF decided that leveraged loans do not comply with the definition set out in article 1(26) of the law of 20 December 2002 as amended, and that they do thus not qualify as transferable securities.

Consequently, leveraged loans do not constitute eligible investments for UCITS pursuant neither to article 41(1)a)-d), nor to article 41(2)a) of the law of 2002.

11. SAVINGS PLANS OFFERED BY LUXEMBOURG UCIS

The issue of the savings plan has already been dealt with in the CSSF Annual Report 2005 in Chapter II, point 8 "Analysis of savings plans offered by Luxembourg UCIs".

Considering the importance of this subject for the setting up of a portfolio of transferable securities with a large public of investors, the CSSF decided to issue certain recommendations for the following situations.

11.1. Savings plans laid down in the constitutive documents/prospectus and offered on behalf of the UCI

- ***The management of the savings plans is done by the UCI.***

The CSSF recommends that the UCI (and, where applicable, the company to which the UCI delegates its administrative management) sets up the means to ensure the permanent accounting segregation of the investors participating in savings plans and the other investors of the UCI.

Generally speaking, UCIs shall ensure that the payments for redemptions are made to the same persons than those that have been registered in the register at the time of the subscription of the savings plans.

- ***The management of the savings plans is done by a professional not belonging to the organisational structure of the UCI.***

The CSSF considers that the board of directors of the UCI, or, where applicable, the management company, is responsible for the organisational structure set up at the level of the management of the savings plans. The CSSF recommends that these persons initiate a due diligence procedure on the professional concerned, considering that the due diligence procedure covers specifically the following aspects:

- the status of the professional (information such as bank or other professional, regulated entity) and, where applicable, the verification of his authorisation to intervene in the register of the shareholders/unit holders in own name on behalf of third parties;
- the adequate organisation as regards the human and technical/IT infrastructure in the context of the savings plan.

The UCI should also have the necessary means in order to ensure at any time the segregation of investors participating in the savings plan and other investors. One manner to reach this segregation could consist in the establishment of a system ensuring that subscription and redemption orders originating from investors of savings plans are transmitted separately from orders coming from other investors.

Generally speaking, UCIs shall ensure that the payments for redemptions are made to the same persons than those that have been registered in the register at the time of the subscription of the savings plans.

Moreover, the CSSF recommends that a reconciliation of the holdings included in the register of shareholders/unit holders and the holdings held with the professional concerned be realised on a regular basis. The UCI should be informed of the number of shares/units issued within the context of the savings plans.

Moreover, UCIs should provide, jointly with the professional, for the access to data to individual underwriters.

11.2. Savings plans laid down in the constitutive documents/prospectus, but not activated on behalf of the UCI

The CSSF has noticed that the constitutive documents/prospectuses of some UCIs mention the possibility of savings plans being offered to investors. The UCIs concerned had not activated this offer, nor organised the administrative framework of these savings plans. It later appeared that third party professionals offer savings plans based on the model of the UCI's shares or units.

The CSSF considers that UCIs that include savings plans in their constitutive documents/prospectuses should have in place the adequate means allowing them to control the usage that is made of the "savings plan" vehicle. The UCIs should notably organise in order to identify the third party(ies) that offer savings plans based on their shares or units.

Consequently, where a UCI notices that a professional offers a savings plan having as an objective to invest in shares or units issued by it, the CSSF recommends that the UCI follows the guidelines set out here above under point 11.1., 2nd indent.

Generally speaking, the CSSF considers that it must be made aware of any problem likely to have an impact on the proper handling of the savings plans that invest in shares or units of Luxembourg UCIs.

Agents hired in 2006 and 2007 – Departments "General Supervision" and "Supervision of UCIs"

First row, left to right: Stéphanie WEBER, Robert BRACHTENBACH, Patrick BARIVIERA, Judith MEYERS, Jacqueline AREND, Ana Bela FEREIRA, Nathalie DE BRABANDERE

Second row, left to right: Marc SCHWALEN, Marco LICHTFOUS, Laurent REUTER, Claude DETAMPEL, Joé SCHUMACHER, Daniel WADLE

Absent: Nadia TRAUSCH

CHAPTER 3

3 SUPERVISION OF PENSION FUNDS

1. Developments in the pension funds sector in 2006

2. Activity of existing pension funds

3. Developments in the legal framework

4. International co-operation

1. DEVELOPMENTS IN THE PENSION FUNDS SECTOR IN 2006

1.1. Pension funds

As at 31 December 2006, fourteen pension funds subject to the law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep) were registered on the official list of pension funds.

In 2006, one pension fund subject to the law of 13 July 2005 has been withdrawn from the official list, namely the pension savings company with variable capital THE RAPALA GROUP SEPCAV.

The pension funds sector has stagnated in 2006. The entry into force on 23 September 2005 of Directive 2003/41/EC, which confers a European passport on institutions for occupational retirement provision, will hopefully facilitate the setting-up of pan-European pension funds in the medium term.

The CSSF expects a positive but slow development of the pension funds activity in the coming years, through the development of existing pension funds activities as well as through the establishment of new entities in Luxembourg.

1.2. Liability managers

Following the withdrawal of ACTUALUX S.A. from the official list of professionals authorised to act as liability managers for pension funds subject to the law of 13 July 2005, the number of liability managers of pension funds authorised by the CSSF amounted to twelve as at 31 December 2006.

2. ACTIVITY OF EXISTING PENSION FUNDS

The majority of the pension funds operate one or several pension schemes set up by Luxembourg companies, usually from the financial sector, in favour of their employees.

Four out of the fourteen pension funds registered on the official list have adopted the legal form of a sepcav and ten have adopted the legal form of an assep.

All sepcav and most assep have been set up with multiple compartments. For all of these pension funds, each compartment corresponds to a segregated part of the concerned entity's assets and liabilities.

All pension schemes operated by sepcav are schemes with defined contributions offering several investment options to their members. The assep offer any type of pension arrangements, i.e. schemes with defined contributions, defined benefits as well as hybrid schemes.

For schemes with defined contributions, it is generally foreseen that the benefits are allocated in the form of a lump sum payment. Similarly, in most schemes with defined benefits, the payment of the retirement capital can be made as a lump sum. In some defined benefit schemes, members may nevertheless opt for benefits in the form of a lump sum or an annuity. If the member opts for an annuity, the benefit is either externalised with an insurance undertaking or the pension fund itself bears the risk of the lifelong pension.

As far as complementary benefits are concerned, most pension funds cover their members against death. A reduced number of schemes offer additional benefits in the form of disability cover, reversion in favour of the surviving spouse and orphans' pensions. It should however be noted that these benefits are often externalised based on a policy concluded with an insurance undertaking.

3. DEVELOPMENTS IN THE LEGAL FRAMEWORK

Upon the adoption of the law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep), transposing Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision into Luxembourg law and replacing the law of 8 June 1999 creating pension funds in the form of sepcav and assep, the Luxembourg legislation on pension funds has not been impacted by major changes in 2006.

4. INTERNATIONAL CO-OPERATION

4.1. Budapest Protocol

In February 2006, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has adopted the "Protocol Relating to the Collaboration of the Relevant Competent Authorities of the Member States of the European Union in Particular in the Application of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision Operating Cross-Border" (Budapest Protocol). This protocol describes the practical co-operation between the different competent national authorities in the notification process of cross-border activities of institutions for occupational retirement provision. It also appends the list of the minimum level of information on the pension scheme's characteristics that must be included in the notification file.

The Budapest Protocol is composed of three parts and seven annexes. The first part covers the general aims and principles for co-operation between the competent authorities of the different Member States. The second part concerns more specifically the notification process, notably the exchange of information between the competent authorities of the home and host Member States when cross-border activities are launched. The third part covers the ongoing supervision and the exchange of additional information between competent authorities after the notification process has been concluded.

As for the annexes, it should be pointed out that enclosure 2 of the Protocol specifies the minimum level of information of the notification file that a pension fund wishing to operate cross-border activities shall submit to the home authority. In annexe 4, a flow-chart illustrates the various steps of the notification and co-operation process, whereas enclosures 5 and 6 include the contact details of the competent home and host authorities.

The Protocol and its annexes are available on the CEIOPS website (www.ceiops.org).

4.2. Other works in progress at CEIOPS level

CEIOPS is currently mapping the prudential approaches of the various Member States in a certain number of prudential supervisory functions.

In this context, CEIOPS focuses in particular on the progress realised in the application of investment rules (in particular the Prudent person rule), on the practices adopted in the Member States for the calculation of technical provisions and on the use of custodians/depositaries in the national supervision systems. These subjects will provide the basis for a review by the European Commission

in 2008, in accordance with Directive 2003/41/EC, to consider, if need be, a modification to the relevant provisions of the Directive.

Moreover, in order to achieve a common interpretation of the Directive and a progressive convergence of supervisory practices in other fields, CEIOPS will draw up an inventory of the Member States' implementation measures on technical issues such as minimum capital and solvency margin requirements, the definition of "ring-fencing" and the possibility for an institution for occupational retirement provision to benefit from financing through subordinated loans. For this same purpose, CEIOPS also analyses the existing reporting requirements for institutions for occupational retirement provision concerning information to be provided to members and beneficiaries as well as to the supervisory authorities.

As regards the above subjects, CEIOPS may issue guidelines or, where applicable, draw up recommendations to the attention of the European Commission in order to consider a modification to the relevant provisions of the Directive.

Finally, information is currently being collected on the content of social and labour law applicable to institutions for occupational retirement provision in the various Member States.

CHAPTER 4

4 SUPERVISORY FRAMEWORK FOR SICARS

1. Developments in the SICAR sector in 2006

2. Regulatory framework

3. Prudential practice

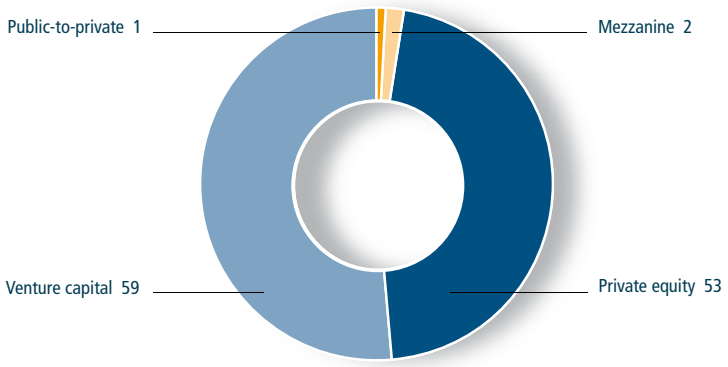
1. DEVELOPMENTS IN THE SICAR SECTOR IN 2006

In 2006, the CSSF has received 91 files from SICARs applying for registration on the CSSF's official list of SICARs, three of them having however been abandoned, at the initiators' request, during the scrutiny process.

As at 31 December 2006, 115 SICARs were registered on the CSSF's official list and about sixty application files were being processed.

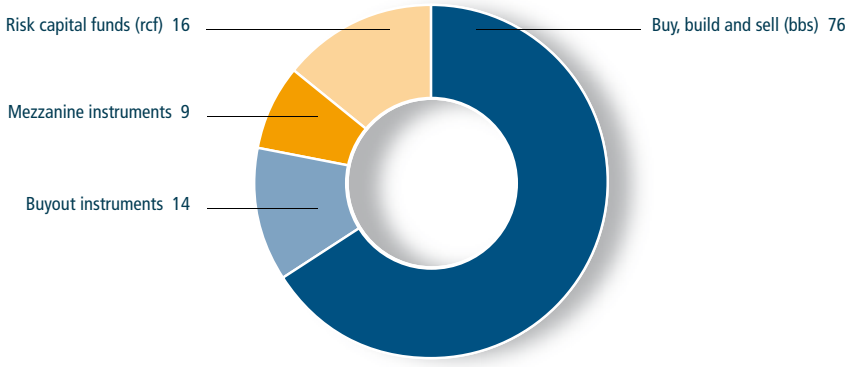
The following graph shows a breakdown of SICARs per investment policy and highlights a slight preference for venture capital, followed by private equity, without however revealing an actual trend for a specific investment policy.

Investment policy



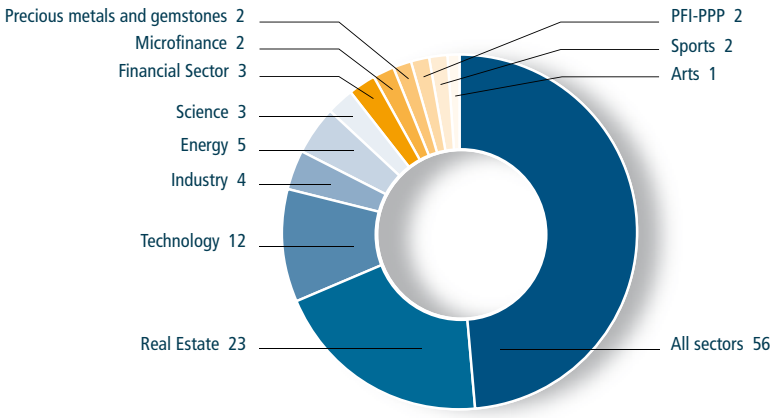
As regards the investment strategy, it can be observed that SICARs choose either to limit their policy to a particular strategy (buy, build and sell, buyouts, mezzanine financing, risk capital funds, etc.) or to adopt a combination of strategies generally used in the field of risk capital.

Investment strategy



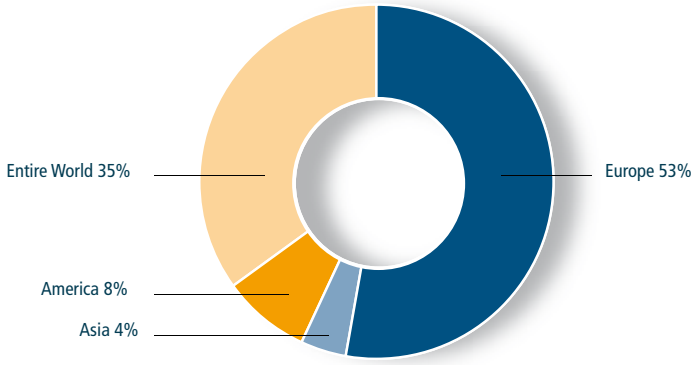
As for the sectoral distribution, a significant number of SICARs would rather not limit their investment policy to a particular investment sector. Among the SICARs having adopted a specialised policy, a certain concentration can be identified in real estate and technology sectors.

Sectoral distribution



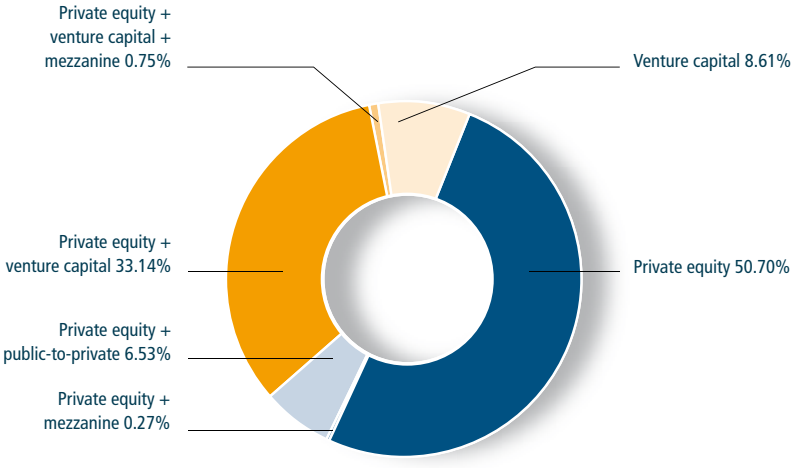
As far as the geographical area of the investments is concerned, 53% of the SICARs invest in Europe, whereas 35% of the SICARs are not limited to a specific region.

Investment region



As regards the financial assets of the SICARs registered on the official list, it should be noted that many SICARs are currently still in the process of collecting funds or identifying investment opportunities. Thus, 75 out of 115 SICARs registered on the official list had already made investments as at 31 December 2006.

Breakdown of balance sheet total according to the chosen investment policy



Based on the provisional figures as at 31 December 2006, the capital commitments of SICARs exceed EUR 18,659.88 million, whereas the balance sheet total reaches EUR 11,875.98 million.

As far as the geographical origin of the initiators is concerned, those from the EU are largely predominant, followed by US initiators.

Geographical origin of the initiators

Country	as a % of total
France	18.9
United States	13.9
Luxembourg	13.1
Switzerland	11.5
Italy	9.8
Great Britain	8.2
Germany	6.6
Spain	2.5
Belgium	2.5
Turkey	1.6
Netherlands	1.6
Denmark	1.6
Austria	1.6
British Virgin Islands	0.8
Slovenia	0.8
Iceland	0.8
India	0.8
Guernsey	0.8
Finland	0.8
Egypt	0.8
Australia	0.8
Total	**100%**

2. REGULATORY FRAMEWORK

2.1. Circular CSSF 06/241 on the concept of risk capital under the law of 15 June 2004 relating to the investment company in risk capital (SICAR)

Article 1 of the law of 15 June 2004 relating to the investment company in risk capital specifies that investment in risk capital refers to capital provided directly or indirectly to entities in view of their launch, development or listing on a stock exchange.

The purpose of circular CSSF 06/241 of 5 April 2006 is to provide a general description of the concept of risk capital and the criteria applied by the CSSF to assess the acceptability of the investment policies proposed for SICARs.

The circular specifies that risk capital under the SICAR law is characterised by the concurrent gathering of two elements, namely a high risk and an intention to develop the target entities (portfolio companies). These elements shall be adequately described in the prospectus.

The main objective of the SICAR shall be to contribute to the development of the entities in which it invests. The concept of development is construed in the broad sense as value creation at the level of the portfolio companies. It should also be noted that as an investment company in risk capital, the declared intention of the SICAR shall be in general to acquire financial assets in order to sell them with a profit, often based on a predefined exit strategy, and to make investors benefit from an increased return as a remuneration of the higher risk that they accepted to incur.

The circular sets down that several aspects need to be considered in order to assess whether an investment policy is acceptable, such as, for example, the number and the nature of the target entities, their maturity level, the development projects of the SICAR and the envisaged duration of holding. It also specifies under what conditions private equity real estate is eligible under the SICAR law.

2.2. Circular CSSF 06/272 concerning technical specifications regarding the communication to the CSSF, under the law on prospectuses for securities, of documents for approval or for filing and of notices for offers to the public of securities issued by SICARs and admissions of securities issued by SICARs to trading on a regulated market

Circular CSSF 06/272 of 21 December 2006 addresses the SICARs whose securities are being offered to the public or admitted to trading on a regulated market within the meaning of the law of 10 July 2005 on prospectuses for securities (Prospectus law).

In this context, the circular provides that the Official Submission with the CSSF can be validly made through the following means:

- *via* the e-file communication platform at http://www.e-file.lu for *Déposants* (applicants) who have an e-file connection;
- *via* e-mail to prospectus.approval@cssf.lu for *Déposants* (applicants) who do not have the necessary e-file connection as yet.

If a *Déposant* (applicant) uses other means of communication, such as filing of paper copies, the latter must enclose an electronic support (CD, DVD, PC floppy disk). The files can be sent in PDF or DOC (MS-Word) format.

The approval procedure described in circular CSSF 06/272 replaces the two-stage procedure (formal and informal) described in Chapter IV, point 3.5. of the 2005 Annual Report of the CSSF.

3. PRUDENTIAL PRACTICE

3.1. Composition of an application file

The application file to be submitted to the CSSF shall comprise the following documents and information:

- the draft prospectus;
- the draft articles of incorporation of the SICAR;
- the draft articles of incorporation of the SICAR's general partner, for SICARs in the form of a limited partnership or a partnership limited by shares;
- the *curricula vitae* of the managers of the SICAR, as well as the information allowing to assess their experience to perform their function;
- a document attesting their professional repute, notably a recent extract from their police record or a declaration of honor case of nationals of countries whose authorities do not issue such extracts;
- the draft agreements between the SICAR and its main service providers (central administration, depositary bank, registrar and transfer agent, domiciliation agent, etc.);
- the identity of the initiator(s);
- information on the marketing of the shares or other securities issued by the SICAR. In this context, it should also be stated whether the SICAR's securities will be offered to the public under the terms of the Prospectus law and if a prospectus shall be published in accordance with the provisions of this law. In the affirmative, the offering prospectus shall be subject to the technical modalities described in the above-mentioned circular CSSF 06/272.

This list of elements for the application file is of course not exhaustive and the CSSF reserves the right to request, at any time, any additional document and information it may deem necessary for the fulfilment of its supervisory task.

3.2. Content of the prospectus

Generally speaking, the offering documents of a SICAR shall provide investors with transparent and adequate information, notably on the investment policy and the inherent risks, on the decision-making processes of the SICAR, on the rules regarding the distribution of dividends and the remuneration of managers, as well as on other costs and commissions to be borne by the investors.

It is also recommended to inform investors about the decision-making mechanisms and the means for disclosure of decisions when major changes occur, relating, for example, to the characteristics and operation of the SICAR itself, the composition of its managing bodies or the identity of its service providers.

3.3. Indirect investments

A SICAR may invest indirectly *via* intermediary companies (special purpose vehicles) or *via* one or several investment vehicles (for example private equity funds).

In this context, the SICAR in question shall ensure that the intermediary companies or investment vehicles follow a policy which is in line with the concerned SICAR's policy and which guarantees that the investors' contributed funds are invested in assets representing risk capital within the meaning of the SICAR law, by requiring that target companies include "risk" and "development" elements as described in circular CSSF 06/241.

A master-feeder structure may be authorised by the CSSF based on an adequate justification. The prospectus shall give a true image of the planned investment by clearly describing the "risk" and "development" elements.

Concerning the presentation of the financial statements of a SICAR opting for the indirect investment structure, it shall be ensured that adequate information is provided on the portfolio companies.

In a "funds of funds" structure, the report of the SICAR shall generally indicate the name and the key characteristics of the target funds, but not the complete list of the investments made by them (often the main underlying companies by fund are nevertheless indicated), whereas in the "master-feeder" structures, the investment(s) made by the master shall be indicated in the report of the feeder fund, in order to provide investors with relevant information. Similarly, if the SICAR invests through a special purpose vehicle, underlying investments in risk capital shall be disclosed.

3.4. Share distribution of a SICAR

The CSSF would like to point out that a validly authorised SICAR in Luxembourg is not *de facto* (because of the restrictions relating to its shareholders) exempt from registration formalities or other rules applicable for the distribution in the country where it intends to distribute its shares, even if it has been exempted from the publication of a prospectus within the meaning of the Prospectus law or if a prospectus approved by the CSSF under the Prospectus law is available.

A SICAR intending to distribute its securities in another State shall thus comply with the rules relating to the offer to the public of securities applicable in that State.

CHAPTER 5

5 SUPERVISION OF SECURITISATION UNDERTAKINGS

1. Developments in the sector of authorised securitisation undertakings

2. Prudential supervisory practice

1. DEVELOPMENTS IN THE SECTOR OF AUTHORISED SECURITISATION UNDERTAKINGS

In 2006, five securitisation undertakings governed by the law of 22 March 2004 on securitisation have been granted authorisation by the CSSF, namely the following multiple-compartment securitisation undertakings, which have all been incorporated in the legal form of a public limited company:

- Artus Finance S.A.
- Strategic Investment Portfolios (Luxembourg) S.A.
- SachsenLux S.A.
- DWS GO S.A.
- Taranis Securities S.A.

The authorisation of these new securitisation undertakings brings the total number of authorised securitisation undertakings to eleven as at 31 December 2006. The total balance sheet of authorised securitisation undertakings exceeds EUR 13.9 billion at the end of 2006.

It should be borne in mind that only undertakings issuing securities to the public on a continuous basis must apply for authorisation.

The application files submitted reveal that securitisation transactions mainly consist in the securitisation of debt, loans and other comparable assets, as well as in repackaging transactions under the form of structured products issues linked to various financial assets.

The securities issued by securitisation undertakings are in general bonds and subject to foreign law. In the vast majority of cases, the articles of incorporation nevertheless reserve the right for the securitisation undertaking to operate securitisations by issuing shares. Some securitisation undertakings also have the possibility to issue warrants.

To date, the CSSF has not received any application file for the licensing of a fiduciary-representative under Luxembourg law, even though the law of 22 March 2004 on securitisation has established a specific legal framework for these independent professionals in charge of representing the interests of investors. Authorised securitisation undertakings usually appoint a trustee governed by foreign law.

The CSSF expects a continuous development of the securitisation activity for 2007, mainly due to a rapid market development and the newly created and innovative securitisation techniques to which the Luxembourg securitisation undertaking seems particularly well suited.

2. PRUDENTIAL SUPERVISORY PRACTICE

In 2006, no changes have been made to the Luxembourg legal framework governing securitisation undertakings. Nevertheless, some details have been clarified on the prudential supervisory practice developed since the entry into force of the law of 22 March 2004 on securitisation and several decisions have been taken by the CSSF in 2006. The most important are described hereafter.

2.1. Securitisation undertakings subject to the supervision of the CSSF

In accordance with article 19 of the law of 22 March 2004 on securitisation, only the undertakings that issue securities to the public on a continuous basis shall be subject to the prudential supervision of the CSSF. These two criteria, "on a continuous basis" and "to the public", must be fulfilled at the same time when requiring the authorisation of the CSSF.

Since neither the law nor the parliamentary works define the concept of "public", the administrative practice of the CSSF has allowed to set out the assessment criteria already published in the Annual Report 2005 and which have been further detailed in 2006 as regards the concept of issues "on a continuous basis".

Concerning the criterion of issues "on a continuous basis", the CSSF considers that it is generally assumed to be fulfilled from the moment the securitisation undertaking has made more than three issues per year. For multiple-compartment securitisation undertakings, the number of issues to consider in order to determine whether an authorisation is required is the total number of issues for the securitisation undertaking as a whole and not the number of issues per compartment.

Moreover, the CSSF considers that the setting up of an issue programme cannot be considered as equivalent to one single issue. In order to determine the number of annual issues of a securitisation undertaking issuing securities under a programme, an analysis of the nature of the programme and of the different series of issues shall be made in order to assess whether the characteristics of these issues allow to consider that they constitute one single issue and not several separate issues.

It should be noted that, on the one hand, the assessment criteria defined by the CSSF are not exhaustive and that, on the other hand, they only constitute assumptions. They do not exempt from examining the conformity of a given situation in relation to the objective of the legislator.

2.2. Nature of the securitisation transactions

The CSSF considers that securitisation transactions whose underlying are units of an undertaking for collective investment, units of a hedge fund or shares or interests in limited companies and limited partnerships are to be considered as securitisations within the meaning of the law of 22 March 2004, as these transactions consist in assuming or taking on a risk linked to the holding of these financial assets and issuing securities whose value or return depends on these risks. These securitisation transactions shall however comply with the laws and regulations applicable to the purchase and distribution of the underlying financial assets.

CHAPTER 6

6 SUPERVISION OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR

1. DEVELOPMENTS IN 2006 OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR (PFS)

The following other professionals of the financial sector fall under the scope of the prudential supervision of the CSSF:

- PFS incorporated under Luxembourg law (the activities performed by these institutions in another EU Member State, by means of a branch or under the freedom to provide services, are also subject to the prudential supervision of the CSSF);
- branches of investment firms from non-EU countries;
- branches of PFS other than investment firms originating from the EU or from non-EU countries.

Branches set up in Luxembourg by investment firms originating from another EU Member State fall under the supervision of their Home State.

Since the coming into force of the law of 2 August 2003, amending the law of 5 April 1993 on the financial sector, the entire financial sector falls under the prudential supervision of the CSSF. The PFS subject to the general provisions of the law on the financial sector, as well as the professionals performing debt recovery and those performing cash-exchange transactions are now subject to the permanent supervision of the CSSF and thus taken into account as far as statistics and official lists are concerned.

1.1. Development in the number of the other professionals of the financial sector

The constant growth in the number of PFS subject to the supervision of the CSSF, observed since the beginning of 2004, continues in 2006 as well, even though this increase is less important than in previous years. The rising number of financial players in 2006 reflects the attractiveness of the Luxembourg financial centre and illustrates more specifically the interest in PFS categories performing a connected or complementary PFS activity of the financial sector, many of the entities authorised during the last twelve months having opted for one of these statuses.

The number of PFS thus rose from 185 entities as at 31 December 2005 to 196 entities at the end of 2006. The number of undertakings authorised in 2006 has however slightly dropped compared to the number of entities that have been granted authorisation in the previous year (29 undertakings in 2006 against 32 in 2005). Eighteen entities gave up their PFS status in 2006, a growing number compared to the thirteen entities having abandoned their status in 2005.

Development in the number of PFS

Categories	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Investment firms										
Commission agents		4	7	10	14	15	17	15	14	10
(Brokers and commission agents)	14	/	/	/	/	/	/	/	/	/
Private portfolio managers	34	37	38	46	51	51	48	46	46	47
Professionals acting for their own account	20	15	17	14	17	16	16	16	14	13
Distributors of units/shares of investment funds	18	22	25	35	43	45	47	37	37	33
Underwriters		1	2	4	4	3	3	3	2	2
(Underwriters and market makers)	3	/	/	/	/	/	/	/	/	/
Professional custodians of securities or other financial instruments	3	1	1	3	4	3	3	3	3	3
Registrar and transfer agents							1	8	11	12
PFS other than investment firms										
Financial advisors	7	9	10	9	10	9	9	8	12	12
Brokers		10	8	7	6	6	5	4	6	7
Market makers		1	2	2	2	2	2	2	1	1
Professionals performing cash-exchange transactions								1	/	/
Debt recovery								3	2	1
Professionals performing credit offering								5	7	6
Professionals performing securities lending								1	1	1
Administrators of collective savings funds								1	1	1
PFS performing a connected or complementary activity of the financial sector										
Domiciliation agents of companies			1	14	32	36	34	31	32	50
Client communication agents							2	8	12	14
Administrative agents of the financial sector								6	8	17
IT systems and communication networks operators of the financial sector							1	11	24	35
Professionals performing services of setting up and of management of companies								2	2	6

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Categories	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter								3	4	3
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services					1	1	1	1	1	1
Total [1]	**80**	**83**	**90**	**113**	**145**	**145**	**142**	**166**	**185**	**196**

Notes concerning the registration of PFS on the official list

- The official list of PFS (as published on the CSSF website) has been adapted on 31 March 2006 in order to further bring out the entities that cumulate several statuses, including the status of domiciliation agent and/or the status of professional performing services of setting up and of management of companies. For this purpose, the companies cumulating the status of domiciliation agent and/or the status of professional performing services of setting up and of management of companies with one or various other PFS statuses are henceforth listed under the category "Domiciliation agents of companies" and/or "Professionals performing services of setting up and of management of companies".

  It should however be borne in mind that the professionals holding concurrently the status of domiciliation agent and professional performing services of setting up and of management of companies are only shown under the category "Domiciliation agents of companies", the latter being *ipso jure* authorised to perform services of setting up and of management of companies, in accordance with article 29-4(3) of the law of 5 April 1993 on the financial sector as amended. In other words, the entities listed under the category "Professionals performing services of setting up and of management of companies" either have exclusively been granted an authorisation for this activity, in accordance with article 29-4 of the law of 5 April 1993 on the financial sector as amended, or are cumulating this activity with other PFS statuses, with the exception of the status of domiciliation agent.
- Following the entry into force of the law of 2 August 2003, the above-mentioned lists include since 31 December 2004 the professionals performing debt recovery, the professionals performing cash-exchange transactions and the PFS authorised under the general provisions of the law of 5 April 1993 on the financial sector as amended, whose activities do not fall under a specific PFS category. These are registered on the official list as professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, except for the PFS categories also referred to in section 2 of the same chapter.

The table outlining the development in the number of PFS by categories over the years reveals again the soaring development of the PFS performing a connected or complementary activity of the financial sector in 2006. Especially the category of IT systems and communication networks operators of the financial sector recorded a positive development with a substantial growth of eleven entities during 2006, followed by the administrative agents of the financial sector, which experienced a considerable increase of nine entities as compared to the previous year, and the

[1] The total is not equal to the arithmetic sum of all the categories mentioned as an institution may be included in several categories.

client communication agents, showing an increment of two entities. This positive trend reflects the particular interest of these market segments in consideration of future developments in the fields of outsourcing and data processing.

The significant growth in the number of domiciliation agents of companies (+18 entities) and, to a lesser extent, of professionals performing services of setting up and of management of companies (+4 entities) is mainly linked to the adaptation of the official list of PFS. Companies cumulating the status of domiciliation agent and/or professional performing services of setting up and of management of companies together with other PFS activities are consequently also listed in the category "Domiciliation agents of companies" and/or "Professionals performing services of setting up and of management of companies". Only companies having been granted an authorisation as domiciliation agent of companies and/or professional performing services of setting up and of management of companies were previously included. The reorganisation of this list allows in particular to bring out the professionals that cumulate several statuses, and especially the two categories mentioned above (cf. above: Notes concerning the registration of PFS on the official list).

Most of the remaining PFS categories show a certain stability or a slight variation (+1 entity for private portfolio managers, registrar and transfer agents and brokers; -1 entity for professionals acting for their own account, debt recovery and professionals performing credit offering). A stronger downward trend has nevertheless been recorded for commission agents and distributors of units/shares of investment funds with four entities less, as compared to 31 December 2005. The number of distributors of units/shares of investment funds has again decreased as a consequence of the transformation of several of these PFS into management companies during 2006.

It is also worth mentioning the decrease of one entity in the category of PFS authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter. The entity concerned ceased its PFS activities in 2006.

As at 31 December 2006, no authorisation has been granted as yet for two categories introduced by the law of 2 August 2003, i.e. the professionals performing money transfer services and the management companies of non-coordinated UCIs.

Breakdown of PFS by geographic origin

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Belgium	27	25	24	21	22	22	18	21	23	28
France	10	10	10	11	14	13	9	12	12	12
Germany	6	6	7	11	11	10	10	10	13	18
Luxembourg	11	12	17	22	31	31	32	48	56	66
Netherlands	2	3	3	7	12	15	15	18	19	17
Switzerland	6	4	4	7	11	10	10	10	12	11
United Kingdom	10	9	8	8	9	10	11	8	8	8
United States	3	4	3	4	8	8	8	11	13	12
Others	5	10	14	22	27	26	29	28	29	24[2]
Total	**80**	**83**	**90**	**113**	**145**	**145**	**142**	**166**	**185**	**196**

[2] Including Italy (4 entities), Sweden (4 entities), Denmark (2 entities).

During 2006, the growth in the number of PFS of Luxembourg origin is again confirmed, increasing from 56 units as at 31 December 2005 to 66 units as at 31 December 2006. This continuous and more than proportional growth over the last years allows entities of Luxembourg origin to still largely remain in the majority.

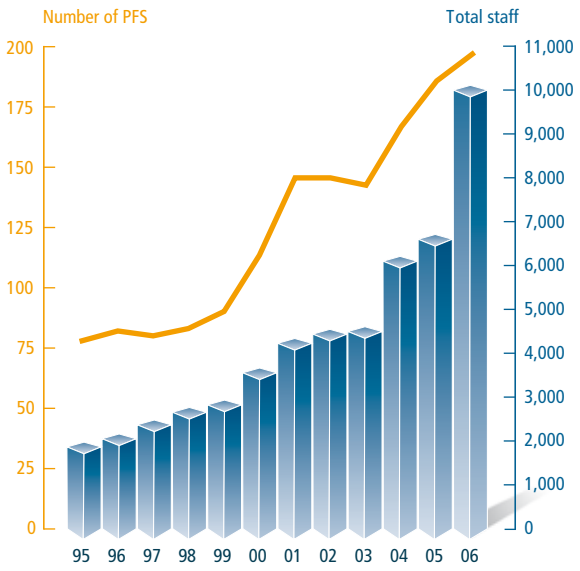
In addition, the significant interest shown in 2006 by the neighbouring countries in the Luxembourg financial centre should be highlighted, as the number of PFS of Belgian and German origin indicated an increment of five entities each. Whereas the majority of other countries showed a certain stability, the number of PFS of Dutch origin decreased by two entities.

1.2. Development in employment of the other professionals of the financial sector

After many years characterised by an upward trend of employment closely related to the increase in the number of PFS active in the financial centre, 2006 shows a more than proportional growth in the number of persons employed as compared to the development in number of the PFS. Indeed, the number of employees rose from 6,547 as at 31 December 2005 to 9,928 as at 31 December 2006, representing a considerable annual growth of 51.64%. This positive trend mainly results from the newly authorised PFS in 2006 and more specifically from two entities having obtained the status of client communication agent, which employed alone already more than 2,000 persons. The employment growth is due, to a lesser extent, to the increasing number of employees of several entities already operating in the financial centre, notably following the diversification of their activities and services offered. Mainly PFS operating in the investment funds sector are concerned.

Summary of employment per year and compared to the development in the number of PFS

Year	Number of PFS	Total staff
1995	78	1,827
1996	82	2,017
1997	80	2,323
1998	83	2,612
1999	90	2,788
2000	113	3,499
2001	145	4,176
2002	145	4,399
2003	142	4,455
2004	166	6,059
2005	185	6,547
2006	196	9,928



The development in the number of staff per quarter shows a substantial increase during the first quarter (+1,252 entities), stemming mostly from a newly authorised institution as client communication agent during this period. In the second and third quarter, the number of people employed with PFS continued to increase, though at a slower pace, growing from 7,799 units as at 31 March 2006 to 8,064 units as at 30 June 2006 and to 8,458 units as at 30 September 2006. This variation in the total number of people employed by PFS is linked to the increase in staff of several institutions operating in the investment funds sector and to newly authorised PFS during this period.

The last quarter is characterised by a more than proportional growth of the total number of people employed, which rose from 8,458 units as at 30 September 2006 to 9,928 as at 31 December 2006, representing an increment of 17.38%. This important increase is mainly linked to the authorisation, during this quarter, of a highly staffed client communication agent. The positive development of employment during this period is due, to a lesser extent, to a slight employment increase for several financial players operating as registrar and transfer agents and/or administrative agents of the financial sector or distributors of units/shares of investment funds.

1.3. Changes in 2006 in the official list of PFS

1.3.1. PFS under Luxembourg law authorised in 2006

- ***Investment firms***

According to chapter 2, section 2 of Part I of the law of 5 April 1993 on the financial sector as amended, the following are considered as investment firms: companies acting on a professional basis as commission agents (article 24A), private portfolio managers (article 24B), professionals acting for their own account (article 24C), distributors of units/shares of investment funds (article 24D), underwriters (article 24E), professional custodians of securities or other financial instruments (article 24F) or registrar and transfer agents (article 24G). An application for authorisation can cover one or more categories.

The following undertakings have been authorised as investment firms in 2006:

- Core Capital Management S.A. — Private portfolio manager[3]
- E. Öhman J: Or Luxembourg S.A. — Private portfolio manager
- HSH N Asset Management S.A. — Distributor of units/shares of investment funds
- HSH N Investment Management S.A. — Private portfolio manager
- Investors Trust S.à r.l. — Registrar and transfer agent
- Orbit Private Asset Management S.à r.l. — Private portfolio manager
- Rhein Asset Management (Lux) S.A. — Private portfolio manager

In 2006, seven entities have been approved as investment firms, including five entities acting as private portfolio manager, which reflects the constant interest for this traditional PFS category in the financial centre. One entity has adopted the status of registrar and transfer agent, while one company has applied for authorisation as distributor of units/shares of investment funds. In addition, one of the newly authorised private portfolio managers has also been granted the status of financial advisor and is therefore registered on the official list of PFS other than investment firms.

- ***PFS other than investment firms***

According to the provisions of articles 25 to 28-8 of the law of 5 April 1993 on the financial sector as amended, financial advisors (article 25), brokers (article 26), market makers (article 27), operators of payment or securities settlement systems (article 28-1), persons performing cash-exchange transactions (article 28-2), debt recovery (article 28-3), professionals performing credit offering (article 28-4), professionals performing securities lending (article 28-5), professionals performing money transfer services (article 28-6), administrators of collective savings funds (article 28-7) and management companies of non-coordinated UCIs (article 28-8) are considered as PFS other than investment firms.

[3] Please also refer to the list of PFS other than investment firms.

The following undertakings have been authorised as PFS other than investment firms in 2006:

• Core Capital Management S.A.	Financial advisor[4]
• FinAdvice-Finanzplanung S.A.	Financial advisor and broker
• Financière Centuria Luxembourg S.A.	Financial advisor and broker[5]
• Monsieur Tommy Schank	Financial advisor

The list highlights that the four professionals authorised in 2006 as PFS other than investment firms have requested the status of financial advisor, either as unique status or as additional activity to one or several other PFS statuses.

Two out of these four PFS have additionally adopted the status of broker. One entity has moreover been granted the authorisation to exercise the activity of domiciliation agent of companies. The institution concerned has therefore been registered on the list of PFS performing a connected or complementary activity of the financial sector. Likewise, the financial advisor which has in addition been granted authorisation as private portfolio manager is shown in the list of investment firms. It should also be highlighted that a newly authorised financial advisor in 2006 exercises this activity as a natural person.

The fact that three out of four newly authorised PFS in 2006 are cumulating different PFS statuses indicates that the players in the financial centre tend to diversify more and more their activities, a trend which has already been initiated during the previous year.

- ***PFS performing a connected or complementary activity of the financial sector***

According to the provisions of articles 29 to 29-4 of the law of 5 April 1993 on the financial sector as amended, domiciliation agents of companies (article 29), client communication agents (article 29-1), administrative agents of the financial sector (article 29-2), IT systems and communication networks operators of the financial sector (article 29-3) and professionals performing services of setting up and of management of companies (article 29-4) are PFS performing a connected or complementary activity of the financial sector.

The following institutions have been authorised as PFS performing a connected or complementary activity of the financial sector in 2006:

• Agir Luxembourg S.A.	Domiciliation agent of companies
• Associated Dexia Technology Services, in abbreviated form "ADTS"	IT systems and communication networks operator of the financial sector, administrative agent of the financial sector and client communication agent
• Atos Origin Luxembourg PSF S.A.	IT systems and communication networks operator of the financial sector
• Brink's Security Luxembourg S.A.	Client communication agent
• BULL PSF S.A.	IT systems and communication networks operator of the financial sector
• Callataÿ & Wouters Association d'Ingénieurs-Conseils	IT systems and communication networks operator of the financial sector and administrative agent of the financial sector
• Carne Global Financial Services Luxembourg S.à r.l.	Professional performing services of setting up and of management of companies

[4] Please also refer to the list of investment firms.

[5] Please also refer to the list of PFS performing a connected or complementary activity of the financial sector.

• Cetrel Securities S.A.	IT systems and communication networks operator of the financial sector and administrative agent of the financial sector
• Euroscript Luxembourg S.à r.l.	Administrative agent of the financial sector
• Financière Centuria Luxembourg S.A.	Domiciliation agent of companies[6]
• Fujitsu Services PSF S.à r.l.	IT systems and communication networks operator of the financial sector
• Getronics PSF Luxembourg S.A.	IT systems and communication networks operator of the financial sector
• G 4 S Security Services S.A.	Client communication agent
• I.R.I.S. Financial Services S.A., in abbreviated form "I.R.I.S. PSF S.A."	IT systems and communication networks operator of the financial sector
• Kneip Communication S.A.	Administrative agent of the financial sector
• Lux Trust S.A.	Administrative agent of the financial sector and client communication agent
• Netto-Recycling S.A.	Client communication agent
• SIMAC PSF S.A.	IT systems and communication networks operator of the financial sector
• Sylis PSF Luxembourg S.A.	IT systems and communication networks operator of the financial sector
• Vision IT Group PSF S.A.	IT systems and communication networks operator of the financial sector

The considerable interest shown in the connected or complementary activities of the financial sector has been confirmed in 2006, in particular as regards the activity of IT systems and communication networks operator of the financial sector, as many players in the financial sector used the services of these specialised entities.

Indeed, eleven institutions have requested an authorisation to perform this activity during the year under review, of which two entities have additionally opted for the status of administrative agent of the financial sector. One institution has been authorised as administrative agent of the financial sector and client communication agent. Five entities have been approved as client communication agent, three of them performing exclusively this activity. During 2006, six institutions have been granted authorisation to perform activities as administrative agent of the financial sector, of which four companies have cumulated this category with one or more different PFS statuses performing a connected or complementary activity of the financial sector.

The status of domiciliation agent of companies has been requested by two undertakings in 2006, a stable situation if compared to the previous year. One of these players has also been granted authorisation as financial advisor and broker and is therefore registered on the official list of PFS other than investment firms. It should be pointed out that only one institution has been authorised during 2006 to perform the activity of professional performing services of setting up and of management of companies.

[6] Please also refer to the list of PFS other than investment firms.

- ***Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter***

The PFS governed by the general provisions (section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended) fall under the scope of prudential supervision of the CSSF following the amendment of the law on the financial sector by the law of 2 August 2003.

Indeed, the activities performed by these entities, even if they do not correspond specifically to the activities of PFS categories defined under articles 24 to 29-4 of the law of 5 April 1993 as amended, are considered as falling within the financial sector and are therefore subject to the continuous supervision by the CSSF.

No institution has obtained an authorisation in this category in 2006.

1.3.2. PFS that gave up their status in 2006

Eighteen institutions, including ten investment firms, gave up their PFS status in 2006. Three entities merged with another institution of the same group, whereas five companies gave up their PFS status in order to become a management company under chapter 13 of the law of 20 December 2002 as amended on undertakings for collective investment. The other withdrawals are due to the winding up of the institution (three entities), the change into a bank (one entity) and the switch to activities which no longer require an authorisation as PFS as they no longer fall under the scope of the law of 5 April 1993 on the financial sector as amended (six entities).

• **Aberdeen Investment Services S.A.** Private portfolio manager Distributor of units/shares of investment funds	Liquidation
• **Cofinor S.A.** Domiciliation agent of companies	Cessation of PFS activities
• **Cyberservices S.à r.l.** Professional of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter	Cessation of PFS activities
• **Destrem Luxembourg S.A.** Broker	Cessation of PFS activities
• **First European Transfer Agent S.A.** Private portfolio manager Distributor of units/shares of investment funds Registrar and transfer agent Administrative agent of the financial sector Client communication agent	Change into a bank (RBC Dexia Investor Services Bank S.A.)
• **Infomail S.A.** Private portfolio manager	Cessation of PFS activities
• **ING Private Capital Management S.A.** Gérant de fortunes	Change into management company
• **IRIS Securities Luxembourg S.A.** Private portfolio manager	Liquidation
• **John Deere Finance S.A.** Professional performing credit offering	Merger with John Deere Bank S.A.

• **Kredietrust Luxembourg S.A.** Private portfolio manager Distributor of units/shares of investment funds	Change into management company
• **L.G.I., Louvre Gestion International S.A.** Professional acting for its own account Distributor of units/shares of investment funds	Change into management company
• **Liberty Ermitage Luxembourg S.A.** Commission agent Distributor of units/shares of investment funds	Cessation of PFS activities
• **Puilaetco Dewaay Luxembourg S.A.** Private portfolio manager	Merger with Banque Puilaetco Dewaay Luxembourg S.A.
• **RCS Corporate Services Luxembourg S.A.** Domiciliation agent of companies	Merger with ATC-RCS Corporate Services
• **Société Luxembourgeoise de Recouvrement S.A., in abbreviated form "SLR"** Debt recovery	Liquidation
• **Sparinvest S.A.** Commission agent Distributor of units/shares of investment funds	Change into management company
• **Trimar Management S.A.** Domiciliation agent of companies	Cessation of PFS activities
• **VPB Finance S.A.** Private portfolio manager	Change into management company

1.3.3. Changes in category in 2006

The changes in categories of the other professionals of the financial sector in 2006 confirm the trend for diversification of activities and thus the extension of the services provided by players already active in the financial centre. The total number of status changes requested in 2006 slightly increased as compared to the previous year and mainly concerned the adoption of an additional PFS status.

Name of the PFS	Category(ies) before the change	Category(ies) after the change
• Bellatrix Investments S.A.	Financial advisor	Financial advisor Professional performing services of setting up and of management of companies
• Carl Kliem S.A.	Commission agent	Professional acting for its own account
• E. Öhman J: Or Luxembourg S.A.	Private portfolio manager	Private portfolio manager Ancillary services referred to in section C of Annexe II of the law of 5 April 1993 on the financial sector as amended
• Experta Corporate and Trust Services S.A., in abbreviated form "Experta S.A."	Private portfolio manager Domiciliation agent of companies	Private portfolio manager Domiciliation agent of companies Administrative agent of the financial sector

• Farad Investment Advisor S.A.	Distributor of units/shares of investment funds Broker Financial advisor	Distributor of units/shares of investment funds Broker Financial advisor Private portfolio manager Commission agent
• IAM Strategic S.A.	Private portfolio manager	Private portfolio manager Domiciliation agent of companies
• Investor Luxembourg S.A.	Financial advisor	Financial advisor Broker
• Notz, Stucki Europe S.A.	Private portfolio manager	Private portfolio manager Distributor of units/shares of investment funds
• Petercam (Luxembourg) S.A.	Professional acting for its own account Distributor of units/shares of investment funds Professional performing cash-exchange transactions	Professional acting for its own account Distributor of units/shares of investment funds Professional performing cash-exchange transactions Registrar and transfer agent Administrative agent of the financial sector
• Siemens Financial Business Services S.A.	IT systems and communication networks operator of the financial sector	IT systems and communication networks operator of the financial sector Administrative agent of the financial sector
• SZL S.A.	Professional acting for its own account	Private portfolio manager
• Tata Consultancy Services Luxembourg S.A.	IT systems and communication networks operator of the financial sector	IT systems and communication networks operator of the financial sector Administrative agent of the financial sector
• WH Selfinvest S.A.	Commission agent	Commission agent Private portfolio manager

This table reveals that the interest already shown in 2005 by PFS for the activity of administrative agent of the financial sector is confirmed for 2006, four institutions having opted for this category as additional activity. Two status extensions concern the activity of private portfolio manager whereas one PFS has requested an authorisation in order to offer as well ancillary services as referred to under section C of Annexe II of the law of 5 April 1993 on the financial sector as amended.

The majority of undertakings that requested a change of status during 2006 are investment firms (nine entities), including seven that have adopted one or several additional statuses, while two entities have requested a change of PFS category.

1.4. Development in the balance sheet totals and results

Categories	Balance sheet total in EUR		
	2004	2005	2006[7]
Investment firms			
Commission agents	228,721,820	234,579,186	265,452,584
Private portfolio managers	450,342,614	370,503,534	315,175,287
Professionals acting for their own account	390,557,957	281,398,716	357,715,564
Distributors of units/shares of investment funds	952,754,027	695,664,559	698,057,725
Underwriters	152,646,460	21,421,713	40,459,378
Professional custodians of securities or other financial instruments	916,534,933	951,217,247	987,074,961
Registrar and transfer agents	110,412,089	95,769,376	111,991,560
PFS other than investment firms			
Financial advisors	8,979,377	26,972,005	24,736,021
Brokers	44,019,211	54,933,045	61,010,849
Market makers	21,122,130	8,017,222	7,971,116
Professionals performing cash-exchange transactions	1,903,163	/	/
Debt recovery	754,826	522,661	458,665
Professionals performing credit offering	1,892,660,216	1,718,118,817	1,658,435,773
Professionals performing securities lending	39,449,146,884	47,830,962,734	63,795,736,399
Administrators of collective savings funds	143,153	161,740	222,275
PFS performing a connected or complementary activity of the financial sector			
Domiciliation agents of companies	55,966,969	264,200,531	310,136,544
Client communication agents	55,064,446	57,244,874	115,359,547
Administrative agents of the financial sector	206,256 933	380,197,225	474,833,493
IT systems and communication networks operators of the financial sector	248,310,954	279,867,462	324,777,627
Professionals performing services of setting up and of management of companies	2,252,807	4,521,072	6,213,716
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter	110,073,668	119,180,579	138,223,025
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services	1,230,334,511	1,424,821,083	1,673,111,586
Total	**45,130,954,839**	**53,420,833,266**	**69,854,412,429**

[7] Preliminary figures.

Categories	Net results in EUR		
	2004	2005	2006[8]
Investment firms			
Commission agents	16,071,631	21,836,089	21,832,336
Private portfolio managers	63,749,770	48,479,188	45,507,206
Professionals acting for their own account	17,628,734	36,848,139	64,357,370
Distributors of units/shares of investment funds	134,295,503	134,181,307	145,918,769
Underwriters	1,886,846	1,350,825	1,506,131
Professional custodians of securities or other financial instruments	102,565,558	192,558,250	185,772,258
Registrar and transfer agents	9,801,438	8,388,170	3,390,189
PFS other than investment firms			
Financial advisors	1,466,072	4,686,911	6,105,958
Brokers	20,620,214	24,176,021	26,845,371
Market makers	211,142	82,242	134,748
Professionals performing cash-exchange transactions	197,219	/	/
Debt recovery	-12,631	25,674	117,951
Professionals performing credit offering	38,326,556	39,487,871	36,746,012
Professionals performing securities lending	1,248,775	241,904	267,504
Administrators of collective savings funds	0	0	0
PFS performing a connected or complementary activity of the financial sector			
Domiciliation agents of companies	7,927,475	28,719,522	38,797,161
Client communication agents	1,607,668	4,732,862	13,409,329
Administrative agents of the financial sector	5,417,473	21,649,730	30,141,207
IT systems and communication networks operators of the financial sector	10,975,582	21,843,205	22,641,436
Professionals performing services of setting up and of management of companies	54,630	-54,962	625,309
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, with the exception of the categories of PFS also referred to in section 2 of the same chapter	541,904	795,128	2,488,555
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services	-3,478,195	-3,088,217	1,251,846
Total	**317,371,968**	**433,342,895**	**483,895,690**

[8] Preliminary figures.

- ***Comment as regards the tables***

Since the same company can operate in several business sectors, the total does not reflect the arithmetical sum of headings under the different PFS categories. For professionals of the financial sector authorised to conduct business under articles 24A to 24D, 24G, 25, 26, 29-1 and 29-2 of the law of 5 April 1993 as amended, the balance sheet total and the results respectively are recorded only once in the total, i.e. in the category for which the capital requirements are the most stringent. If the professional conducts additional business outside of the above-mentioned categories, governed by section 2 of chapter 2 of the aforementioned law, the balance sheet total and net result respectively are aggregated for each category but are not included in the grand total to avoid double counting. It should also be borne in mind that the professionals cumulating the status of domiciliation agent of companies and professional performing services of setting up and of management of companies are only shown under the category "Domiciliation agents of companies", the latter being *ipso jure* authorised to perform services of setting up and of management of companies, in accordance with article 29-4(3) of the law of 5 April 1993 on the financial sector, as amended.

The balance sheet total of the PFS established in Luxembourg (196 entities as at 31 December 2006) reached EUR 69,854 million as at 31 December 2006 as against EUR 53,421 million at the end of 2005, which represents a 30.76% increase. This significant increase stems mainly from a substantial growth in the business volume of the institution authorised as professional performing securities lending. The positive development in the number of PFS in 2006, rising from 185 as at 31 December 2005 to 196 entities as at 31 December 2006, is another factor that explains the growth in the balance sheet total over a period of twelve months.

The increment in the balance sheet total in 2006 goes hand in hand with a rise, even though weaker, in net results of the PFS, which amounted to EUR 484 million as at 31 December 2006 against EUR 433 million as at 31 December 2005, representing an 11.67% increase year-on-year. This positive trend, which has developed in a context of rising stock markets, results on the one hand from a better profitability of some players operating as professionals acting for their own account and/or distributors of units/shares of investment funds and, on the other hand, from newly authorised PFS in 2006, including some client communication agents and administrative agents of the financial sector that have contributed to the increase of the total result over one year.

Concerning the breakdown of the net result as at 31 December 2006 by PFS category, the professional custodians of securities or other financial instruments (3 entities) rank first, recording alone a net result of EUR 185.77 million. They are followed by the distributors of units/shares of investment funds (33 entities) whose global result amounted to EUR 145.92 million and by the professionals acting for their own account (13 entities) with a net result of EUR 64.36 million.

The table plotting the development of the balance sheet total and net results in 2006 reveals a growth in the balance sheet total for a majority of PFS categories, including in most cases a better profitability as compared to last year.

- ***Commission agents***

Despite a decrease in number as compared to end 2005 (10 entities as at 31 December 2006 against 14 entities as at 31 December 2005), the commission agents recorded a clear increase of their balance sheet total over a twelve-month period. This variation can be explained by the growth in the balance sheet total of some important players in this category, compensating by far the negative development linked to a lower number of commission agents. The net result of commission agents remains stable as compared to the previous year.

- ***Private portfolio managers***

Private portfolio managers, whose number rose from 46 entities as at 31 December 2005 to 47 entities as at 31 December 2006, recorded a considerable decrease in their balance sheet total as compared to the end of last year. This decrease, mainly linked to the change into a bank of the PFS First European Transfer Agent S.A. and to the change into a management company of Kredietrust Luxembourg S.A., formerly active as private portfolio manager and distributor of units/shares of investment funds, could only be partially compensated by the positive variation of the balance sheet total of several other institutions of this category.

The private portfolio managers experienced a fall, even though less important, in their net results over a twelve-month period. This decrease is mainly linked to the abandoned statuses as indicated above. The positive financial developments of several private portfolio managers during 2006 were not sufficient to compensate this negative effect at the level of the net result.

- ***Professionals acting for their own account***

The table shows that both the balance sheet total and net result of the professionals acting for their own account increased significantly during 2006. This positive development in balance sheet totals is mainly due to several important players in this PFS category. As regards the increase of the net result as compared to 31 December 2005, the majority of institutions have managed to benefit from the positive trend of financial markets and show a higher profitability for 2006.

- ***Registrar and transfer agents***

Registrar and transfer agents, whose number increased by one unit as compared to last year (12 entities as at 31 December 2006 against 11 entities as at 31 December 2005), show a net increase in their balance sheet total. This development is mainly due to several institutions with higher balance sheet totals. Compared to the figures of 31 December 2005, the net results have nevertheless decreased, as several important players of this category show less positive results.

- ***Professionals performing credit offering***

The consequence of one professional giving up its status as professional performing credit offering, i.e. John Deere Finance S.A. (merger with John Deere Bank S.A.), was a decrease in the balance sheet total from 2005 to 2006. The positive development in 2006 of the figures of the remaining players in this category partially offset this effect. As regards the net result, the professionals performing credit offering only suffered a slight decrease as compared to the net result of last year.

- ***Domiciliation agents of companies***
  Professionals performing services of setting up and of management of companies

Following the adaptation of the official list of PFS as at 31 March 2006, which highlights the institutions cumulating several statuses, mainly the status of domiciliation agent and/or the status of professional performing services of setting up and of management of companies, the number of entities listed under those two categories has considerably increased (cf. point 1.1.: Notes concerning the registration of PFS on the official list). This change also impacts the total balance sheet and the net result of these PFS as at 31 December 2006.

In order to allow a better comparison between the yearly figures for these two categories, the final financial data of December 2005 already consider the adjustments made on the official list. The list reveals a significant growth of both the balance sheet total and the net results as compared to 31 December 2005 for domiciliation agents of companies as well as for professionals performing services of setting up and of management of companies.

- ***Client communication agents***
  Administrative agents of the financial sector
  IT systems and communication networks operators of the financial sector

  These three PFS categories have experienced a substantial increase in the balance sheet total and net results in 2006. This growth is mainly due to the important development in the number of entities authorised as client communication agent (+2 entities), administrative agent of the financial sector (+9 entities) and IT systems and communication networks operators of the financial sector (+11 entities).

1.5. Expansion of PFS at international level

1.5.1. Formation of subsidiaries during 2006

The investment firm European Fund Administration S.A., authorised to act as distributor of units/shares of investment funds, registrar and transfer agent, client communication agent, administrative agent of the financial sector and IT systems and communication networks operator of the financial sector, opened a subsidiary in France in 2006.

1.5.2. Freedom of establishment

In 2006, two investment firms incorporated under Luxembourg law set up branches in one or several EU/EEA countries under the principle of freedom of establishment, namely Vontobel Europe S.A., which set up a branch in Italy, and European Fund Services S.A., which set up in Germany and in Ireland by means of a branch.

The company AIG Global Investment (Luxembourg) S.A. (formerly Financial Advisor Services (Europe) S.A.), acting as distributor of units/shares of investment funds, closed its branches in Germany and Italy in 2006 and is no longer registered on the list of investment firms incorporated under Luxembourg law having a branch in one or several EU/EEA countries.

As at 31 December 2006, the following Luxembourg investment firms are represented by way of a branch in one or several other EU/EEA countries.

- **BNP Paribas Fund Services** — Spain
  Private portfolio manager
  Distributor of units/shares of investment funds
  Administrative agent of the financial sector
- **Clearstream International S.A.** — United Kingdom
  Professional custodian of securities or other financial instruments
- **Compagnie Financière et Boursière Luxembourgeoise S.A., in abbreviated form "Cofibol"** — Belgium
  Professional acting for its own account
  Registrar and transfer agent
- **Createrra S.A.** — Belgium
  Professional acting for its own account
  Domiciliation agent of companies
- **Creutz & Partners, Global Asset Management S.A.** — Germany
  Private portfolio manager
- **Foyer, Patrimonium & Associés S.A.** — Belgium
  Private portfolio manager
  Distributor of units/shares of investment funds

• **European Fund Services S.A.** Commission agent Distributor of units/shares of investment funds Registrar and transfer agent Domiciliation agent of companies Client communication agent Administrative agent of the financial sector IT systems and communication networks operator of the financial sector	Germany Irland
• **IAM Strategic S.A.** Private portfolio manager Domiciliation agent of companies	Sweden
• **Moventum S.A.** Private portfolio manager Distributor of units/shares of investment funds Registrar and transfer agent	Germany
• **Notz, Stucki Europe S.A.** Private portfolio manager Distributor of units/shares of investment funds	Italy
• **SZL S.A.** Private portfolio manager	Belgium
• **Vontobel Europe S.A.** Private portfolio manager Distributor of units/shares of investment funds	Germany Austria Italy
• **WH Selfinvest S.A.** Commission agent Private portfolio manager	Belgium

The number of branches set up in Luxembourg by investment firms originating from another EU/EEA Member State totals six entities as at 31 December 2006 (+2 entities as compared to 2005).

Indeed, two branches have started their activities in Luxembourg in 2006, i.e. Aberdeen Asset Managers Limited, from the United Kingdom, and Mellon Fund Administration Limited, from Ireland.

• Aberdeen Asset Managers Limited	United Kingdom
• Gadd Capital Management Ltd	Gibraltar
• Mellon Fund Administration Limited	Ireland
• Morgan Stanley Investment Management Limited	United Kingdom
• PFPC International Limited	Ireland
• T. Rowe Price Global Investment Services Limited, in abbreviated form “TRPGIS”	United Kingdom

1.5.3. Freedom to provide services

In 2006, eight investment firms incorporated under Luxembourg law applied to pursue business in one or several EU/EEA Member States under the freedom to provide services. The total number of investment firms operating in one or several EU/EEA Member States, following a notification, amounted to 35 as at 31 December 2006. The majority of the investment firms freely provide services in several other EU/EEA countries.

After two years of a clear upward trend in the number of notifications to freely provide services in Luxembourg introduced by investment firms from other EU/EEA countries, 2006 is characterised by a certain stabilisation. Indeed, the number of foreign entities having applied for free provision of services in Luxembourg is 127 units in 2006, as compared to 128 units in 2005. These continuous requests illustrate the interest that the Luxembourg financial centre arouses in a context of internationalisation of the financial sector activities.

The geographical breakdown of foreign investment firms having introduced a notification in 2006 reveals that British investment firms remain by far the most important in number to apply for free provision of services in Luxembourg, followed by Dutch and German investment firms.

Country of origin	Number of entities having applied for free provision of services in 2005	Number of entities having applied for free provision of services in 2006
Austria	5	2
Cyprus	8	/
Denmark	2	2
France	4	2
Germany	12	5
[Gibraltar]	1	1
Greece	/	1
Ireland	3	1
Liechtenstein	/	1
Malta	1	/
Netherlands	12	11
Norway	1	3
Sweden	2	/
United Kingdom	77	98
Total	**128**	**127**

The table reveals a strong increase in the notification requests from the United Kingdom, growing from 77 units in 2005 to 98 units in 2006. This significant growth has allowed to compensate the decrease in the number of requests received from several other European countries, as for example Cyprus (-8 units) and Germany (-7 units). The number of notifications received by the CSSF from Austrian, French or Irish investment firms decreased to a lesser extent.

As at 31 December 2006, a total of 1,175 EU/EEA investment firms were authorised to freely provide their services on Luxembourg territory.

2. PRUDENTIAL SUPERVISORY PRACTICE

2.1. Instruments of prudential supervision

Prudential supervision is exercised by the CSSF by means of four types of instruments:

- the financial information submitted periodically to the CSSF enabling it to continuously monitor the activities of PFS and the inherent risks, as well as the periodic control of capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended;
- the annual report drawn up by the external auditor (including a certificate relating to the fight against money laundering and a certificate concerning compliance with circular CSSF 2000/15);
- the internal audit reports relating to audits carried out during the year and the management's report on the state of the internal audit of the PFS;
- on-site inspections carried out by the CSSF.

2.2. On-site inspections

The CSSF attaches particular importance to this instrument of continuous supervision, as it allows a global and direct view of the situation and functioning of the PFS in practice.

In 2006, the CSSF carried out on-site inspections at the premises of five professionals of the financial sector.

The purpose of one on-site inspection was to ensure the effective implementation of adequate administrative structures, in compliance with the existing regulation, as required by the CSSF during a previous inspection at the premises of this institution. The CSSF observed that adequate corrective measures had been taken, allowing a proper operation of the entity, in particular as regards the administrative and accounting organisation.

The second on-site inspection carried out by the CSSF concerned the administrative and accounting organisation, and was more specifically linked to the supervision of compliance with the rules relating to the fight against money laundering.

The remaining inspections carried out by the CSSF concerned breaches with respect to the principle of daily management by one of the financial players, whereas the aim of the inspection at another entity was the analysis of the realised results, focusing in particular on certain elements which had been observed in previous financial year closings. Following the on-site inspection, the CSSF could establish that the entity operates properly. It should also be mentioned that one entity received a courtesy visit by the CSSF, in order to get a global and direct view of the functioning of this PFS in practice.

2.3. Meetings

A total of 157 meetings concerning the activities of professionals of the financial sector were held at the CSSF's premises during the year under review.

Most of these meetings were held within the scope of applications for approval as PFS, submitted either by companies newly incorporated or to be incorporated, or by existing entities that intend to carry out financial activities that require prior approval. This figure also includes the meetings that were held with entities that enquired whether the activities performed fall under the scope of the law of 5 April 1993 on the financial sector as amended.

The remainder of the meetings held with representatives of PFS covered the following areas in particular:

- planned changes notably relating to business activities, shareholders and daily management of PFS;
- presentation of the general context and activities of the companies concerned;
- requests for information within the scope of the prudential supervision carried out by the CSSF;
- courtesy visits.

2.4. Specific controls

Article 54(2) of the law of 5 April 1993 on the financial sector as amended entitles the CSSF to require external auditors to carry out a specific audit of a financial professional, covering one or several specific aspects of the business or operation of the entity concerned. The ensuing costs are to be borne by the professional concerned. The CSSF has not made formally use of this right in 2006.

2.5. Supervision on a consolidated basis

The supervision of investment firms on a consolidated basis is governed by the law of 5 April 1993 on the financial sector as amended and more particularly by chapter 3a of Part III. The relevant articles define the conditions governing the supervision of investment firms on a consolidated basis and its scope. The form, extent, content and means of supervision on a consolidated basis are also laid down therein.

As at 31 December 2006, the CSSF had carried out supervision on a consolidated basis of fifteen investment firms falling under the above-mentioned law. An in-depth study of the financial groups to which most of the investment firms belong was required in order to determine whether, at what level and in what form, consolidation should apply. For the investment firms concerned, circular CSSF 00/22 on the supervision of investment firms on a consolidated basis specifies the practical aspects of the rules as regards this type of supervision. Many companies supervised on a consolidated basis belong to major groups operating in the financial sector and whose ultimate parent company is usually a credit institution.

The following PFS were subject to supervision by the CSSF on a consolidated basis as at 31 December 2006:

- Alternative Leaders S.A.
- BNP Paribas Fund Services
- Brianfid-Lux S.A.
- Capital @ Work International S.A.
- Citco (Luxembourg) S.A.
- Clearstream International S.A.
- Compagnie Financière et Boursière Luxembourgeoise S.A., in abbreviated form “Cofibol”
- Crédit Agricole Luxembourg Conseil S.A., in abbreviated form “CAL Conseil”
- Fortis Intertrust (Luxembourg) S.A.
- Foyer Asset Management S.A.
- Hottinger & Cie
- IAM Strategic S.A.
- Petercam (Luxembourg) S.A.
- Premium Select Lux S.A.
- UBS Fund Services (Luxembourg) S.A.

CHAPTER 7

7 SUPERVISION OF SECURITIES MARKETS

1. Reporting of transactions on financial assets

2. Supervisory practice

3. Developments in the regulatory framework

1. REPORTING OF TRANSACTIONS ON FINANCIAL ASSETS

1.1. Reporting requirements

The year 2006 was not only marked by the modification of the market abuse legislation which, *inter alia*, extended the transaction reporting requirement to financial assets admitted to trading on a multilateral trading facility (MTF), but also by the preparation of the transposition of Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (MiFID). On 26 October 2006, the Minister of Treasury and Budget introduced Bill No 5627 in the Parliament, relating, among other things, to the transposition of MiFID into Luxembourg law.

In accordance with MiFID, the new provisions, including those that will govern the reporting of transactions on financial assets, should take effect from 1 November 2007. Given the technical adaptations due to the changes regarding transaction reporting and in accordance with circular CSSF 06/265 of 9 November 2006, the professionals of the financial sector subject to the reporting requirement are invited to refer to Bill No 5627 on the website of the Parliament (www.chd.lu) to learn about the new requirements that have been completed in the field of transaction reporting by Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive.

With respect to the reporting requirement that currently applies to credit institutions and investment firms, the CSSF supervises compliance with the requirements laid down in circular CSSF 99/7 on reporting to the CSSF, in accordance with the law of 23 December 1998 on the supervision of securities markets as amended.

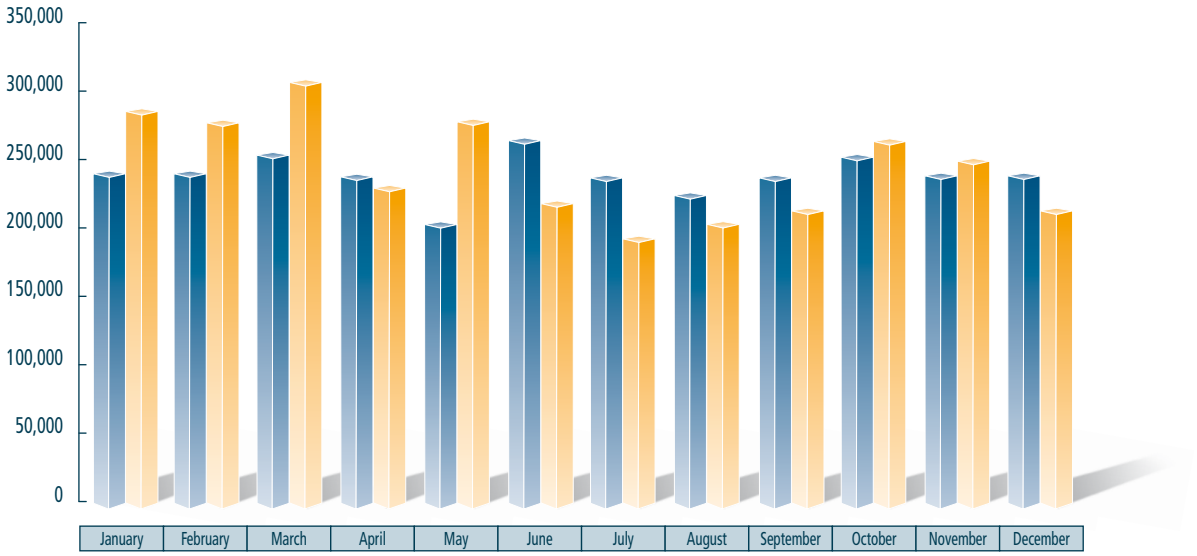
In this context and within the scope of its daily supervisory mission, the CSSF addressed a total of 39 letters covering the following subjects to investment firms in 2006:

Subject	Number
Mailing of the *Recueil* to new firms	11
Authorisations (reporting *via* fax, exemptions, deferrals)	9
TAF reporting irregularities	5
Request for explanations regarding transactions	4
Reminders	6
Others	4
Total	**39**

1.2. Development in the number of trades reported

The number of trades reported in 2006 amounted to 2,889,221, which is almost the same as in 2005 (2,830,548 trades reported).

Monthly volume of trades reported



	January	February	March	April	May	June	July	August	September	October	November	December
2005	237,519	238,528	250,181	235,887	200,544	259,696	233,509	220,783	233,151	248,577	236,171	236,002
2006	283,178	272,482	302,355	226,738	275,124	214,479	189,348	200,388	210,239	259,428	245,608	209,854

Breakdown of transactions by type of instrument

Type of instrument	**Number of trades reported** *(as a % of the total)*	
	2005	2006
Shares	66.08%	70.91%
Bonds	29.48%	23.29%
Futures	0.92%	0.97%
Options	1.81%	1.96%
Warrants	1.51%	2.63%
Bonds with warrants attached	0.20%	0.24%

The reported data allow to monitor the trends of the European markets and more particularly the Luxembourg market. The main purpose of the supervision of the securities markets is to prevent and detect infringements of financial and stock market laws and regulations. In this context, monthly internal reports, as well as specific internal reports, based on the trades reported, are drawn up. These *ex post* analyses of transactions on financial assets can be used as a starting point for inquiries of the CSSF.

2. SUPERVISORY PRACTICE

2.1. Supervision of stock exchanges

The establishment of a stock exchange in Luxembourg is subject to a concession to be granted by Grand-ducal decree. The only company currently licensed under Luxembourg law is the Société de la Bourse de Luxembourg S.A. (Luxembourg Stock Exchange). In accordance with article 2 of the amended law of 23 December 1998 creating a commission for the supervision of the financial sector, the CSSF is the competent authority for the prudential supervision of persons that are active as stock exchange, in particular the Société de la Bourse de Luxembourg S.A., and for the supervision of securities markets, i.e. the two markets currently operated by the Société de la Bourse de Luxembourg S.A..

In addition to its first market named "Luxembourg Stock Exchange" which is a "regulated market" within the meaning of the European Directives and which is included in the list of regulated markets published by the European Commission, the Société de la Bourse de Luxembourg S.A. is operating a second market called "Euro MTF" since 18 July 2005. The operating rules of this market are defined in the Rules and Regulations of the Luxembourg Stock Exchange. This second market, which is not included in the list of regulated markets of the European Commission, is an alternative for issuers that wish to benefit from a certain regulatory framework, but do not require a European passport for prospectuses. In order to ensure an adequate level of investor protection and to preserve the integrity of all Luxembourg markets, the prohibition of insider dealing and market manipulation under market abuse law applies to regulated markets within the meaning of the European Directives, as well as to markets of the type "MTF" that the law defines as "multilateral trading facility" under MiFID.

On 6 April 2006, the Luxembourg Stock Exchange and the pan-European bourse Euronext announced the signature of a Memorandum of Understanding to take the co-operation between their markets several steps further. The agreement covers the exchange of admission to trading and trading technology as well as joint efforts to develop the corporate bond market. This partnership is expected to take shape during 2007 and any change to the rules governing the Luxembourg Stock Exchange or one of the markets operated by the latter shall be subject to approval in accordance with the regulations in force.

In the context of its markets supervision, the CSSF is kept informed of market activities and related issues on a daily basis by means of an activity report provided by the Société de la Bourse de Luxembourg S.A..

As far as market activities are concerned, the turnover on markets operated by the Société de la Bourse de Luxembourg S.A. amounted to EUR 1,500.47 million in 2006, which represents a decrease of about 32.63% against 2005 (EUR 2,227.25 million). Total turnover of variable income securities represented 13.9% of trading (12.2% in 2005) against 86.1% (87.8% in 2005) for bonds. Turnover in Luxembourg shares amounted to EUR 182.38 million in 2006 against EUR 192.35 million in 2005.

At the end of 2006, the Luxembourg Stock Exchange counted 66 members (against 65 in 2005), including nine cross-members.

The year 2006 was again characterised by intense activity as regards new admissions to markets operated by the Société de la Bourse de Luxembourg S.A. with 10,544 new admissions (9,092 in 2005). As at 31 December 2006, both markets operated by the Société de la Bourse de Luxembourg S.A. totalled 39,860 listings (against 36,054 in 2005), i.e. 28,625 bonds, 292 shares, 4,056 warrants and rights

and 6,887 undertakings for collective investment and sub-funds of Luxembourg and foreign UCIs. The regulated market accounted for 37,593 of the 39,860 listings, and the Euro MTF for 2,267.

2.2. Investigations conducted by the CSSF at national and international level

The regulatory framework governing the prevention, detection and sanction of market abuse was completely reshuffled in 2006 with the entry into force of the law of 9 May 2006 relating to market abuse (market abuse law), transposing into Luxembourg law Directive 2003/6/EC of 28 January 2003 on insider dealing and market abuse (Market Abuse Directive). This law is discussed in detail in point 3 of this chapter.

The CSSF is the administrative authority competent to ensure that the provisions of the market abuse law are applied.

In the context of its supervision of securities markets, the CSSF either initiates inquiries itself or conducts them in response to a request for assistance from a foreign administrative authority within the framework of international co-operation. The decisions to open an investigation or to address a request to a professional of the financial sector are first based on analytical reports of daily trading activity at the Luxembourg Stock Exchange, as well as on the analysis of trades reported to the CSSF. After its assessment of all the available information, the CSSF decides on the appropriateness of an intervention.

2.2.1. Inquiries initiated by the CSSF

In 2006, the CSSF opened two inquiries into insider dealing and/or price manipulation. The examinations made by the CSSF in these inquiries continue in 2007.

The information obtained in relation to inquiries already opened in 2005 allowed the CSSF to close these inquiries without taking any further action.

2.2.2. Inquiries conducted by the CSSF at the request of a foreign authority

- ***Inquiries into insider dealing***

In 2006, the CSSF processed 34 requests concerning inquiries into insider dealing (against 54 in 2005). The CSSF handled all these requests with the necessary diligence befitting co-operation between authorities and no major issues relating to the requests of information submitted to the involved financial institutions have arisen.

- ***Inquiries into price manipulation, fraudulent public offers, breaches of the requirement to report major shareholdings and other breaches of the law***

The CSSF received four inquiries into breaches of the requirement to report major shareholdings, three inquiries into price manipulation, two inquiries relating to Luxembourg-incorporated companies and one inquiry relating to information contained in a prospectus. The CSSF responded to all these requests within the scope of its legal competence.

2.2.3. Notifications of suspect transactions under the law relating to market abuse

In accordance with article 12 of the market abuse law, all credit institutions or other professionals of the financial sector established in Luxembourg must notify the CSSF if there are reasons to suspect that a transaction might constitute insider dealing or market manipulation.

Regarding this new provision, the CSSF received seven suspicious transaction reports in 2006. Where underlying financial instruments are admitted to one or several foreign markets, the reported information was forwarded to the relevant authorities of the market(s) concerned, thereby observing the obligation to co-operate referred to in the market abuse law. This information can, if appropriate, lead these authorities to open inquiries.

The CSSF received one report from a foreign authority on a financial instrument admitted to the Luxembourg regulated market.

2.3. Approval of prospectuses relating to offers to the public or admission to trading on a regulated market

2.3.1. Application of the Prospectus Directive (Directive 2003/71/EC)

- ***Organisation of the teams in charge of the approval of prospectuses for securities***

Since 1 January 2006, the CSSF is the sole intervening party in the approval of prospectuses relating to offers to the public and admissions to a regulated market of securities, as the Luxembourg Stock Exchange ceased to perform the preliminary review of the documents filed for approval on 31 December 2005. The staff responsible for the review within the Luxembourg Stock Exchange until that date was entirely transferred to the CSSF as from 1 January 2006.

The integration of the employees concerned into the department "Supervision of securities markets" went smoothly and the approval process increased in efficiency and transparency for issuers.

The team responsible for prospectus approval is henceforth composed of two groups of file managers that handle applications for approval, each group being assisted by an administrative support and a coordination function.

The file managers of both groups review the applications for approval. In order to make the approval process as smooth as possible, the files are in general distributed according to category. The *Déposants* of files (listing agents, lawyers, etc.) liaise directly with the file managers throughout the file review process, i.e. from the drawing-up of the comments to the issue of the approval letter.

Administrative support receives, manages and files the documents and notifications to or from foreign authorities, issues invoices and is in charge of statistics and other tasks relating to the approval of prospectuses.

- ***Approval and publication procedure***

The second part of circular CSSF 05/226 of 16 December 2005 explains in detail the technical procedures regarding filing of documents for the approval relating to offers of securities to the public and admissions of securities to trading on a regulated market.

It seems appropriate in this context to evoke the time limits laid down with respect to the review of an application for CSSF approval. Following the filing, the *Déposant* receives an acknowledgement of receipt from the CSSF as soon as possible, mentioning the file number and the beginning of the review process. Supposing an average flow of new applications for approval, the file managers send preliminary comments to the *Déposant* on the working day following that on which the application for approval was filed. In accordance with the provisions of circular CSSF 05/226, the final comments are, in principle, issued within five working days following the reception date of a complete file. These CSSF-specific time limits meet the expectations of the market players, who are responsive to the reactivity, efficiency and especially to the quality of the file handling.

Where a file reviewed by the CSSF has not been approved for some reason within two months following its filing, and where the CSSF has not received any feedback thereon, an e-mail and a reminder is sent to the *Déposant*. A time limit of fifteen working days is granted to provide the CSSF with a new draft of the prospectus including the previous comments or explanations justifying an extension of the time limit. If the CSSF does not receive any feedback within fifteen days, the file is closed and a letter confirming the file closing is sent to the *Déposant*.

Without prejudice to the publication requirement imposed on the issuer, offeror or the person seeking admission to trading on a regulated market, the CSSF publishes the full prospectuses, including the documents incorporated by reference, it approves on the website of the Luxembourg Stock Exchange (www.bourse.lu) for twelve months.

- ***European passport and CSSF practices***

The Prospectus Directive allows an issuer to use a prospectus approved by the CSSF to make an offer to the public or to seek admission to trading on a regulated market in another EU Member State without having to obtain a new approval of the authority of the host Member State. Conversely, a prospectus approved and notified by a competent authority of another Member State is valid in Luxembourg from the moment the CSSF receives the notification from the relevant home Member State authority.

In the event of a written notification request, the CSSF issues a certificate of approval according to a schedule defined by the Committee of European Securities Regulators (CESR). The CSSF sends the certificate of approval, the approved prospectus, the translation and, if any, the documents incorporated by reference, to the authority of the host Member State. A confirmation e-mail is then sent to the person that requested the notification to inform that the CSSF has indeed processed the request concerned. The notification time limit is one working day for a prospectus that has been the object of a notification request prior to its approval. The notification time limit is three working days for a notification request that follows the prospectus approval.

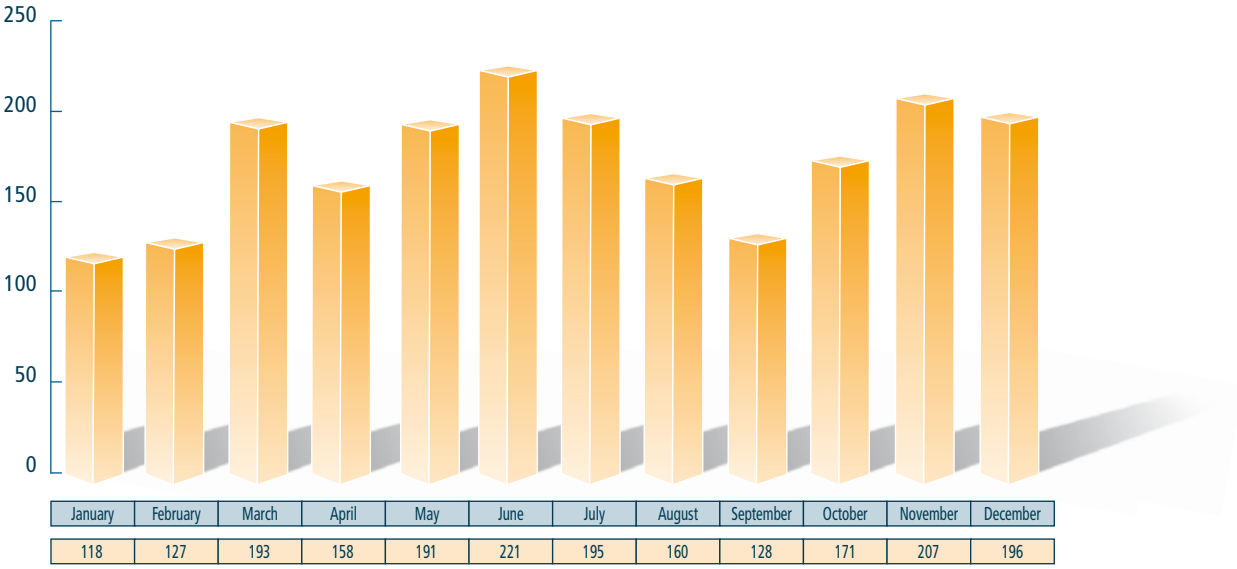
As regards the notifications received from the other regulators of EU Member States, the CSSF is one of the authorities that only require the documents imposed by CESR standards. In the context of notifications for the admission to trading on the regulated market in Luxembourg, it should be borne in mind that the competence regarding the decisions on the admission of securities to trading on a market and/or official listing are not affected by the law on prospectuses for securities. Indeed, these decisions fall under the competence of the market operator concerned to whom the applications for admission to trading on the market concerned must be sent and who may request additional information in this context.

2.3.2. Approvals and notifications in 2006

- ***Documents approved by the CSSF in 2006***

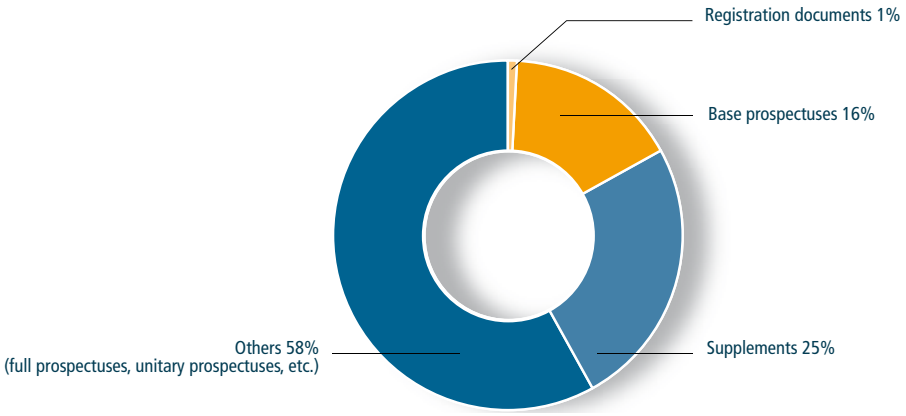
In 2006, 2,065 documents were approved by the CSSF, i.e. 1,202 prospectuses, 333 base prospectuses, 12 registration documents and 518 supplements.

Number of files approved in 2006



January	February	March	April	May	June	July	August	September	October	November	December
118	127	193	158	191	221	195	160	128	171	207	196

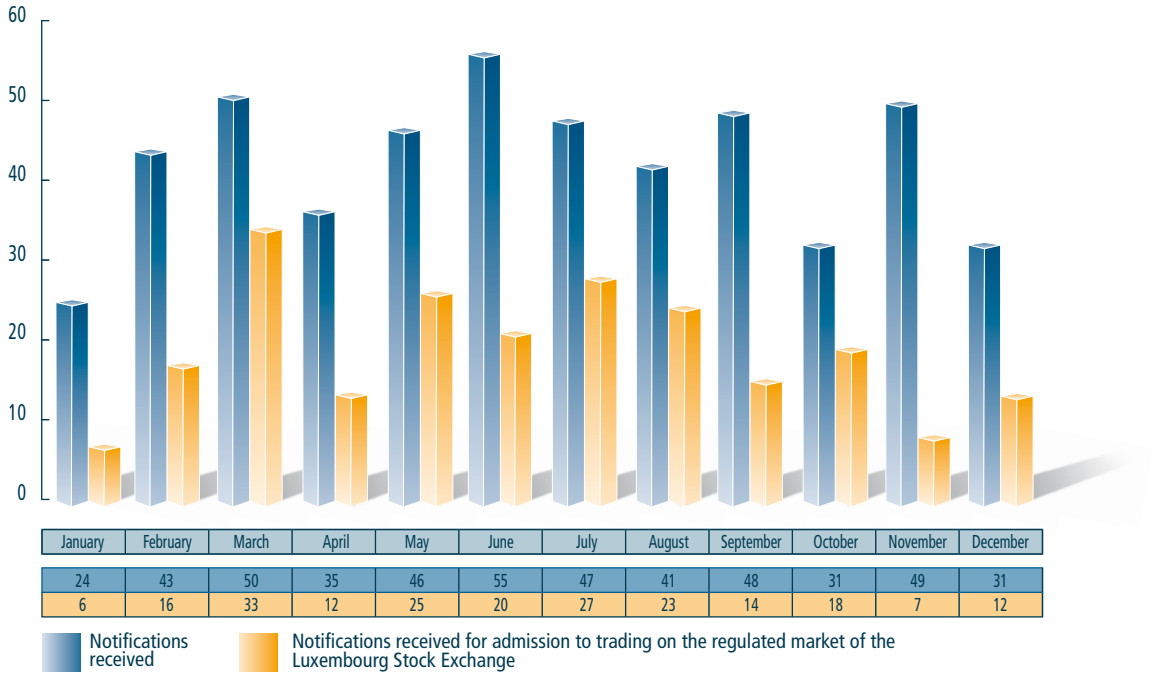
Distribution of files approved in 2006



- ***Documents drawn up under the European passport regime in 2006***

In 2006, the CSSF received 500 notifications from the relevant authorities of several EU Member States, including 213 notifications that were established for the purpose of admission to trading on the regulated market operated by the Société de la Bourse de Luxembourg S.A..

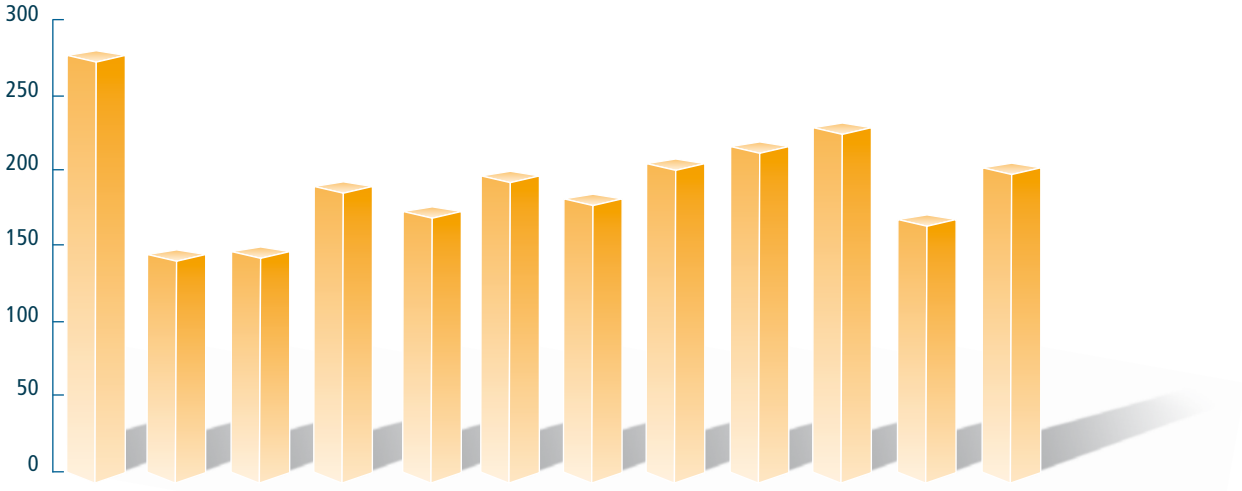
Notifications received in 2006



	January	February	March	April	May	June	July	August	September	October	November	December
Notifications received	24	43	50	35	46	55	47	41	48	31	49	31
Notifications received for admission to trading on the regulated market of the Luxembourg Stock Exchange	6	16	33	12	25	20	27	23	14	18	7	12

The CSSF sent notifications concerning 652 documents it has approved to the competent authorities of EU Member States.

Notifications sent in 2006



	January	February	March	April	May	June	July	August	September	October	November	December
	273	140	143	185	171	194	178	199	215	225	163	201

As regards the notifications sent by the CSSF, it should be noted that a large number of the certificates was issued for the purpose of notifications to Germany, the Netherlands and Austria. Indeed, this trend can be explained by the fact that the CSSF approves prospectuses in English, German, French and Luxembourgish, as well as by the geographic proximity of these countries. Furthermore, a large number of investors of the neighbouring countries are active in the Luxembourg market.

Notifications sent by country

Country	Number
Germany	297
Netherlands	248
Austria	237
United Kingdom	202
Italy	202
Ireland	196
France	144
Belgium	139
Spain	120
Sweden	71

2.3.3. Some interpretation issues raised in 2006

- ***Financial information of an SPV (Special purpose vehicle)***

Q&A No 52 relating to "Financial information of an SPV" provided in the document "60 FAQs", published on www.cssf.lu, stresses that a distinction must be made between, on the one hand, SPVs issuing ABSs (Asset Backed Securities) to which applies, among others, point 8.1. of Annexe VII to the Prospectus Regulation (Regulation (EC) No 809/2004), and on the other hand, the other SPVs that can, where applicable, submit a reasoned request for exemption with respect to the preparation of their first annual accounts under the provisions of article 10 of the law on prospectuses for securities. The CSSF wishes to stress that where such a duly justified request for exemption is received, the exemption can be granted.

However, Q&A No 52 does not address the comparative interpretation of the formulation of points 8.1. and 8.2. of Annexe VII relating to ABSs in the two following situations:

- the issuer has not commenced operations and no financial statements have been made up as at the date of the registration document;
- the issuer commenced operations and financial statements have been made up since the date of incorporation or establishment.

Indeed, Annexe VII does not consider the situation in which the issuer of the ABSs has commenced operations but has not drawn up financial statements since the date of incorporation or establishment. In this particular case, the CSSF adopted the "either/or" approach for the exemption referred to in point 8.1. of Annexe VII. Thus, where the issuer has already commenced operations, but not drawn up financial statements since the date of incorporation or establishment, a statement clarifying that fact must be included.

- ***Exchange offers related to securities admitted to trading on the Euro MTF market that are likely to trigger an offer to the public***

Exchange offers related to securities admitted to trading on the Euro MTF market for new securities shall be considered as price-sensitive transactions impacting the securities concerned and must be made public in accordance with the Rules and Regulations of the Luxembourg Stock Exchange. The notices relating to these exchange offers could be considered as constituting offers of securities to the public and trigger the obligation to publish a prospectus in accordance with the Prospectus Regulation. In this case, a distinction must be made between notices that generally aim to inform

the public of an issuer's debt restructuring through an exchange offer (which are not offers to the public of new securities) and specific invitations to the public to participate in this exchange offer (which can constitute an offer to the public). While the notices on an issuer's debt restructuring can and must be published, invitations to take part in an exchange offer may for instance be addressed to investors concerned *via* the clearing system, in order to avoid that these invitations are immediately considered as offer to the public, without prejudice however to the definition of an offer to the public and the conditions governing the publication of a prospectus as provided for by the law on prospectuses for securities and explained in circular CSSF 05/225.

- ***Multiple-issuer programmes and article 13.2 of the law on prospectuses for securities***

According to article 13.1 of the law on prospectuses for securities, "Every significant new factor, material mistake or inaccuracy relating to the information included in the prospectus which is capable of affecting the assessment of the securities and which arises or is noted between the time when the prospectus is approved and the final closing of the offer to the public or, as the case may be, the time when trading on a regulated market begins, shall be mentioned in a supplement to the prospectus". Article 13.2 of the law sets up a period called cool-off period by laying down that the "investors who have already agreed to purchase or subscribe for the securities before the supplement is published shall have the right, exercisable within a time limit which shall be no shorter than two working days after the publication of the supplement, to withdraw their acceptances". In the case of multiple-issuer programmes, the base prospectus includes information on several issuers. Where a supplement to the prospectus that only concerns one issuer of the programme must be published and where the information included in this supplement is such as to influence only the assessment of the securities issued by this particular issuer, the CSSF considers that the publication of the supplement does not affect the issues of the other issuers.

- ***Financial information to provide under an issue guaranteed by several companies belonging to the same group (e.g. High Yield Bond Issuers)***

Where an issue of securities is guaranteed by several companies, Annexe VI of the Prospectus Regulation applies in principle to each of these entities. The provisions concerned require that the guarantor discloses the same information on itself as if it was the issuer of the security that is the object of the guarantee.

However, a strict application of this point would be likely to prejudice issues that benefit from more complex structural guarantees under which several subsidiaries of the same group are guarantors, in particular where these subsidiaries do not publish non-consolidated financial statements separately from the consolidated financial statements of the group to which they belong. This is notably the case for so-called "High Yield Issues". In these constellations, it is often the group's subsidiaries which have the most significant assets that act as guarantors.

As it cannot be affirmed in general that the financial statements of the subsidiaries are always of minor importance, the CSSF considers that an exemption can nevertheless be granted on a case-by-case basis in the following practical situations:

- the guarantees concerned are unconditional and irrevocable (without prejudice to the other legal provisions applicable in the jurisdictions of these entities);
- the guarantor subsidiaries represent at least 75% of net assets or of the group's EBITDA; and
- the prospectus includes a description of the reasons explaining the omission of separate financial information for the subsidiaries concerned under the section relating to risk factors.

In these cases and provided that an exemption request is received, the inclusion of the group's consolidated financial statements will be considered sufficient by the CSSF as historical financial information required for the group and the guarantor subsidiaries.

2.4. Takeover bids

2.4.1. Offer documents approved by the CSSF

In 2006, the CSSF approved three offer documents relating to takeover bids. The first file had already been closed before the law on 19 May 2006 on the implementation of Directive 2004/25/EC of 21 April 2004 concerning takeover bids (law on takeover bids) had come into force. As regards the second case, the initial information document had been approved before the law on takeover bids had come into force and the subsequent elements of the file could be handled in accordance with the new law. As regards the third takeover bid for which the CSSF was competent, it could be dealt with from beginning to end under the law on takeover bids.

- The first file for which the CSSF had to approve an offer document in 2006 concerned the takeover bid by the company Leasinvest Real Estate SCA, a Belgian real estate sicafi, on the Luxembourg SICAV Dexia Immo S.A., of which the French version of the offer document was approved on 12 May 2006.
- The second file, which was by far the most important in 2006, concerned the takeover bid of Mittal Steel Company N.V. (Mittal Steel) on ARCELOR S.A. (Arcelor). The information document on this takeover bid had already been approved on 16 May 2006 while a first and second supplement have then been approved under the law on takeover bids on 31 May 2006 and 4 July 2006 respectively. Detailed information on this complex file is provided in point 2.4.5. below.
- A third offer document was approved by the CSSF on 20 September 2006, namely the offer document relating to the takeover bid of El Rocio Investments Ltd on Artemis Fine Arts S.A..

2.4.2. Files for which the CSSF was competent as authority of the Member State in which the company concerned has its registered office

According to Directive 2004/25/EC of 21 April 2004 on takeover bids (Directive on takeover bids), the authority competent to supervise a takeover bid is that of the Member State in which the offeree company has its registered office, if that company's securities are admitted to trading on a regulated market in that Member State (even if, in addition, these securities are also admitted to trading on other markets). In these cases, all aspects of the takeover bid are exclusively governed by the law of this Member State (i.e. issues relating to the course of the takeover bid, as well as matters relating to company law).

In all instances where the Member State of the registered office is not the Member State of the regulated market(s) on which the securities are admitted to trading, the Directive on takeover bids provides for rules allowing to determine the competent supervisory authority. Indeed, where the securities of the offeree company are not admitted to trading on a regulated market in the Member State in which this company has its registered office, the law on takeover bids provides that in matters relating to the information to be provided to the employees of the offeree company and in matters relating to company law, the applicable rules and the competent authority shall be those of the Member State in which the offeree company has its registered office. It follows in that case that the rules relating to takeover bids (i.e. matters relating to the bid procedure, in particular the information on the offeror's decision to make a bid, the contents of the offer document and the disclosure of the bid) shall be dealt with in accordance with the rules of the Member State of the authority competent to supervise the takeover bid, while the matters relating notably to company law and the ensuing matters (including notably the right of squeeze-out and the right of sell-out) are exclusively governed by the national law of the registered office of the offeree company.

This principle was applied in the context of the takeover bid of the company GEMALTO NV in respect of the shares admitted on Euronext Paris of the Luxembourg company GEMPLUS INTERNATIONAL S.A.

for which the French authority approved an offer document on 6 July 2006. In this file, the CSSF notably intervened in the context of the determination of the fair price for the exercise of the right of sell-out followed by the right of squeeze-out in accordance with the law on takeover bids.

2.4.3. Files for which the CSSF was consulted under article 6(2) of the law of 19 May 2006 concerning takeover bids

In the event of a takeover bid for which the CSSF is not the competent authority, the offer document is recognised in Luxembourg, subject to its approval by the competent authority and its translation into Luxembourgish, French, German or English, where the securities of the offeree company are admitted to trading in Luxembourg, without it being necessary to obtain the CSSF's approval. The CSSF may require the inclusion of additional information in the offer document only if such information is specific to the Luxembourg market and relates to the formalities to be complied with to accept the bid and to receive the consideration due at the close of the bid, or to the tax arrangements to which the consideration offered to the holders of the securities will be subject.

However, the offeror must notify the CSSF in good time by communicating all the necessary documents thereby enabling the CSSF to inform the offeror if it requires any additional information and to verify, where applicable, if the additional information it required has really been inserted in the offer document. Three particular cases emerged in 2006:

- the takeover bid of MAN AG on SCANIA AB for which the Swedish authority approved an offer document;
- the takeover bid of EDF International S.A. on South Hungarian Electricity Supply Company LTD for which the Hungarian authority approved an offer document;
- the takeover bid of BUZZI UNICEM S.P.A. on the company DYCKERHOFF AG for which the German authority approved an offer document.

2.4.4. Files under review at the end of 2006

The offer document concerning the takeover bid of Beverage Associates Holding Ltd (BAH), a subsidiary of the group AMBEV, on the shares of the Luxembourg company Quilmes Industrial (Quinsa) S.A. was approved by the CSSF on 25 January 2007.

2.4.5. Chronology of a specific case: Mittal Arcelor

On the morning of 27 January 2006, Mittal Steel announced its plan to launch a takeover bid on Arcelor in exchange for securities and cash, valuing the Arcelor group at EUR 18.6 billion. Mittal Steel informed the CSSF early in the morning of 27 January 2006 of its intention to launch a takeover bid on Arcelor. On the same day, a Mittal Steel press release was reviewed by the CSSF before being published by Mittal Steel. Within the CSSF, the department "Supervision of securities markets" was responsible for the file and started to deal with it in close co-operation with the Executive Board of the CSSF. On 30 January 2006, the CSSF received a preliminary draft of the takeover offer document.

On 3 February, the CSSF published a press release concerning its competences and the legislation applicable to this takeover bid. The press release stressed that "The Luxembourg law of 23 December 1998 on the supervision of securities markets as amended sets down in article 2(1) that the Commission is the competent authority for the supervision of securities markets. The general missions of the CSSF are laid down in article 3 of the law and apply to the sector of securities markets, as well as to the other sectors under the supervision of the CSSF. Moreover, the law of 23 December 1998, as amended, relating to the supervision of securities markets reiterates and specifies the general powers of the CSSF relating to the supervision of the Luxembourg securities

markets and notably provides that the CSSF ensures enforcement, in a broad sense, of the rules regarding public "exposures, offers and sales of securities". The legal doctrine has firmly established as jurisdiction criteria the law applying to the market on which the transaction takes place and the law of the company issuing the securities in respect of which the transaction is proposed which is in the present case the target company of the takeover bid. These criteria are now also incorporated in article 4(2)(a) of Directive 2004/25/EC of 21 April 2004 on takeover bids. Thus, the applicability of Luxembourg law and the competence of the Luxembourg authorities are clearly established, since both above-mentioned criteria are concurrently fulfilled, without prejudice however, because of the multiple listing of the securities concerned, to the international public interest provisions and other mandatory standards relating to the proper operation of the market of the Member States on whose territory the other markets concerned are located. While the intended takeover bid targets a company whose registered office is located in Luxembourg, corporate law aspects that might arise in this case will be exclusively governed by Luxembourg law. Moreover, pursuant to the law of 23 December 1998 relating to the supervision of securities markets, the CSSF's duties include, within the context of its supervisory mission of securities markets, the co-operation and exchange of information with the authorities of the other EU Member States vested with the mission to supervise financial markets. While enforcing its prerogatives, the CSSF will actively co-operate with the other authorities concerned, with whom fruitful discussions have already been opened. (…) Should the Luxembourg legislator specify the CSSF's missions in this context by means of a specific law relating to takeover bids, the CSSF would apply this law in an objective manner from the moment it enters into force, at the latest." The CSSF's legal interpretation was finally accepted by all parties, authorities and institutions concerned.

On 6 February, Mittal Steel officially submitted the first draft offer document and the offer conditions proposed as final by the offeror. The same information was simultaneously communicated to the competent authorities of the Member States on whose territory the other markets concerned are located. The CSSF was in daily contact with these other authorities since the announcement of the intended takeover bid: Autorité des marchés financiers (AMF, France), Commission bancaire, financière et des assurances (CBFA, Belgium) and Comisión Nacional del Mercado de Valores (CNMV, Spain). Later on, intensive contact was established with the Autoriteit Financiële Markten (AFM, Netherlands) and the Securities Exchange Commission (SEC, United States) as well. On 7 February, the CSSF specified, by means of a press release and following consultation with the other chiefly concerned authorities, the market rules governing Mittal Steel's takeover bid on Arcelor. In co-operation with the other authorities, the CSSF would ensure, throughout the process, that false markets would not be created in the securities of the offeree company, the offeror company or any other company concerned by the bid in such a way that the rise or fall of the prices of the securities would become artificial and the normal functioning of the markets distorted. While enforcing their public mission consisting in the supervision of securities markets and in order to ensure proper operation of the market until the closing of the bid, the authorities concerned had thus agreed to establish rules of intervention and transparency governing the takeover bid.

On 16 February, the CSSF published together with its press release of that date, a document produced by Mittal Steel detailing the main terms of the takeover bid, following negotiations with the authorities concerned. The document contained the information that must be included in the notice to be received and published by the Belgian regulator, in accordance with article 6 of the royal decree of 8 November 1989. The wording of the main conditions of the Mittal Steel offer, which was made public by the CSSF in order to ensure an appropriate level of information and the proper operation of the market, was discussed and/or verified by all authorities concerned by the takeover bid. These main conditions of the offer only reflected the main technicalities of the offer that could not be fully appreciated without knowledge of certain important supplementary elements (such as any relevant conditions or formulae for possible adjustments to the level or

composition of the consideration) that were to be set forth in detail in the offer document. The press release also stated that the holders of the securities of the offeree company should wait for the publication of the entire offer documentation in order to be able to reach a properly informed decision on the takeover bid. After the main terms of the offer had hereby been made public, the authorities concerned further analysed and reviewed the offer documentation for approval and publication. The comments of the authorities concerned on the offer document were based on the different national legislations and were then compiled to avoid contradictions. The authorities' comments relating to the legal requirements applicable were transmitted to the offeror who had to take them into account in the revised versions of the documents to be submitted to the competent authorities.

Following preliminary explanations given to the CSSF, Arcelor publicly announced on 4 April that its board of directors had met on 3 April and taken various measures, such as: (i) increase of the proposed dividend to EUR 1.85; (ii) establishment of a structure to ensure the integration within Arcelor of the newly acquired Canadian steel company Dofasco, through the transfer of shares to a Dutch foundation called Strategic Steel Stichting; (iii) distribution of EUR 5 billion to the shareholders that could be made notably through a share buyback (OPRA). On 28 April 2006, the general meeting of Arcelor shareholders approved the accounts of the financial year 2005, as well as the payment of a gross dividend of EUR 1.85 per share, to be paid on 29 May 2006.

On 16 May, the CSSF announced that the AMF, the CBFA and the CSSF had finally approved the information document relating to Mittal Steel's cash and exchange offer. This document constitutes, together with the public offer and admission to trading prospectus approved by the Dutch AFM in accordance with the Prospectus Directive, the offer document. Copies of the offer document were available from Mittal Steel as from 18 May and, in accordance with national rules applicable, in the different jurisdictions concerned. The approval process had been coordinated by the aforementioned regulators in close cooperation with the CNMV which, principally due to specific Spanish procedures and rules, was expected to approve the Spanish version of the information document shortly after that date. The offer period was expected to last from 18 May 2006 until 29 June 2006 inclusive. The closing of the offer period was expected to occur on the same day in all the jurisdictions concerned by the offer, i.e. Luxembourg, France, Belgium, Spain and the United States. The same information was disclosed in all European jurisdictions concerned by the offer, with the exception of country-specific information, such as information on national tax treatments or local tender agents.

On 18 May, Mittal Steel launched indeed its takeover bid on Arcelor. On the following day, 19 May, Mittal Steel however announced a 34% increase of its takeover bid, to EUR 25.8 billion, and submitted a first draft supplement to the information document to the authorities concerned. On 19 May 2006, Arcelor called a second extraordinary general meeting of shareholders for 21 June in order to decide on the share buyback. On 22 May, the initial information document was approved by the CNMV as well, and on the same date, the law on takeover bids transposing the European Directive in this field came into force in Luxembourg.

On 26 May, following preliminary discussions with the CSSF, Arcelor and the Russian steel company OAO SeverStal publicly announced their agreement to merge. Arcelor indeed announced that it had signed an agreement (Strategic Alliance Agreement or SAA) with Mr Alexey Mordashov, the controlling shareholder of the company OAO SeverStal, under the terms of which Mr Mordashov would contribute its 89% interest in SeverStal and EUR 1.25 billion in cash in exchange for 295 million new Arcelor shares representing an interest of about 32% in Arcelor. This information was considered as likely to materially influence the stock market price and should be disclosed as soon as possible (subject to the publication of more detailed information following this first disclosure). The proposed participation of Mr Mordashov of about 32% in Arcelor capital could exceed this threshold owing to the share buy-back announced by Arcelor's board of directors in

April and on which Arcelor shareholders still had to decide. The latter would have the opportunity to take a decision on the proposed merger in a general meeting. The transaction was expected to be finalised at the end of July, unless it would be rejected in the general meeting by shareholders representing more than 50% of Arcelor's capital.

On 31 May, the CSSF approved, after having actively co-operated with the other authorities concerned, a supplement to the information document of Mittal Steel. Both documents constitute together with the public offer and admission to trading prospectus and the supplement relating thereto, which have been approved by the AFM (and incorporated by reference in the aforementioned documents), the updated offer document. The information disclosed by Mittal Steel in those four documents was still to be completed by a reply document to be published by Arcelor during the offer acceptance period.

On 2 June, the CSSF published a press release on its interpretation of article 5(1) of the law on takeover bids in respect of the proposed merger of Arcelor and SeverStal. The CSSF specified with respect to the final shareholding of Mr Mordashov in Arcelor capital following a possible buy-back, that the Luxembourg legislator had generally chosen, by enacting the relevant wording of article 5(1) of the law on takeover bids, that the mandatory bid rule would only be triggered if the relevant threshold was passed by way of acquisition of shares. Given the considerable effect of the possible buy-back (and cancellation) by Arcelor of its own shares, the CSSF had however imposed certain conditions on Arcelor and SeverStal (including notably the requirement that the general meeting of shareholders deciding whether the buy-back would effectively take place – and thereby implicitly also deciding whether the stake of shareholders not participating in the buy-back (including Mr Mordashov) would automatically rise – must be fully informed of that effect and all material information on the buy-back (including the determination method of the price) had to be disclosed before shareholders have to take a decision). Arcelor shareholders could thus take an informed decision on the proposed transactions.

On 11 June, Arcelor's board of directors decided among other things not to launch the share buy-back before the announcement of the results of Mittal Steel's offer. Moreover, the board of directors of Arcelor recommended shareholders to participate massively in the general meeting of 30 June and to vote for the SeverStal transaction. On 13 June, the CSSF informed the public that Arcelor would publish on the same day, following the CSSF's intervention, more detailed information on the agreement between Arcelor and SeverStal as announced on 26 May 2006, including on the valuation of both companies, the determination method of the price and corporate governance. In a press release published on 19 June 2006, Arcelor announced the withdrawal of the convening of the extraordinary general meeting of 21 June 2006. Arcelor also published an information document relating to the proposed transaction, describing the terms and conditions of the SAA. On 20 June 2006, SeverStal announced that it had proposed Arcelor's board of directors to improve the terms and conditions of the SAA.

On 21 June, the market authorities concerned announced in a joint press release that they had decided to have the listing of Arcelor securities suspended and required Arcelor's managers and the different participants in the ongoing discussion to disclose comprehensive information on their projects in firm and final terms within the shortest possible time. The regulators considered that the shareholders were to take key decisions for the future of their company within the context of the takeover bid of Mittal Steel or during the general meeting convened for 30 June.

On 25 June 2006, the board of directors of Arcelor examined the revised offer of Mittal Steel and the revised offer of Mr Mordashov and decided that Mittal Steel's offer was to be considered as superior to the offer of Mr Mordashov. Consequently, Arcelor's board of directors decided unanimously to recommend Mittal Steel's offer. In the memorandum of understanding between both companies,

Arcelor committed to cancel the SAA as soon as it would be authorised thereto under its terms and conditions, which would be the case, for instance, if shareholders representing 50% of the issued capital voted against the transaction proposed under the SAA at the shareholders' general meeting convened for 30 June 2006 in this matter.

On 26 June, the market authorities published a second joint press release stating that, considering the information contained in the press releases published the previous day by Arcelor and Mittal Steel on the decision of Arcelor's board of directors to recommend the improved Mittal Steel offer and the proposed creation of Arcelor-Mittal, the regulators decided that the suspension in trading of Arcelor securities should be lifted the same date at 1.00 p.m.. On 29 June, the Luxembourg, French, Belgian and Spanish authorities supervising the markets on which the Arcelor security is listed requested Mr Mordashov and the company SeverStal to publicly state their intentions *vis-à-vis* the company Arcelor. On 30 June 2006, Arcelor announced that at the general meeting, shareholders representing about 58% of the capital issued by Arcelor had voted against the SeverStal transaction and that, as a consequence, Arcelor would cancel the SAA in accordance with the terms and conditions of this agreement.

On 5 July, the CSSF announced that it had approved, together with the AMF, the CBFA and the CNMV, following the press releases of 25 June 2006 and the general meeting of Arcelor shareholders of 30 June 2006, a second supplement to the information document relating to Mittal Steel's mixed cash and exchange offer for the securities of Arcelor. Those three documents constituted together with the public offer and admission to trading prospectus and the three supplements relating thereto, the updated offer document. The offer period was extended until 13 July 2006 inclusive. The information disclosed by Mittal Steel in those documents was to be completed by a reply document (including the opinion of Arcelor's board of directors on Mittal Steel's offer) to be published by Arcelor.

On 26 July, Mittal Steel announced that 92% of Arcelor shareholders had accepted its offer. On 9 August, the CSSF confirmed the reopening of the bid (in accordance with the law on takeover bids) which lasted until 17 August 2006 inclusive. Moreover, the CSSF confirmed that in accordance with article 16 of the law on takeover bids, the remaining shareholders, who had chosen not to participate in the offer, would have, within a period of three months following the expiration of the subsequent offering period, a sell-out right against Mittal Steel in respect of their Arcelor shares, as Mittal Steel already owned more than 90% of the voting rights of Arcelor (subject to the possible squeeze-out right of Mittal Steel).

On 20 November 2006, Mittal Steel announced that the mandatory sell-out period for minority ownership referred to in the law on takeover bids had expired on 17 November 2006. No squeeze-out procedure for remaining Arcelor ownership was triggered where the interest held by Mittal Steel in Arcelor is less than 95% of the equity capital, which is the threshold laid down in the law on takeover bids to perform a mandatory squeeze-out of minority ownership. On 7 March 2007, the CSSF announced, in relation to the merger between Arcelor and Mittal Steel, that it had granted, by virtue of article 4(5) of the law on takeover bids, the controlling shareholder of Mittal Steel a derogation from the obligation under article 5(1) of the law to launch an offer for the shares of Arcelor, considering mainly that, following the successful takeover bid by Mittal Steel on Arcelor and as already described in the second supplement to the information document relating thereto (section V.A.3.4. "Intentions regarding corporate restructuring"), the control over Arcelor would not change again as a result of the proposed merger as it would ultimately remain with the controlling shareholder of Mittal Steel and that, in addition, the steps leading to the merger would not result in an "acquisition" of Arcelor shares by the controlling shareholder of Mittal Steel in the sense of article 5(1) of the law on takeover bids.

2.5. Luxembourg companies listed on the Luxembourg Stock Exchange

2.5.1. Financial information disclosed by listed companies

The law of 23 December 1998 on the supervision of securities markets as amended lays down the principle that financial information disclosed by companies listed on the Luxembourg Stock Exchange be monitored. The number of Luxembourg companies whose shares are listed amounted to 36 as at 31 December 2006.

Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting standards (IAS Regulation) introduces the obligation for European companies, whose securities are traded on a regulated market, to draw up their consolidated financial statements in accordance with the international accounting standards IAS/IFRS for each financial year starting on 1 January 2005 or later.

In the context of its missions encompassing the control of financial information disclosed by Luxembourg companies, the implementation of the international accounting standards, as well as the future transposition of Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (Transparency Directive), the CSSF dealt with several requests for information submitted by companies listed on the Luxembourg Stock Exchange and relating notably to the consolidation requirement, the time limits governing the publication of financial statements and the uncertainties linked to the options laid down in the Transparency Directive. The CSSF also intervened several times with listed companies for non-compliance with IAS/IFRS in the context of the preparation of annual or interim financial statements requesting the companies concerned to remedy the deficiencies in the allotted time.

2.5.2. Reporting of major shareholdings

The CSSF systematically verifies compliance with the law of 4 December 1992 on the information to be published when a major holding in a listed company is acquired or disposed of, notably by considering attendance registers of ordinary and extraordinary meetings, as well as other sources of information. The CSSF handled the reports in close co-operation with the Luxembourg Stock Exchange, which publishes them and responded to several requests for information it received with respect to reports.

3. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

3.1. Grand-ducal regulation of 2 August 2006 determining the modes of setting up a register of persons considered as qualified investors within the meaning of Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC and of the law on the prospectuses for securities

The purpose of the Grand-ducal regulation is to lay down the modes of setting up at the CSSF a register of persons considered as qualified investors ("Register") within the meaning of the Prospectus Directive and the Prospectus law.

The CSSF registers the natural persons residing in Luxembourg and the small and medium-sized enterprises having their head office in Luxembourg that have requested expressly to be considered as qualified investors on the condition that these persons, at the moment of their registration request, fulfil at least two of the criteria set down in the Prospectus law. The CSSF does not verify

however if the criteria are really fulfilled, but the persons referred to in articles 1(2) and 1(3) of the Grand-ducal regulation shall expressly confirm in their registration request (i) that they fulfil at least two of the three criteria, (ii) that they wish to be considered as qualified investor within the meaning of the Prospectus Directive and the Prospectus law and (iii) that they agree to their listing on the Register and the consultation of the latter in accordance with the Grand-ducal regulation. The registration request of a natural person, submitted to the CSSF, shall notably include the surname(s), first name(s) of the natural person, the date and the place of birth and the private home address. For the purpose of data security and protection, only the surname(s), first name(s) of the natural person, a contact address (which need not be the home address) and, where applicable, his/her e-mail address, will be available to the users of the Register. Moreover, a natural person or an SME can choose that only the name and the professional address in Luxembourg of a proxy are communicated or made available to "issuers or persons making an offer, or to persons acting on their behalf" that request consultation of the Register in order to offer securities. This entails that a larger number of "natural persons" or family SMEs will probably wish to be listed on the Register and credit institutions and other professionals of the financial sector authorised in Luxembourg will be, where applicable, named as proxies, which would then be able themselves to offer securities to investors without having to prepare or use a prospectus that needs to comply with the new regulations.

Every registered person can decide any time, and without justification, to opt out. The person concerned will be delisted from the Register and the opting-out will thus be effective and reflected in the Register within five working days from the reception by the CSSF of such request.

In order to be listed on the Register, the person concerned shall expressly confirm that it meets at least two of the three criteria or characteristics set down for both investor categories respectively. Likewise, the persons registered that no longer fulfil at least two of the three criteria or characteristics must notify the CSSF thereof and opt out. The information relating to the person concerned will be taken off the Register and the loss of qualified investor status will be effective within five working days from the reception by the CSSF of such demand. Moreover, the CSSF can request a person listed on the Register to confirm that it still fulfils at least two of the three criteria or characteristics laid down in article 1 of the Grand-ducal regulation. If the CSSF does not receive a confirmation from this person within three months from the date it sent the request, it will delist this person within five working days. This provision will allow the CSSF not only to obtain confirmation if the persons listed on the Register still meet at least two of the three criteria or characteristics of article 1 of Grand-ducal regulation, but also to update the Register in the event for example a natural person deceased.

Where a natural person or an SME listed on the Register opts out or must opt out, the CSSF updates the Register, but does not specifically notify the persons that have already consulted the Register before that update and that are allowed to use the information of the Register at the time of their consultation for at least one month. Indeed, the persons consulting the Register are allowed to use the information communicated to them by the CSSF for one month - to launch an offer of securities - following the date of the communication, unless they have been informed by an investor of its delisting from the Register. In this case, it is the natural person or the SME concerned that is responsible itself to notify the persons that have consulted the Register that it is no longer to be considered as qualified investor, where the person opting out or having had to opt out still is, where applicable, contacted by the latter for the purpose of an offer of securities.

3.2. Law of 9 May 2006 on market abuse

The purpose of the market abuse law is to fight against insider dealing and market manipulation ("market abuse") in order to ensure the integrity of financial markets, to enhance investor confidence in those markets and thereby to ensure a level playing field for all market participants. It establishes a new framework for the prevention, detection and efficient sanction of market abuse, imposes new obligations on market participants, entrusts the CSSF with new competences and missions and sets down new preventive measures.

The law transposes Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (Market Abuse Directive) into Luxembourg law, as well as the Directives specifying the implementing measures of the Market Abuse Directive, namely:

- Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC as regards the definition and public disclosure of inside information and the definition of market manipulation (which lays down detailed criteria for defining information deemed to be of a precise nature and likely to have an effect on prices);
- Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC as regards the fair representation of investment recommendations and the disclosure of conflicts of interest;
- Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the suspicious transactions reports.

However, the law does not transpose Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC as regards exemptions for buy-back programmes and stabilisation of financial instruments, as European Regulations are directly applicable.

The law of 9 May 2006 applies to all financial instruments admitted to trading on at least one regulated market or for which a request for admission to trading on such a market has been made. Prohibitions of insider dealing and market manipulation also apply to all financial instruments admitted to trading on at least one multilateral trading facility (MTF) or for which a request for admission to trading on an MTF has been made. This obligation shall apply whether the transaction was carried out on such a regulated market or such an MTF or not. Article 5 of the law specifies that the prohibitions and requirements laid down in the law apply, without prejudice to other provisions, to actions carried out in Luxembourg or abroad concerning financial instruments admitted to trading on a regulated market situated or operating in Luxembourg or for which a request for admission to trading on such a market has been made, and, as regards foreign regulated markets, to actions carried out in Luxembourg concerning financial instruments admitted to trading on such a foreign regulated market or for which a request for admission to trading on such a market has been made. The prohibitions in question do not apply to actions concerning financial instruments admitted to trading on a foreign MTF or for which a request for admission to trading on such a market has been made. The foreign rules applicable to this foreign MTF should impose prohibitions for these types of cases. It must also be noted that attempts of insider dealings are also punishable under the law, which was not the case under previous Luxembourg legislation.

The law lays down a set of new requirements for market participants with the major aim of preventing market abuse, namely in short:

- Credit institutions and the other professionals of the financial sector established in Luxembourg are notably required to notify the CSSF without delay if they reasonably suspect that a transaction might constitute insider dealing or market manipulation.

- The regulated markets, credit institutions, investment firms and market operators of an MTF must adopt structural provisions aimed at preventing and detecting market manipulations.
- Issuers of financial instruments are required to disclose to the public inside information that directly concern them as soon as possible.
- Issuers or persons acting on their behalf and for their account shall establish a list of persons who have access to inside information.
- Moreover, the persons discharging managerial responsibilities within an issuer having its registered office in Luxembourg and persons closely associated with them, shall notify to the CSSF and to the issuer all operations conducted on their own account related to the issuer's shares admitted to trading on a regulated market, or to derivatives or other financial instruments linked to these shares and the issuer shall make these operations public.
- The persons who produce or disseminate investment recommendations in Luxembourg or who, from abroad, specifically target the Luxembourg public shall notably ensure that the recommendations are presented fairly, that they clearly mention conflicts of interests and that they include all the other references provided for by the law.

In this context, circular CSSF 06/257 of 17 August 2006 concerning the coming into force of the law of 9 May 2006 on market abuse must be mentioned. This circular informs on the coming into force of the law and outlines the new framework for the prevention, detection and efficient sanction of market abuse, the new requirements imposed on market participants, the new competences and missions of the CSSF and the new preventive measures. It notably describes the scope of the law and the different disclosure means. It also announces the publication of a future circular to complete the new regulatory framework with explanations and additional guidelines.

Circular CSSF 07/280 on the implementation rules of the law on 9 May 2006 on market abuse was published on 5 February 2007. Its purpose is to provide explanations and guidelines concerning (i) the elements that could be indications of market manipulation, (ii) the arrangements and format for suspicious transaction reports, (iii) the lists to be drawn up by issuers, or persons acting on their behalf or for their account, including those persons having regular or occasional access to inside information, and (iv) the notifications relating to operations conducted by persons discharging managerial responsibilities within an issuer and persons closely associated with them, as well as the modalities for public disclosure of such operations. Circular CSSF 07/280 also details buy-back and stabilisation activities falling under the safe harbour exemptions as laid down by Regulation (EC) No 2273/2003. Finally, it clarifies several elements relating to the obligation imposed by the law on UCIs in their role as issuer or, where applicable, on their management.

3.3. Law of 19 May 2006 on takeover bids

The purpose of the law of 19 May 2006 (law on takeover bids) is to transpose Directive 2004/25/EC of 21 April 2004 concerning takeover bids (Directive on takeover bids) which aims at setting up minimum guidelines for takeover bids on companies governed by the law of a EU or EEA Member State, where all or some of the securities of the target are admitted to trading on a regulated market in one or several Member States.

According to the definition of the law on takeover bids, a takeover bid is a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of these securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law. Securities are defined by the law on takeover bids as transferable securities carrying voting rights in a company, including depositary receipts in respect of shares carrying a possibility to give instruction for a vote. The offeror may offer, under certain conditions, by way of consideration, securities, cash or

a combination of both. The law on takeover bids applies to takeover bids of a company governed by the law of a EU or EEA Member State, where all or part of these securities are admitted to trading on a regulated market in one or several Member States. However, it does neither apply to takeover bids for securities issued by companies, whose object is the collective investment of capital provided by the public, which operate on the principle of risk-spreading and the units of which are, at the holders' request, repurchased or redeemed, directly or indirectly, out of the assets of those companies, nor to takeover bids for securities issued by the Member States' central banks. Consequently, the law on takeover bids does not apply to the securities of companies governed by the law of a non-EU and non-EEA country, even if these securities are admitted to trading on a regulated market of one or several Member States, nor to the securities of companies of a EU Member State which are only admitted on a non-regulated market, such as the Euro MTF operated by the Société de la Bourse de Luxembourg S.A..

As regards the legal provisions that apply in the context of a takeover bid, a distinction should be made between the rules of the market on which the securities are admitted to trading and which apply independently and in accordance with specific provisions (such as the rules and regulations of the market concerned, the transparency rules, "market abuse" provisions, etc.), and the rules that specifically apply to takeover bids (i.e. the rules of the Member State of the authority competent to supervise the bid) and finally company law provisions (*lex societatis*, i.e. the "national" law of the company concerned). According to the Directive on takeover bids, the authority competent to supervise a takeover bid shall be that of the Member State in which the offeree company has its registered office if that company's securities are admitted to trading on a regulated market in that Member State (even if, in addition, these securities are also admitted to trading on other markets). In these cases, all aspects of the takeover bid are exclusively governed by the law of this Member State (i.e. issues relating to the course of the takeover bid, as well as matters relating to company law). In all instances where the Member State of the registered office is not the Member State of the regulated market(s) on which the securities are admitted to trading, the Directive on takeover bids provides for rules allowing to determine the authority competent for supervision.

The law on takeover bids also lays down the conditions in which a mandatory bid must be launched. Indeed, where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company (as referred to in article 1(1) of the law on takeover bids defining its scope), which, added to any existing holdings of those securities he/she owns and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, thus giving him/her control of that company, such a person is required to make a bid as a means of protecting the minority shareholders of that company.

The decision to make a bid shall be made public by the offeror immediately after the decision has been taken by the offeror and the CSSF shall be informed of this bid before such decision is made public. As soon as the bid has been made public, the boards of the offeree company and of the offeror shall inform the representatives of their respective employees or, where there are no such representatives, the employees themselves. The offeror is required to draw up and make public in good time an offer document containing the information necessary (in accordance with the requirements of the law on takeover bids and including at least the information required in article 6(3) of the law on takeover bids) to enable the holders of the offeree company's securities to reach a properly informed decision on the bid. Before this document is made public, the offeror shall communicate it to the CSSF for approval within ten working days from the day on which the bid has been made public. The CSSF notifies its decision concerning the approval of the offer document within 30 working days following the presentation of the draft offer document to the offeror. If the CSSF reasonably considers that the document submitted is incomplete or that additional

information is necessary, it informs the offeror within ten working days running from the day the offer documents has been submitted for approval. In this case, the time envisaged above only runs as from the date on which the offeror provides the required information. Approving the offer document does not bind the CSSF with regard to the economical and financial opportunity of the operation or the quality or solvency of the offeror or the offeree company.

Circular CSSF 06/258 of 18 August 2006 on the coming into force of the law of 19 May 2006 implementing Directive 2004/25/EC of 21 April 2004 concerning takeover bids aims at presenting the basic mechanisms set down in the law on takeover bids to the public, including notably its scope of application and the rules determining the competent authority and the law applicable to a takeover bid.

3.4. Regulation (EC) No 1787/2006 of 4 December 2006 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC as regards information contained in prospectuses, as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements

This Regulation notably amends article 35 concerning the transitional provisions relating to historical financial information.

3.5. Regulation (EC) No 211/2007 of 27 February 2007 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC as regards the financial information to be included in the prospectus where the issuer has a complex financial history

As mentioned in its title, this Regulation amends the Prospectus Regulation with respect to financial information to be included in the prospectus where the issuer has a complex financial history.

CHAPTER 8

8 SUPERVISION OF INFORMATION SYSTEMS

1. Activities in 2006

2. Supervisory practice

1. ACTIVITIES IN 2006

1.1. Meetings and participation in national groups

In 2006, IT Audit took part in 129 meetings, 29 national meetings, three internal committees and eight international meetings, i.e. a total of 169 meetings. IT Audit agents have also participated in six conferences related to IT systems security or financial tools or applications. They also took part as speaker in four national and international conferences. IT Audit participated in one on-site inspection performed by the department "Supervision of banks".

The meetings focused mainly on the following subjects:

- scrutiny of applications for authorisation to perform a support PFS[1] activity, in co-operation with the other departments involved;
- operation and security of the supervised entities' IT systems;
- determination of whether an authorisation is required or not regarding the activities of companies that provide services to the financial sector.

These meetings were held with companies offering outsourcing services to the financial sector, IT services companies, law firms, consultancy firms, auditing firms and supervised entities.

It is interesting to note that the number of meetings on IT issues initiated by credit institutions decreases, while the number of meetings initiated by support PFS is on the rise. This can be explained, and confirmed by the substance of these meetings, by the fact that it is more and more the support PFS that consult the CSSF about issues impacting their banking customers.

As far as national meetings are concerned, IT Audit represents the CSSF within the following committees, commissions, associations or working groups:

- ABBL's Payments Commission in which the CSSF participates as observer. The Commission deals with topics relating to payment and clearing systems, credit cards, domiciliation of debt and especially the European project SEPA (Single European Payment Area) coordinated by EPC (European Payment Council).
- the *Fonds National de la Recherche* (FNR, National Research Fund). The CSSF participates in the FNR Foresight exercise. IT Audit helps to identify the research domains with medium-term interest in the area of IT.
- CRP Henri Tudor. Co-operation between CRP Henri Tudor and the CSSF with respect to the GRIF project has been redefined. The CSSF now takes part in the strategic sub-committees in the fields of IT systems security and service quality.
- ANSIL/CNLSI. The *Association de Normalisation pour la Société de l'Information Luxembourg* (ANSIL) was created in line with the standardisation works in the field of information security initiated by the *Comité de Normalisation Luxembourgeois de la Sécurité de l'Information* (CNLSI). ANSIL federates the standardisation initiatives such as CNLSI and comprises two working groups, namely CNLSI, which works on the standards ISO/IEC of the SC27 group and the working group that deals with quality (SC7 group of ISO).

[1] Support PFS are PFS that are authorised only as communication agent (art. 29-1), administrative agent (art. 29-2) or IT systems and communication networks operator of the financial sector (art. 29-3 of the law of 5 April 1993 on the financial sector as amended). The professionals and the CSSF chose this denomination in order to make a distinction between PFS that only provide operational services to other financial players and not financial services. The risk inherent in their business is mainly of operational nature.

1.2. International co-operation

IT Audit takes part in the annual international conference Supervisory Group on IT (ITSG), which gathers the persons responsible within the different authorities for the prudential supervision of the IT systems.

The aim of this group is to foster the exchange of information regarding the current technological stakes and covers aspects such as business continuity plans, electronic banking, countermeasures against the phishing phenomenon and, in general, the specific weaknesses of banking IT, as well as the supervision of cross-border IT outsourcing. Throughout the year, the group's members share information concerning IT and Internet-related frauds, attacks on information systems, identity thefts or weaknesses of certain systems. In 2006, the group concentrated on preparing the different financial centres for a possible crisis management following an epidemic, such as avian influenza (bird flu – cf. point 2. below).

1.3. Developments in the regulatory framework

In 2006, the CSSF received many questions by supervised entities concerning outsourcing services. The CSSF released circular CSSF 06/240 "Administrative and accounting organisation; IT outsourcing and details regarding services provided under the status of support PFS, articles 29-1, 29-2 and 29-3 of the law of 5 April 1993 on the financial sector as amended; modification of IT outsourcing conditions for branches located abroad" to clarify the different recurring issues.

Circular CSSF 06/240 specifies the following points:

- the responsibilities of the financial professional with regard to confidential information when dealing with a support PFS for services other than those requiring an authorisation;
- the differentiation between the status IT systems and communication networks operator of the financial sector (OSIRC) as defined in article 29-3 of the law and the status administrative agent as defined in article 29-2 of the law;
- activities that require authorisation as OSIRC;
- the proper use of temporary staff for key IT functions;
- IT services, in addition to circular CSSF 05/178, regarding the migration of infrastructures and data, as well as user assistance (help desk);
- mail management and customer assistance functions;
- IT subcontracting by a subsidiary or a branch of a financial professional located abroad.

2. SUPERVISORY PRACTICE

Supervision covers verification that the supervised entities implement the legal and regulatory framework, with the direct or indirect purpose to maintain or improve the professionalism of the activities, focusing in particular on aspects relating to implemented technologies as regards information systems and by taking account of the specificities of the support PFS, which offer their subcontracting services to other supervised institutions.

2.1. Management of a pandemic crisis

European and international authorities are concerned about the potential threat of an avian influenza epidemic. A mutation in the H5N1 virus which would make it transmissible between human beings, would lead to a pandemic which would have serious consequences at all levels, including at social and economic level. Most of the banking supervisory authorities consider that the

real threat of a pandemic requires rethinking the way in which financial institutions, mainly banks, deal with business continuity plans. Indeed, it emerges from the exchange of views concerning the possible scenarios, that the main continuity issue – or resilience issue – in the event of a pandemic is the unavailability of the people responsible for banking transactions, assuming that energy supply is ensured and that the infrastructures remain operational.

As business continuity plans usually suppose that IT systems become unavailable following a disaster, emphasis is often laid on a redundancy of premises or computers. However, if individuals in charge of activities are not available, the traditional model no longer works.

It is advisable from a prudential standpoint to consider one or several scenarios under which the success of the business continuity and crisis management plan relies on the reallocation of tasks to the fit individuals. Moreover, the risk of contamination would require reducing close human contacts to a minimum, for instance by promoting telework, if possible from an operational, legal and regulatory standpoint, and by changing social habits (handshakes, exchanging documents from hand to hand, working less than one meter away from a colleague, etc.).

Reallocating tasks while operating with reduced workforce also raises the problem of maintaining the "four eyes" principle. Indeed, it becomes crucial to maintain segregation of duties as long as possible, even if more tasks are allocated to an individual, but they should be assigned to several departments or divisions. If, in certain cases, segregation of duties becomes difficult, or even impossible, it will be very important to plan, at best, very recurrent checks, or, at worst, *a posteriori* checks, in order to make sure that the crisis situation does not generate too many unnoticed errors or that it does not give rise to frauds. It would therefore be useful in general to have a clear communication plan stating that checks will be performed and sanctions taken in the event of abuse, so as to preclude any attempt of taking advantage of the situation.

Responses to a pandemic crisis prove to be very complex and shall therefore be prepared early, notably owing to the needs for specific and additional staff training, as each individual may be constrained to take on new tasks or functions in areas that may be different from those he/she was used to.

Prudence must also prevail as regards telework. Indeed, it has not been formally established that the national teleommunication means are likely to absorb a substantial increase in traffic generated by the professional use of domestic media. Internet traffic generated by domestic use, even if based on broadband access (ADSL), does not have the same characteristics in usage frequency or destination address as the traffic generated by professional use. It is thus possible that access providers will have to face saturation that could lead to a breakdown and make these accesses impossible or unreliable.

These comments are not a comprehensive list of aspects to consider for business continuity in the event of a pandemic, but allow to stress the complexity of the preparation for crisis management, as well as the time necessary to make a chosen solution operational.

2.2. Latest developments regarding hacking

2.2.1. E-banking and phishing

The phishing phenomenon, which appeared on Internet in recent years, continues to spread and techniques are more and more sophisticated. Phishing consists in deceiving a customer by means of a fake e-banking website and convincing the customer to provide his/her login ID so as to allow the phisher to steal his/her "electronic" ID. The phisher is thus able to perform value transfers in his favour and on behalf of his victim.

The means to conceal the redirection of a web address (URL) from a banking website to a fake address are sophisticated enough so that customers who are IT laymen, cannot recognise that they are the object of fraud.

Financial institutions responded by informing their customers that they would never request them to provide their password once again "online". This measure certainly contributed to avoid many cases of phishing.

But the attempted frauds are more and more based on techniques that rely on spying customer PCs. Whereas computer viruses are rather aimed at destroying data or sending non-solicited mail (spam), the new generations are created more and more with the purpose to pick up everything that is typed on the keyboard and to send the result to the cracker who analyses the content in order to collect passwords of all kinds, including e-banking. There is a risk that future generations of "Trojans"[2] would be even more sophisticated and sponsored by organised crime in order to target certain financial institutions and their e-banking websites.

The only efficient riposte against key loggers, i.e. this piracy spy software, consists for financial institutions to introduce the electronic token technology which generates a single password or a token for every session. Thus, even if the cracker is able to obtain the login ID, password and token of a customer of the e-banking website, he will not be able to connect on another occasion under the identity of this customer, as the token necessary to authentication will be different. The token is, in principle, not predictable and is generated by a dedicated electronic device that is in the possession of the customer alone. These token-generating devices are cryptographic micro-calculators, as small as credit cards or key rings, with a display on which the current token is shown. Some of these devices are interactive and generate the token based on a code proposed by the e-banking website to the customer who must enter the code on the mini-calculator's keyboard. Other devices are based on the date and hour of the moment.

In its report "Internet-based financial services"[3], the CSSF had already recommended that identification of e-banking website users should be based on at least two factors: what you know (password) and what you have (16-digit (or more) TAN[4] card). This authentication method is called "two factors authentication" and is recommended by the vast majority of banking supervisory authorities worldwide.

It must be stressed that the authentication factor "what you have" is no longer sufficient to fend off key logger attacks or other spies. Only the one time password mechanism is sufficiently resistant to current attacks, even though it represents additional costs due to the token-generating device.

[2] Trojan: Trojan Horse; computer programme smuggled into the PC with the aim of using certain resources for the benefit of the hacker.

[3] *Services financiers par Internet*, only available in French.

[4] TAN: Transaction authentication number.

However, potential weaknesses remain in relation with "man-in-the-middle" (MITM) attacks. The attacks are theoretically possible if the cracker intercepts the encrypted communication (SSL/https), decrypts it and sends it to the other party. Interception is only possible if the session is no longer encrypted from the e-banking website to the customer's computer, which is the case if the intermediary equipment (proxy) has been hacked. Moreover, if the customer reads on his browser that the connection is encrypted (SSL symbolised by a closed padlock) this means that he must have accepted a certificate on its browser that did not originate from the bank. The customer must thus be particularly watchful when connecting to his e-banking website for the first time and when prompted to accept the initial certificate. More and more banks specify this point in their user manuals or agreements, or even in the "help" section of their information website.

A MITM attacker might alter account numbers or amounts during the session and consequently independently from the token.

2.2.2. IT and mobility

The use of mobile IT devices poses increasingly problems in terms of security. The following two examples allow to highlight certain security weaknesses.

- Example 1: Access to an e-banking website from a cybercafé

It is easier to carry out an MITM attack (cf. point 2.2.1. above) from a cybercafé than from an individual computer, for the mere reason that the false certificate, i.e. a certificate that did not originate from the real banking website but from the attacker, may already have been accepted on the public computers. In this event, the customer sees that his communication is encrypted, but is not aware that he may not be connected to his bank. Moreover, it is possible that the e-banking address the customer entered into the browser does not direct to the bank's website but to the attacker's website or a "proxy" website, in particular if the DNS was spoofed or if a local DNS[5] was interposed in the cybercafé's network. The "proxy" website intercepts decrypted traffic and is able to change the content of the transactions performed.

- Example 2: Access to an e-banking website from a WiFi, UMTS or GPRS connected mobile phone or PDA (Personal Digital Assistant)

These mobile devices are often poorly protected, without anti-virus or firewall, although they are connected to Internet and can be attacked, as they are visible on the network. Moreover, as is the case in a cybercafé, the user does not necessarily know the access provider (in particular as regards WiFi) and cannot know if there is not an intermediate proxy capable of acting as MITM.

These are only two examples showing that mobility may conceal other risks than the use of family computers at home which should be better protected.

IT security is difficult to apprehend by the general public and it is difficult to find a balance between the real risk incurred by the customers, the complexity of the solutions to implement by financial professionals and making the public aware, without entailing a feeling of fear and refusal to use these technologies.

2.2.3. WiFi

The weakness of the protocols implemented in wireless connectivity solutions (WiFi and Bluetooth) are at the root of new potential attacks on WiFi networks.

The CSSF points out certain risks inherent to the use of WiFi devices within financial institutions. Demonstrations by IT security experts showed the emergence of new, high-performance tools

[5] DNS: Domain Name Server. These servers link an URL to an IP address (www.my-bank.lu and the IP address, for example 68.213.34.25).

allowing to crack a network, even a secure network. These tools use different techniques to eavesdrop on traffic between servers and PCs, generate additional traffic which contributes to finding the encryption key and, at the same time, search for the active key. The protocols 802.11 being weak, there is no blocking of communications after a certain number of attempts. The attacker may also substitute his physical address (MAC address spoofing) to that of another neighbouring machine without provoking a refusal. Indeed, the IP mechanism, where for a given IP address in a network there is only one MAC address, does not exist for WiFi. These attacker tools thus allow to inject traffic into existing traffic and to crack *in fine* the WEP or even WPA-PSK cryptography.

Moreover, where a WiFi network is secured through WPA-PSK, the key (passphrase) or keys in the case of a rotation that would have been given to guests, consultants, friends or others, cannot be modified easily, especially if tens of company PCs or PDAs use this network. Every visitor who leaves with his computer containing the passphrase is likely to re-enter the network again, provided that the computer is equipped with the appropriate software. Indeed, these networks are often only able to filter IP and MAC addresses; however, the new tools allow to eavesdrop on authorised traffic and to substitute themselves to one of these computers, while blocking the one that is usurped.

The only valid protection today consists in using the WPA(2) or WPA-EAP protocol (Extensible Authentication Protocol) with a Radius type server for example. Thus, every user receives a specific key or a passphrase.

2.2.4. VoIP

As regards voice over IP, the protocols are just as weak. Experts demonstrated the ease with which it is possible not only to eavesdrop on a communication (except if it is encrypted), but also to redirect the number of the caller to another number, allowing to pass oneself off as the person or the company called. The technique resembles that of DNS spoofing, but applied to VoIP routing devices.

The interconnection between IP and traditional networks also entails that it is not always possible to guarantee the security of the communication or routing, even if the company does not have a VoIP solution. Indeed, there is nothing that allows a subscriber being called to detect that this call is not a VoIP call and thus prone to attacks.

VoIP solutions should thus only be set up after thorough analyses performed by provider-independent security experts and be based on an appropriate security policy. It is very important for any financial institution implementing a VoIP solution to be in control of its risks and, consequently, to be aware of the solution's weaknesses and the possible VoIP attacks.

CHAPTER 9

9 MEANS OF SANCTION AVAILABLE TO THE CSSF

1. MEANS OF INTERVENTION AVAILABLE TO THE CSSF

The following means of intervention are available to the CSSF to ensure that the persons subject to its supervision comply with the laws and regulations relating to the financial sector:

- injunction, sent by registered letter, requesting the establishment concerned to remedy the particular situation;
- suspension of persons, suspension of the voting rights of certain shareholders or suspension of the activities or of a sector of activities of the establishment concerned.

In addition, the CSSF has the right to:

- impose or ask the Minister of Treasury and Budget to impose disciplinary fines on the persons in charge of the administration or management of the establishments concerned;
- under certain conditions, apply to the District Court responsible for commercial affairs for suspension of payments of an establishment;
- ask the Minister of Treasury and Budget to refuse or withdraw registration from the official list of credit institutions or the other professionals of the financial sector, if an establishment does not fulfil or no longer fulfils the conditions for being or continuing to be registered on the official list in question;
- refuse or withdraw registration from the official list of undertakings for collective investment, pension funds, management companies (Chapter 13 of the law of 20 December 2002 as amended), SICARs or securitisation undertakings, if an establishment does not fulfil or no longer fulfils the conditions for being or continuing to be registered on the official list in question;
- in extreme cases and under precise conditions laid down by law, request the District Court responsible for commercial affairs to order the winding up and liquidation of an undertaking.

Moreover, the CSSF informs the State Prosecutor of any instance of non-compliance with legal provisions relating to the financial sector, giving rise to penal sanctions and that could entail prosecution against the implicated persons. The following cases are concerned:

- persons performing an activity of the financial sector without holding a licence;
- persons active in the field of company domiciliation without belonging to any of the professions entitled by the law of 31 May 1999 governing the domiciliation of companies as amended to carry on this activity;
- persons other than those registered on the official lists of the CSSF, who use a title or appellation, thereby breaching article 52(2) of the law of 5 April 1993 on the financial sector as amended, that gives the appearance that they are authorised to perform one of the activities reserved for persons registered on one of the lists;
- attempted fraud.

2. SANCTIONS IMPOSED IN 2006

2.1. Credit institutions

In 2006, the CSSF did not need to order fines nor to impose sanctions against managers (*idem* in 2005).

However, the CSSF exercised its right of injunction with respect to one case (*idem* in 2005) as the specific information it had required had not been delivered within the granted time limit despite several reminders.

Two complaints against bank employees have been filed with the State Prosecutor's Office. In one case, the bank employee held at his domicile abroad documents relating to clients, of which third parties had become aware. In the second case, the bank employee forged documents with the purpose to embellish the financial situation of clients which had deteriorated as a consequence of inopportune investments made by the employee.

2.2. Other professionals of the financial sector (PFS)

During 2006, the CSSF did not exercise the right of injunction nor the right of suspension under article 59 of the law of 5 April 1993 on the financial sector as amended (compared to two injunctions and one suspension in 2005).

In 2006, the CSSF imposed disciplinary fines of EUR 1,500 each on the persons responsible for the daily management of two PFS, in accordance with article 63 of the law of 5 April 1993 on the financial sector as amended.

In one case, the disciplinary fine has been imposed because of a refusal to communicate financial information in application of circular CSSF 05/187, including the information schemes that the different PFS categories must submit to the CSSF on a regular basis. The other disciplinary fine was more specifically linked to the absence of information provision in the context of articles 53 and 54 of the law of 5 April 1993 on the financial sector as amended. In this case, the documents and information relating to the closing of a previous financial year had not been transmitted to the CSSF by the PFS concerned.

In 2006, the CSSF filed one complaint with the State Prosecutor's Office for illegal domiciliation activities of a company not authorised thereto. The CSSF also lodged eight complaints for illegal financial activity with the State Prosecutor's Office this year. In the majority of the cases, the entities concerned have performed financial advisory services or services of setting-up and management of companies without being authorised to do so.

2.3. Undertakings for collective investment

In 2006, the CSSF did not need to order fines nor to impose sanctions against UCIs.

CHAPTER 10

10

GENERAL SECRETARIAT

1. Activities in 2006

2. Customer complaints

3. Reports related to the fight against money laundering and terrorist financing

1. ACTIVITIES IN 2006

The responsibilities of the General Secretariat (SG) cover the following fields:

- ***General Secretariat***

The SG is entrusted with coordinating the external relations and communications of the CSSF, i.e. the contacts with foreign supervisory authorities, national and international administrations, professional associations, as well as with any other counterpart that does not fall under the competence of the other functions and departments of the CSSF.

In 2006, the SG has thus had contact in writing with the supervisory authorities of 32 different countries on subjects as diverse as the organisation of co-operation meetings between the CSSF and the other authorities as home or host authorities, consultation procedures provided for by the European Directives, handling of notifications regarding the freedom to provide services and establish branches, requests for information relating to national laws and regulations or authorised entities and natural persons, etc.

Moreover, the SG answers the requests for general information of the public in relation to the CSSF's activities or the financial centre.

The SG is also in charge of producing, where applicable in co-operation with the other functions and departments concerned, the CSSF's publications in the broad sense (annual report, brochures, press releases, monthly Newsletter, management of the website, etc.). In this context, the year 2006 was marked in particular by the publication on the CSSF's website (www.cssf.lu) of an additional part relating to Supervisory disclosure, in co-operation with an external company and the CSSF's IT team.

- ***Legal issues***

The SG is entrusted with handling general legal issues and cases of presumption of fraudulent and illegal activities in the financial sector (such as the performance of unauthorised or illegal activities), including the response to be given, if necessary, by the CSSF.

- ***Professional obligations and consumer protection***

The SG handles concrete files relating to professional obligations, rules of conduct and consumer protection.

In this context, it receives the complaints of customers against professionals under the supervision of the CSSF (credit institutions, UCIs, PFS, SICARs, pension funds, securitisation undertakings) and intervenes with the professionals with a view to reaching an amicable settlement in accordance with article 58 of the law of 5 April 1993 on the financial sector as amended (please refer to point 2 below).

Furthermore, based on concrete files (*inter alia*, on reports to the State Prosecutor and observations following on-site inspections), the SG controls compliance with anti-money laundering rules (please refer to point 3 below) and rules of conduct.

2. CUSTOMER COMPLAINTS

The CSSF is an intermediary in conflict settlement between the professionals subject to its supervision and their customers. This mission is conferred on the CSSF by article 58 of the law of 5 April 1993 on the financial sector as amended, which provides that the CSSF "shall be competent to receive complaints from clients of the entities subject to its supervision and to intercede with these entities with a view to settling the disputes amicably". In drawing up this law, the legislator had taken into account a recommendation of the European Commission which advocated that extra-judicial conflict settlement means should be set up. It considered that customers of the professionals of the financial sector had the right to bring their dispute before a public authority. In order to put holders of units in UCIs on equal footing with the customers of the professionals subject to the law of 5 April 1993 as amended, an identical provision was introduced into the law of 20 December 2002 relating to undertakings for collective investment. Article 97(3) thus provides that "the CSSF is competent to receive complaints from holders of units in UCIs and to mediate with such UCIs in order to resolve such complaints amicably".

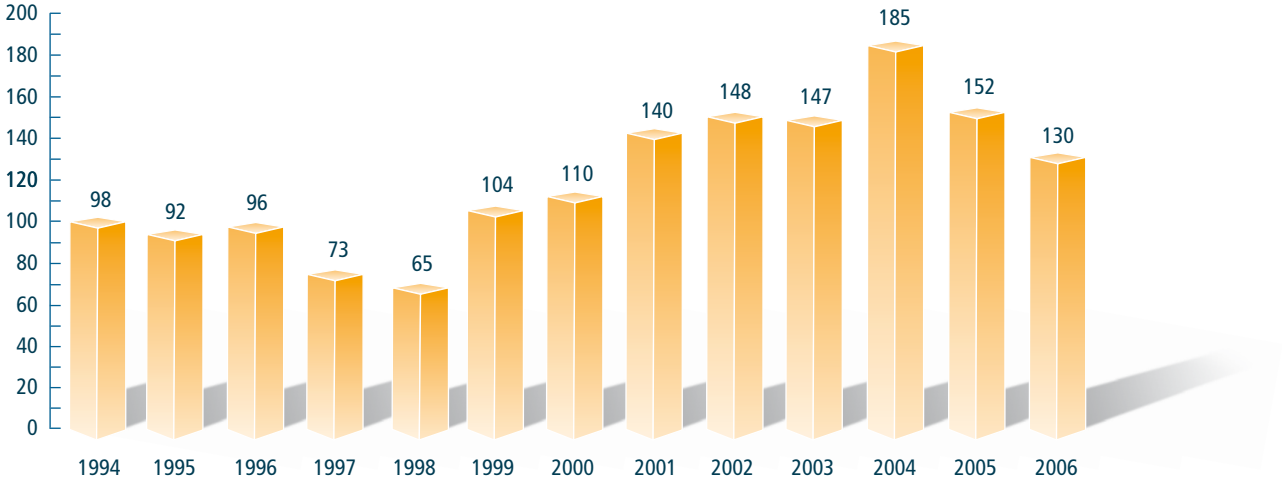
In order to avoid that the same people handling the complaints received also perform the daily supervision of the professionals concerned, the CSSF entrusted the General Secretariat with this task in accordance with the principle of task segregation.

2.1. General data

In 2006, the downward trend in the number of complaints received as compared to the previous year was confirmed: it fell from 152 in 2005 to 130 in 2006.

Certainly, this decrease can be explained by quite calm financial markets, but it is probably also due to the fact that the competent departments in the financial institutions solve more cases on an internal basis. Indeed, for a complaint to be handled efficiently by the CSSF, the complainant should have addressed the competent department of the financial institution without having obtained satisfaction within a reasonable timeframe beforehand. The files handled by the General Secretariat are therefore more complex, as the simpler cases are directly solved by the institutions concerned.

Development in the number of complaints



It is important to note in this context that apart from the complaints that are submitted to the General Secretariat in a formal manner, the latter also receives a large number of phone calls from customers who, on the one hand, are not always informed about the CSSF's procedure or who, on the other hand, wish to obtain the CSSF's opinion on a specific issue with a professional.

Many phone enquiries thus concerned the regulations in force, the conformity of the fees applied or the consequences of the enhancement of certain anti-money laundering and terrorist financing measures (control of accounts, ID, etc.).

Among the 130 complaints received in 2006, 122 were lodged by natural and eight by legal persons. Four complainants contacted the CSSF through a lawyer. 116 complaints concerned credit institutions, eight concerned PFS and six UCIs.

Taking into account the 48 files from 2005 in addition to the 130 complaints received in 2006, a total of 178 files have been dealt with in 2006.

Among the 178 files handled in 2006, 131 have been closed, with the following outcome or reason for closing:

Files closed in 2006		**131**
Unjustified complaints[1]	64	
Amicable settlement[2]	20	
Amicable settlement following the CSSF's opinion	20	
Contradictory positions	5	
Withdrawal by client[3]	19	
Non-article 58	3	
Open files carried forward into 2007[4]		**47**
Total files handled in 2006		**178**

It must be noted that the disputes concerning compliance with the legislation relating to protection of data privacy, requests of ID copies and ID controls for counter transactions (e.g. cashing of cheques) are not dealt with under article 58, as these concern existing measures, notably anti-money laundering measures, that have been enhanced, and which are now applied in a more stringent and systematic manner.

In 64 of the 131 files closed in 2006, the CSSF did not conclude to misconduct of the professional. In 20 files, the CSSF considered that the reproaches evoked by the customers with respect to the professionals were justified and sent a reasoned opinion to the latter. In 20 other cases, the CSSF did not have to decide, as the professional spontaneously submitted a proposal for an amicable settlement to the customer. In five cases, the CSSF concluded that the positions of the opposing parties were contradictory so that it could not decide in favour of any party. As a conclusion, it can be said that the CSSF's intervention contributes to working out an acceptable solution for the parties concerned. Even if its positions are not binding on the professionals, the CSSF's advices are however largely followed. In the few cases where the professionals refuse to follow the CSSF's advice, the CSSF terminates its intervention, as its means of intervention under article 58 are exhausted.

It is useful to specify that the CSSF does not answer questions concerning the quality or the performance of a professional, its solvency or soundness, and does not pass judgement on the quality of the products offered. Its mission is limited to complaints between customers and professionals, and aims to seek concrete solutions.

[1] Unjustified complaints are those for which the CSSF did not conclude to misconduct of the professional.

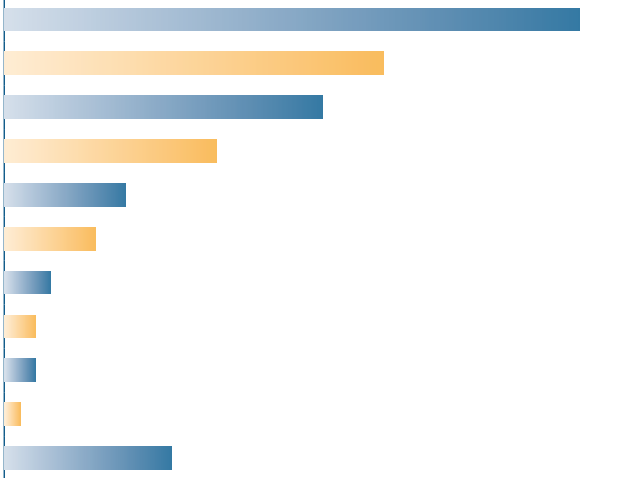
[2] Proposal for an amicable settlement made spontaneously by the professional, before any reasoned opinion issued by the CSSF.

[3] This category not only encompasses the complaints on which the complainant does not follow up, but also those where the client decides to refer the matter directly to the courts, thus putting an end to the CSSF's intervention.

[4] 22 out of the 47 files carried forward into 2007 have been settled by 1 March 2007.

Breakdown of the complaints closed in 2006 according to the complaints' countries of residence

Country	Number
Luxembourg	38
Belgium	25
Germany	21
France	14
Spain	8
United Kingdom	6
Italy	3
Sweden	2
Netherlands	2
Denmark	1
Others (non EU)[5]	11
Total	**131**



The entire customer complaint handling process is in writing. The CSSF receives complaints from resident as well as from non resident customers. In 2006, for the first time it were customers residing in Luxembourg that accounted for most of the complaints. Correlatively, the number of complaints coming from Belgium, Germany and France are falling.

The fact that 71% of the complaints were submitted by non-resident customers shows that many foreign customers are aware of the CSSF's existence and its mission in the field of handling their complaints against financial institutions. Endeavours at national and European level to inform customers thus start to bear fruit.

In 2006, the majority of complaints concerned asset management. As regards advisory management agreements, most grievances addressed against professionals related to insufficient or even lack of information on the risks inherent in the investments made, non-execution or faulty execution of orders or deadlines. In the context of discretionary management, the complainants mostly reproach the institutions with non-professional management, non-respect of the investment profile defined at the beginning of the business relationship, as well as with the absence of a mandate.

The complaints about fees and commissions levied by the professionals make up an important number of complaints across all categories as well. It should be noted in this context, however, that the CSSF only intervenes in price matters if the professional violates the prices communicated to the clients or a legal provision. Indeed, fixing the fees and commissions is part of the professional's commercial policy and is thus solely the professional's competence and responsibility.

[5] Switzerland, United States, Brazil, China, Thailand, Moldavia.

Breakdown of complaints closed in 2006 according to their object

	Number	
Transferable securities		**75**
Discretionary management	12	
Advisory management	27	
Various securities transactions	30	
UCIs	6	
Banking accounts and investments		**20**
Savings account	7	
Current account	13	
Various banking transactions		**16**
Inheritance	7	
Account blocking	4	
Identification	2	
Value date	1	
Counter transactions	2	
Payments		**12**
Transfers	10	
Cheques	2	
Credits		**8**
Mortgage loans	2	
Others	6	
Total		**131**

2.1. Analysis of the complaints handled in 2006

2.2.1. Cross-border transactions

Charges for cross-border transfers, which had given rise to many discussions in the past, did not really bring about any complaints anymore since the coming into force of the European regulations, which imposed that charges for cross-border payments in euros (within the European Union) below EUR 50,000 must be in line with charges for national payments.

Problems may arise where the payer transmits payment orders that do not meet the requirements to benefit from the provisions of the European regulation. Non-compliant payments can sometimes generate high costs.

2.2.2. Transfers

The CSSF dealt with several complaints regarding poor execution of transfer orders by the professional. In one case, the indications mentioned on the transfer order were contradictory, as the payee's account number did not correspond to the payee's name. As the payee mentioned on the transfer order was a legal person, the bank contacted its representative in order to clarify the problem. The executive concerned then instructed the bank to credit his personal account with the amount. The bank followed this instruction promptly. The payer blamed the bank for having disregarded its obligation to verify the transfer order, as the payment had not been made to the correct person. The CSSF concluded that the bank was responsible as it had not employed the due diligence with respect to a transfer order that showed an obvious contradiction between the payee's

name and the account to be credited. The CSSF considered that in cases of contradiction between the payee's name and the account number stated in the transfer order, the banks is obliged to contact the payer in order to obtain details.

2.2.3. Sell orders

It must be stressed that it is important that banks contact the customers when in doubt about or when they do not understand an instruction. Customers, for their part, must express their orders clearly, precisely and unequivocally.

The CSSF thus dealt with a case where the customer blamed the professional for having ignored part of his sell orders transmitted by fax. Considering that the terms of the faxed sell order were rather equivocal, the bank concluded that this fax could not be a sell order. Indeed, the customer had not used the term "sell" but the term "keep", indicating for every security quantities that did not match the number of securities held in the portfolio. According to the customer, the bank should have sold the securities constituting the difference between the securities held in his portfolio and the securities stated with "keep". It turned out that the customer's usual contact person was absent, so that the customer's instructions were handled by another bank employee who was not used to dealing with this customer. The CSSF reproached the bank for its inaction in the face of an equivocal document. The bank proposed an arrangement to the customer.

In another case, the bank had received by fax a sell order for a certain number of securities each with a limit, except for one security that was followed by the word "without". The customer then considered that the bank should have requested additional information about this order as he affirmed that he never intended to sell this security "at best". Nevertheless, the CSSF concluded that the order concerned was sufficiently clear and that the bank showed common sense by interpreting that this security should be sold without any particular limit, i.e. "at best".

In another case submitted to the CSSF, the complainant had given a written instruction to the bank to sell his entire portfolio shortly after having asked the bank to diversify his investments. The bank had immediately tried to contact the complainant in order to have this intention confirmed. However, it was only ten days later that the bank was able to obtain confirmation of this sell order and to execute it. As the value of the securities had dropped in the meantime, the complainant considered that he had suffered a loss and claimed compensation. The CSSF considered the fact of having sought confirmation from the complainant of his written instruction instead of only verifying the signature on the order as falling within the usual diligence of the bank and therefore not as misconduct.

2.2.4. Fees and commissions

A customer complained that after having given the instruction to close his account, sell his shares in an investment fund and transfer the profit made to an account with another bank, he had been charged for the repurchase of securities and the resulting transfer of the funds. The complainant considered that he did not have to bear these fees as he had subscribed to a package including commissions on repurchase and subscription transactions. The bank noted that the repurchase operations had been initiated after the termination of the package and that the customer could consequently not benefit from these operations for free. The CSSF deemed this complaint unjustified.

In one case, the charging of fees for the sale of shares in a SICAV was disputed as it was supposedly agreed verbally that this transaction would be executed free of charge. In this specific file, the explanations and reports of the parties on the potential existence of a verbal promise of free sale transaction were contradictory, so that the CSSF was not able to verify them. The CSSF's role was thus limited to observe that the fees were in line with the tariffs in force. It should be stressed in this

context how important it is to lay down in writing any special conditions that have been granted and that differ from the usual tariffs. The CSSF also notices regularly that certain customers do not pay attention to the current price lists issued by the professionals. Moreover, the CSSF recommends that the professionals, notably those that provide discretionary management, inform their customers on the applicable fees and commissions, in order to avoid any subsequent problem.

One of the problems that can arise in such context is that of retrocession of fees, as shown in the following case. The complainant had opened a deposit account within a Luxembourg bank managed by a German independent manager with whom he had signed a portfolio management agreement. After having sustained losses, the customer terminated the agreement. The customer then learned that the German asset manager had been granted retrocessions by the bank for the transactions performed for his account (the account of the complainant), regardless of whether the transactions had generated profits or not. The customer complained that he had not been informed of these retrocessions. The CSSF had to take a stance on the application, in such a situation, of circular CSSF 2000/15 on the rules of conduct in the financial sector. Indeed, the person subject to this information requirement in the first place was the German asset manager, not subject to the circular concerned. The CSSF did not conclude to misconduct by the bank in this case, owing mainly to the fact that the bank, in its capacity as depositary bank, did not play an active role with respect to the customer. The obligation to inform the customer on the professional's mode of remuneration was thus the task of the German portfolio manager in the first place. Nevertheless, the CSSF insistently reminded the bank that it is important in such circumstance that the customer be made aware of the retrocessions granted by a bank to the portfolio manager.

2.2.5. Hold-mail agreement

One of the complaints submitted to the CSSF dealt with securities that had been transferred on a wrong account. The customer noticed this error only four years later when he wished to sell these securities. The customer argued that he had a hold-mail agreement with the bank. This argument can hardly be sustained as the customer, according to such an agreement, is supposed to have received the mail held at the bank. Despite the late submission of his complaint, the bank proposed to the customer to refund the value of the securities at the date of their transfer, in order to settle the dispute.

It should be noted that there is no term of limitation to submit complaints to the CSSF. Customers should, however, address their complaints to the professional within reasonable timeframes, allowing the latter to track back and analyse the facts reproached. Consequently, customers should not exceed the statutory limitations for record safekeeping imposed on the professionals.

2.2.6. Power to sign

The CSSF dealt with a case where a customer, i.e. a co-ownership, blamed its bank for having authorised the property management firm to withdraw several amounts in cash from the co-ownership's account. The bank concerned claimed that it had a power of attorney in due form, submitted by the property management firm, giving notably power of attorney to the sole managing agent to perform all banking operations with his sole signature on the account held by the co-ownership. The CSSF considered in this case that it was not for the bank to question the way the property management firm executed the transactions (wire transfers or cash withdrawals), as it was for the management committee of the co-ownership to ensure the proper execution of its decisions by the property management firm.

In a similar case, the CSSF came to the same conclusion, namely that it is not for the bank to judge the appropriateness of the instructions given by the property management firm, as the

management committee of the co-ownership is responsible for supervising the management of the co-ownership's accounts. The bank is only required to ensure compliance with the power to dispose of the account.

2.2.7. Internet banking

The number of complaints received with respect to Internet banking remained marginal. In general, it is not the functioning of the system that is concerned. The problems encountered are most often related to handling errors that entailed that the results obtained were not the results expected or are due to poor understanding of the general terms and conditions that apply in this area. Although Internet banking could prove less costly for customers that intend to execute stock exchange operations, it requires customers to have minimum technical as well as financial knowledge.

2.2.8. Mortgage loans

The CSSF received a certain number of questions, as well as a few complaints concerning arrangement fees and prepayment of loans. Customers are sometimes surprised by the rating of applications for loans, or even by the fact that scrutiny of an official loan application is not free of charge. Prepayment of mortgage loans sometimes results in a dispute between the customer and the bank, owing to the importance of the amount claimed by the bank by way of compensation for prepayment.

2.2.9. Payment cards

Frauds committed by means of stolen debit or credit cards give rise to various complaints. The law of 14 August 2000 relating to electronic commerce brings about interpretation difficulties due to lack of established jurisprudence in this matter. Article 68(3) of this law specifies that the owner accepts the consequences of the loss, theft or fraudulent use by a third party, up to an amount not exceeding EUR 150, until notification of the loss or theft of an electronic payment instrument or the means allowing the use thereof, except where the owner is guilty of fraud or gross negligence.

In one case, the bank invoked gross negligence of its customer as the latter had left his credit card in the car that had been burgled. It turned out later that the customer had preferred leaving his card in the car equipped with an alarm system and parked in a supervised parking instead of taking it and risking aggression. To assess whether it was gross negligence, the CSSF considered that the actual circumstances should be taken into account and thus asked the bank to reconsider its position and to seek, where applicable, to find an agreement with the customer. The bank did not change its position.

2.3. FIN-NET network, the cross-border out-of-court complaints network for financial services

The Fin-net network, which was set up by the European Commission in 2001, gathers all bodies responsible for the out-of-court settlement of cross-border disputes between consumers and financial services providers of the European Economic Area. The CSSF and the Commissariat aux Assurances are members representing Luxembourg. The members of the Fin-net network met twice in 2006 at the premises of the European Commission in Brussels. The meetings notably dealt with sharing experience in the area of network operation and with recent developments in the field of extra-judicial dispute settlement, as well as in more general fields of financial services at the level of the European Union.

3. REPORTS RELATED TO THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

Ensuring the integrity of the financial sector and its players is one of the chief objectives of the preventive anti-money laundering and terrorist-financing provisions. This prevention is necessary so that various financial activities and operations of the professionals in the Luxembourg financial centre can be performed in a favourable environment.

The professionals of the financial sector contribute actively to the fight against illegal activities, notably by referring any suspicion of money laundering and terrorist financing to the competent authorities. Article 5(1) of the law of 12 November 2004 on the fight against money laundering and terrorist financing expressly provides for this professional obligation within the context of co-operation with the authorities competent for the fight against money laundering and terrorist financing. According to circular CSSF 05/211, the professionals of the financial sector are, in case of notification to the State Prosecutor under article 5(1) of the law, required to transmit a copy of the file concerned to the CSSF as well.

In 2006, a meeting was held with representatives of the Luxembourg Financial Intelligence Unit (FIU) of the Luxembourg State Prosecutor's Office. The purpose of this formal get-together was to share opinions on several interpretation issues as regards the fight against money laundering and terrorist financing.

Moreover, in order to simplify the administrative process and to avoid doubling circulars, it has been agreed that only the CSSF would issue circulars on combating terrorism that fall under the scope of circular CSSF 05/211 and financial embargoes based on EU texts.

As regards the reports transmitted to the CSSF by the professionals, the CSSF noted that almost a quarter of the spontaneous reports originated in the information according to which the customer could be associated with a criminal affair. The professionals often relied on sources of information including press articles, Internet searches (notably by using automatic controls of lists of suspect persons), and information provided by an entity of the group to which the professional belongs, other financial intermediaries or foreign authorities.

The facts are not always obvious and the professional ought to be guided by its professional experience, taking into account the data relating to the customer and his behaviour. It is therefore required to have proper knowledge of the customer, not only as regards data collection when establishing the business relationship, but also with respect to monitoring the risk (represented by the customer).

More than a third of the spontaneous reports were submitted by the professionals because they had received insufficient explanations from the customer on the origin of the funds, on cash payments/withdrawals, on the structure contemplated or simply because of a lack of supporting evidence.

With respect to customer identification measures, Directive 2005/60/EC that expressly provides for a risk-based approach must be mentioned. This approach, which has already been set down in the law of 12 November 2004 and circular CSSF 05/211, allows further flexibility and possible adaptation for the professionals in performing their activities. The consequence of this flexibility is however a greater responsibility of the professional in assessing the knowledge it must have of the customer and its activities.

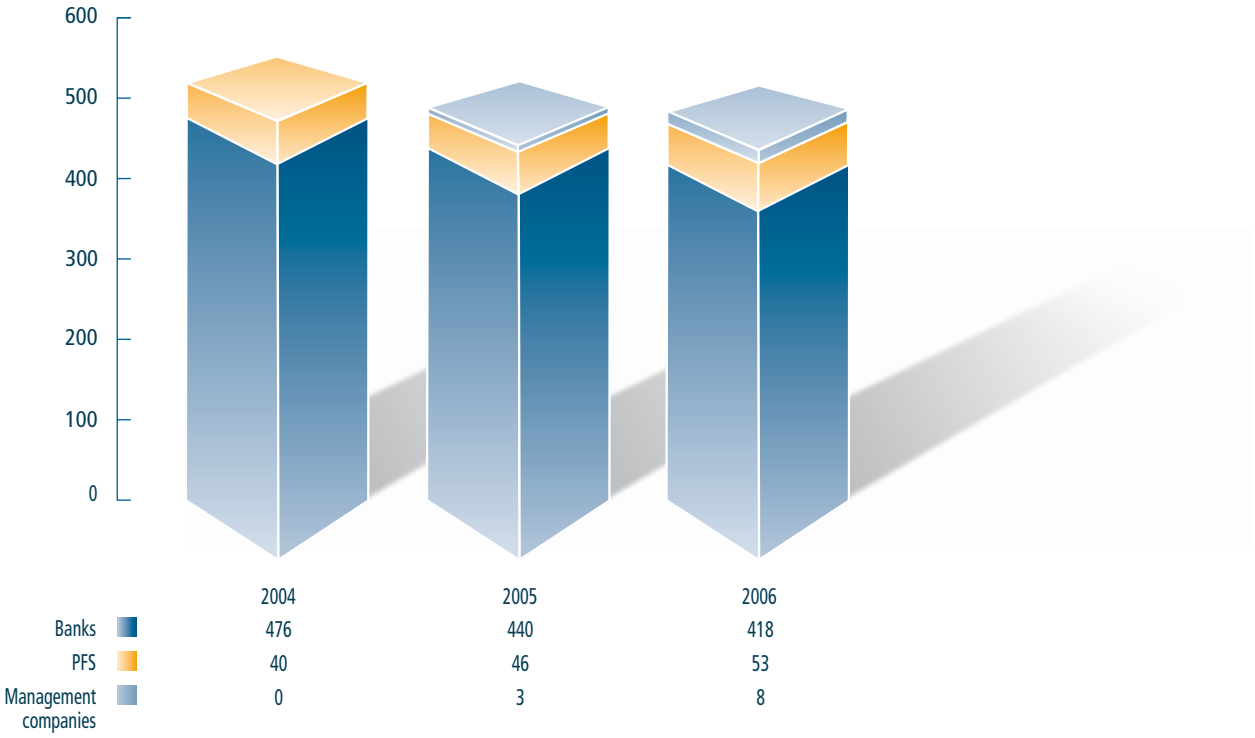
Detailed records regarding customer knowledge allow to reduce the legal risks to which the professional can be exposed in general during its relationship with the customer, even beyond the fight against money laundering and terrorist financing.

A suspicious transaction report must be envisaged where the professional is faced with a persistent and ongoing refusal by the customer to provide the information the professional deems necessary for a proper understanding of the customer's transactions and to lift any doubts concerning their legality. However, reports of suspicions in response to a first-time refusal of co-operation by the customer should be avoided.

In order to reduce the risk of being liable and having its reputation challenged, the professional must observe its internal procedures in a consistent manner, not only as regards identification, but also the control and monitoring of the customer. The professional will thereby be able to prove its good faith and will to co-operate, if blamed for not having observed its professional obligations in this field.

The following statistics reflect the development in reports with respect to combating money laundering and terrorist financing received by the CSSF.

Reports received by the CSSF



The total number of reports transmitted to the CSSF by entities under its supervision reached 479 for the year 2006 (against 489 in 2005 and 516 in 2004).

As regards PFS and management companies, it can be noted that not only the volume of reports increased in 2006, but also the number of PFS (22) and management companies (7) that have submitted these reports. At the same time, it should be noted that the overall number of professionals of both categories registered on the official lists has also increased during 2006 (196 PFS and 149 management companies as at 31 December 2006).

This is not the case for banks, whose number of reports continued to decrease, at the same time as the number of banks registered on the official list as at 31 December 2006 (156 banks). On the other hand, it must be stressed that the number of banks having made a report in 2006 increased by several entities to 73 banks against 67 banks in 2005.

It is also interesting to note that the reports made in 2006 by professionals having made at least ten

reports (i.e. nine banks and one PFS) make up about 54% of the total number of reports in 2006.

According to the information available to the CSSF, 359 reports of a total of 479 reports it received were reports made spontaneously by the professionals based on article 5(1)(a) of the law of 12 November 2004.

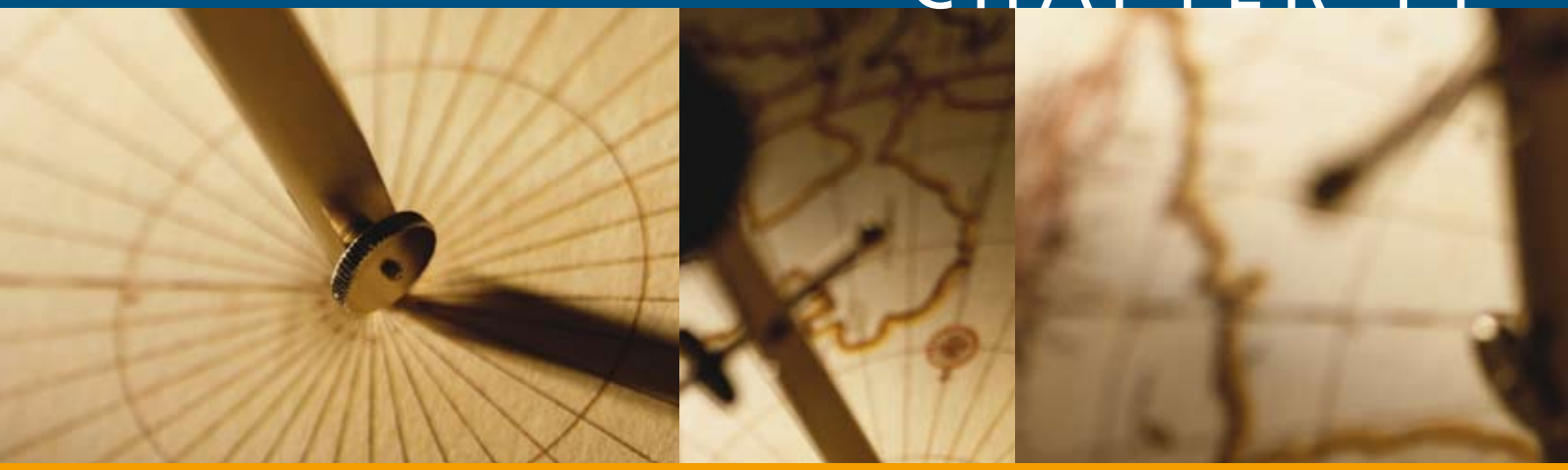
As far as these reports are concerned, it can be stressed that 84 concern persons that requested to enter into a business relationship with the professional, but to whom the professional did not respond favourably owing to suspicions of money laundering or terrorist financing.

Moreover, the number of reports that have not been submitted spontaneously, but following a request for information from the authorities competent for the fight against money laundering and terrorist financing, notably the Luxembourg Financial Intelligence Unit (FIU) of the Luxembourg State Prosecutor's Office or the judicial police, amounted to 80. Although the number of such reports has grown compared to the previous years, it must be stressed that it also includes the reports made on the basis of a FIU circular. It should be specified that the objectives of these circulars may be national as well as international inquiries and that a single enquiry can concern several different customers or a customer can hold accounts with a certain number of banks. Indeed, in several cases, the professionals' initial report revealed that the customers concerned held accounts with other banks, thereby allowing the FIU to make more punctual inquiries.

On the basis of the execution of a measure of inquiry such as a search and/or a seizure ordered by the examining magistrate within the scope of a national inquiry, or of judicial co-operation (international letters rogatory), 33 reports have been submitted to the CSSF in 2006.

Seven reports made by professionals based on a circular issued by the CSSF as regards the combat against terrorism or concerning restrictive measures taken by the European Union against certain persons or entities must be added to this figure.

CHAPTER 11



11

GENERAL SUPERVISION AND CSSF INVOLVEMENT IN INTERNATIONAL GROUPS

1. General Supervision

2. Co-operation within European institutions

3. Multilateral co-operation

1. GENERAL SUPERVISION

The transversal function "General Supervision" (SGE) deals, on a horizontal basis, with prudential supervisory, accounting and reporting issues common to the CSSF's departments.

The objective of this "think tank", which proposes approaches, instruments for analysis and assessment, is thus to develop competence fields that require specific knowledge and experience, to provide methodological support for the day-to-day performance of prudential supervision, to transmit and communicate the knowledge acquired at internal training sessions and to join in on-site inspections that deal with more complex subjects, such as the validation of risk management models.

1.1. Activities in 2006

In 2006, the SGE, which currently comprises twenty-four agents, issued 320 letters related to statements of position regarding prudential and accounting supervision. Moreover, the agents working in this function have attended thirty meetings that were held in Luxembourg with representatives of the banking industry and international bodies.

SGE agents have taken part in 203 meetings of international groups in 2006, in addition to eight multilateral meetings with foreign supervisory authorities which were either periodic bilateral meetings, or meetings held within the framework of the works relating to the implementation of the new provisions on capital adequacy (Basel II) in certain cross-border banking groups with subsidiaries in Luxembourg. In this context, it should be stressed that the SGE function has also carried out 80 on-site controls and inspections either at the premises of credit institutions of the financial centre, or abroad at the premises of the parent companies of Luxembourg subsidiaries, in order to ensure the implementation of the new provisions on capital adequacy (circular CSSF 06/273) within Luxembourg banks.

A major part of the SGE's resources have been committed in 2006 to drawing up circulars CSSF 06/251, 06/260, 06/273 and 07/279 (cf. point 1.2. below).

1.2. Implementation of the new capital adequacy framework

1.2.1. Circular CSSF 06/251: Description of the new prudential reporting scheme regarding capital adequacy applicable as from 2008 and transitional provisions for 2007

On 13 July 2006, the CSSF released a circular that describes the new prudential capital adequacy reporting scheme (new tables B 1.4 and B 6.4) applicable as from 1 January 2008, as well as the transitional provisions for 2007.

Indeed, following the adoption of the new European capital adequacy framework (Directives 2006/48/EC and 2006/49/EC, commonly referred to as Capital Requirements Directive or CRD), which was transposed into Luxembourg law through circular CSSF 06/273, and the introduction of European regulations on international accounting standards IAS/IFRS, the CSSF decided to implement the new prudential reporting framework as from 1 January 2008, the date of the compulsory implementation of CRD.

The purpose of the circular is to provide in its annexe a detailed description of the new prudential reporting scheme on capital adequacy that will replace tables B 1.4 and B 6.4. The new tables B 1.4 and B 6.4 are based on the European scheme COREP (*CO*mmon *REP*orting) of CEBS. The annexe to the circular comprises the following elements:

I. Main annexe

The main annexe describes the new capital adequacy reporting scheme applicable as from 2008, the transitional provisions for 2007 and specifies the transmission format and frequency.

II. Technical annexes

The tables relating to the new reporting scheme on capital adequacy are included in the technical annexes in English. A list of references to the relevant CRD provisions is given for every table. In so far as own funds items refer to accounting items, the relating table also refers to the European FINREP scheme (*FI*nancial *REP*orting) of CEBS and to circular CSSF 05/228.

III. Summary of reporting tables to provide to the CSSF

This part indicates all the reporting tables concerning capital adequacy that banks must submit to the CSSF as from 2008 and during the transition period according to the regime they apply.

From 1 January 2008 onwards, the new reporting scheme shall be submitted to the CSSF in the transmission format XBRL (eXtensible Business Reporting Language). Reporting on an individual level shall be submitted quarterly, reporting on a consolidated level half-yearly.

1.2.2. Circular CSSF 06/260: Implementation, validation and assessment of the internal ratings-based approach (IRB approach) and the advanced measurement approaches (AMA) within the framework of the new capital adequacy rules

The primary aim of the circular, published on 27 September 2006, is to explain the implementation, validation and assessment of the internal ratings-based approach (IRB approach) to determine the minimum capital requirements for credit risk as described in articles 84 to 89 of Directive 2006/48/EC, as well as of the advanced measurement approach (AMA) to determine the minimum capital requirements for operational risk as described in article 105 of Directive 2006/48/EC.

In this context, the circular refers to Guidelines 10 (GL10) released by CEBS on 4 April 2006. This document does not only reflect an agreement between the competent European supervisors on the procedures as regards processing, assessment and decision-making regarding application files for the use of the internal ratings-based approach or the advanced measurement approach (AMA), but is also a common denominator as regards the interpretation and implementation of the minimum requirements described in Directive 2006/48/EC.

The second objective of the circular is to describe in concrete terms the authorisation procedure for the above approaches. Indeed, the application for permission referred to in article 129(2) of Directive 2006/48/EC must be submitted only once, namely to the authority competent for the consolidated supervision of the institutions within the European Union that wish to use the IRB or AMA approaches. The circular also specifies in which cases the CSSF is the competent authority and where the requirements of the second and third annexes to the circular shall therefore be met; these annexes lay down the minimum content of the application file to submit to the CSSF under the IRB approach and the AMA approach.

1.2.3. Circular CSSF 06/273: Definition of capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended

This circular, released on 22 December 2006, is intended to replace circular CSSF 2000/10 and transposes the following European Directives into Luxembourg banking regulation:

- Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions;
- Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

Both Directives, also known as Capital Requirements Directive (CRD) are the equivalent in the European legislation of the new Basel Accord (Basel II).

The rules defined in the circular came into force on 1 January 2007. However, banks may continue to use the rules laid down in circular CSSF 2000/10 during the entire or part of the year 2007. As of 1 January 2008, the application of the new rules is mandatory. The most advanced approaches, namely the advanced internal ratings-based approach for credit risk and the advanced measurement approach for operational risk may be used only as of 1 January 2008.

As circular CSSF 2000/10, circular CSSF 06/273 defines a capital ratio, as well as rules relating to large exposures limits. Comparing the main provisions of both circulars reveals the following:

- Part III of circular CSSF 06/273 deals with the trading book and in particular with the elements that credit institutions may include in the trading book. Credit institutions shall set up appropriate policies and procedures that govern this inclusion or trading intent. These rules are more detailed as those of circular CSSF 2000/10 as regards the valuation of the positions included in the trading book. They notably ensure that the valuation of these positions is prudent and reliable.

- The definition of prudential own funds has changed only slightly compared to the definition given in circular CSSF 2000/10. These changes were necessary owing to the integration into Part IV of circular CSSF 06/273 of circular CSSF 05/228 which relates to prudential filters for accounting capital to determine prudential own funds, following the introduction of the IAS accounting standards.

  In this context, it should be noted that the denominator of the simplified/integrated ratio changes compared with the current rules in that a requirement for operational risk is added. The possibility to calculate a simplified ratio remains, according to the same terms as in circular CSSF 2000/10.

- The provisions relating to the calculation of the requirement for non-trading book credit risk (Part VII) change fundamentally compared to circular CSSF 2000/10 in the sense that several approaches are proposed to take into account the different levels of complexity of the banks. There are three approaches with increasing levels of complexity:

  • standardised approach;
  • foundation internal ratings-based approach (foundation IRB approach);
  • advanced internal ratings-based approach (advanced IRB approach).

  The standardised approach for credit risk is a revised version of the method set out in circular CSSF 2000/10 in which risk weights are allocated to assets according to risk. These risk weights are based on external ratings to improve the risk differentiation without introducing undue complexity. As regards banking counterparties, the CSSF chose to make their risk weights dependent on the external rating of the State in which they are incorporated. Furthermore, there are favourable risk weights for retail customers (75%) and mortgages on residential property (35%).

Under the IRB approaches, credit institutions must be able to provide their own estimates of certain risk parameters relating to exposures to credit risk and dilution risk. In particular, in the foundation IRB approach, credit institutions may use their own estimates of PD (probability of default), while applying the regulatory values laid down for other risk parameters, namely loss given default and conversion factors for off-balance sheet items. Under the advanced IRB approach, they may also use their own estimates of loss given default and conversion factors. Transitional and ongoing partial uses of IRB approaches with the standardised approach are allowed under certain conditions.

- The circular introduces two new calculation methods to determine the exposure value of OTC derivative instruments and other transactions subject to counterparty credit risk.

- Recognition of credit risk mitigation techniques for the purpose of reducing the requirement (Part IX) has been considerably extended compared with circular CSSF 2000/10, not only as regards the range of eligible credit protection, but also with respect to the proposed approaches. A substitution approach similar to that set out in circular CSSF 2000/10 is applied with respect to the treatment of guarantees and credit derivatives. For the treatment of collateral, there is a simple method that also works according to the substitution principle and a general method that uses haircuts. Credit institutions that use the advanced IRB approach may also use a wider range of credit risk mitigation techniques insomuch as they are able to differentiate and quantify their impact.

- Part X of the circular introduces a harmonised set of capital requirements for securitisation activities that apply to the originators and sponsors of securitisation transactions (traditional and synthetic) as well as to investors in instruments such as Asset-Backed Securities (ABS) or Collateralized Debt Obligations (CDO). Similarly to Part VII (credit risk), the new framework on securitisation provides for a standardised and an IRB approach. In both cases, where a securitisation position is rated externally, this rating is used to determine the capital requirement. The new framework proposes alternative methods to calculate requirements for unrated positions, notably for exposures in the context of an Asset-Backed Commercial Paper (ABCP) programme, such as liquidity facilities.

- Part XI of the circular defines a position risk measurement system associated with items of the trading book, as well as a capital requirement for this risk. It differs from circular CSSF 2000/10 in that it introduces a specific treatment for investments in units/shares of UCIs. The capital requirement for positions in undertakings for collective investment that meet certain criteria may be determined by using particular methods (full look through, partial look through, etc.). Otherwise the requirement must be determined by applying the default treatment. The methods for calculating the capital requirement described in Part XI constitute the standardised approach. Credit institutions may use the internal ratings-based approach as described in Part XIV instead of this approach.

- As regards the measurement system for foreign exchange risk associated with overall banking business and the capital requirement for this risk, there is no major change compared to circular CSSF 2000/10. Banks may still use a standardised approach as described in Part XII or the internal model approach described in Part XIV.

- Part XIII of the circular defines a risk measurement system for commodity risk associated with overall banking business, as well as a capital requirement for this risk. Credit institutions may adopt one of the three methods to calculate the capital requirement set out in Part XIII, subject to compliance with the relating requirements.

- Part XIV defines the methods for calculating the capital requirements based on the banks' internal risk management models. Subject to the prior consent of the CSSF, banks may use this method instead of or in combination with the standardised approach in order to calculate capital requirements for foreign exchange risk, position risk (interest rate, equities, undertakings for collective investment) or commodity risk.

- Another major innovation compared to circular CSSF 2000/10 is the taking into account of operational risk. Operational risk means the risk of loss resulting from inadequate or failed processes, personnel, and internal systems or external events. It also includes legal risk. Minimum capital requirements for operational risk can be calculated according to several approaches. The three approaches with an increasing degree of complexity are the Basic Indicator Approach (BIA), The Standardised Approach (TSA) and the Advanced Measurement Approaches (AMA).

- The rules relating to large exposures do not change much compared to circular CSSF 2000/10, apart from the addition of provisions allowing a rather limited recognition of the methods used for credit risk mitigation.

- As from 1 January 2008, credit institutions must have in place an internal capital adequacy assessment process. This process should allow credit institutions to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are exposed. The process concerned will be reviewed on a regular basis under the supervisory review process. The term "supervisory review process" refers to the means employed by the CSSF to ensure compliance with the provisions of circular CSSF 06/273.

- Finally, Part XIX of the circular specifies the information that credit institutions must disclose on the approaches adopted to cover the different types of risk. Nevertheless, credit institutions approved in Luxembourg that are part of a group whose head established in the European Union is subject to these disclosure requirements, are not required to publish this information, unless the Luxembourg subsidiary is a significant subsidiary.

1.2.4. Circular CSSF 07/279 describing the new financial reporting scheme applicable from 1 January 2008

Circular CSSF 07/279 presents the new reporting scheme applicable from 1 January 2008, as previously announced in circular CSSF 05/227. The new financial reporting scheme is derived from the common European framework for financial reporting (*FIN*ancial *REP*orting, FINREP) designed by CEBS and revised on 15 December 2006.

This new reporting scheme is applicable to all Luxembourg credit institutions and to all branches established in Luxembourg, including EU branches. Furthermore, the reporting shall be made on an individual, and, where applicable, on a consolidated level.

2. CO-OPERATION WITHIN EUROPEAN INSTITUTIONS

Article 3 of the law of 23 December 1998 creating a Commission de Surveillance du Secteur Financier as amended appoints it, *inter alia*, to deal with and participate in the negotiations concerning problems relating to the financial sector, at both European Union and international level. In accordance therewith, the CSSF participates in the work of the following forums.

2.1. Committee of European Banking Supervisors (CEBS)

The Committee of European Banking Supervisors (CEBS) was established by Commission Decision 2004/5/EC of 5 November 2003. Its duties encompass reflecting, discussing and giving advice to the European Commission in the fields of banking regulation and supervision. The Committee also co-operates with the other competent committees in banking matters, notably with the European Banking Committee established by Commission Decision 2004/10/EC.

CEBS was chaired by Mr José-María Roldan (Banco de España, Spain) until January 2006. In February 2006, this function was taken over by Mrs Danièle Nouy (Commission Bancaire, France) who was vice-chairman until that date. Vice-Chairman is now Mr Helmut Bauer (Bundesanstalt für

Finanzdienstleistungsaufsicht, Germany). Mr Andrea Enria (Banca d'Italia, Italy) is General Secretary. The Chair is supported by a "Bureau" comprising Mr Andreas Ittner (Österreichische Nationalbank, Austria), Mrs Kerstin af Jochnick (Finansinspektionen, Sweden) and Mr Andrzej Reich (National Bank of Poland, Poland). Following the expiry of the mandates of Mr Ittner and Mrs af Jochnick on 7 January 2007, CEBS has appointed Mr Rudi Bonte (Commission bancaire, financière et des assurances, Belgium) and Mr Jukka Vesala (Financial Supervision Authority, Finland) as new Bureau members. The Committee's Secretariat is based in London.

CEBS will fulfil the Level 3 functions for the banking sector under the Lamfalussy procedure, its missions being the following:

- advise the European Commission either at the Commission's request, within the time limit that the Commission may lay down according to the urgency of the matter, or on the Committee's own initiative, in particular as regards the preparation of draft implementing measures in the field of banking activities;
- contribute to the consistent application of European Directives and to the convergence of Member States' supervisory practices throughout the European Community;
- enhance supervisory co-operation, including sharing of information.

In 2006, CEBS continued its works relating to Directives 2006/48/EC and 2006/49/EC on capital adequacy which transpose the New Basel Accord into Community law.

It has notably released a recasting document relating to the common reporting framework to be used by credit institutions and investment firms when they report their solvency ratio for the purposes of the supervision of own funds (known as COREP). In addition, CEBS published a document relating to the standardised financial reporting framework based on IAS standards for credit institutions and investment firms operating within the European Union (known as FINREP).

Guidelines on outsourcing of credit institutions' business activities were published on 14 December 2006.

Moreover, CEBS has set up a working group relating to the principle of proportionality, jointly with the three banking associations European Association of Co-operative Banks, European Banking Federation and European Savings Banks Group. This working group gathers the representatives of the supervisory authorities and of the industry in order to exchange views on an informal basis on the application of the principle of proportionality laid down in Directives 2006/48/EC and 2006/49/EC.

Furthermore, following calls for advice from the European Commission, CEBS published a set of surveys and advice:

- following the call for technical advice issued by the European Commission on 1 December 2005, CEBS published a survey on supervisory practices regarding large exposures on 3 May 2006 and a report on industry practices on the management and recognition of large exposures on 31 August 2006. This report provides information on the industry's perception of large exposures. On 4 January 2007, the European Commission issued a second call for technical advice relating to large exposures;
- on 23 June 2006, CEBS published a survey on the implementation of the current rules on own funds and on current trends in new capital instruments. This survey follows a call for technical advice of the European Commission;
- on 29 September 2006, CEBS, together with CESR (Committee of European Securities Regulators) and CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors), sent a joint technical letter to the European Commission concerning the proposal of the European Directive to improve the approval process of supervisory authorities in the event of cross-border mergers and controls;

- a survey on supervisory practices with respect to commodities business and companies carrying out commodities business was published on 9 January 2007 and followed a call for technical advice from the European Commission of 22 August 2006;
- on 3 January 2007, together with the two other Level 3 committees (CESR and CEIOPS), CEBS sent a report to the European Commission comparing the capital instruments that are eligible for prudential purposes in the application of the European rules in the three relating sectors (banks, insurance and investment firms).

Joint Protocol between CEBS, CEIOPS and CESR

On 24 November 2005, CEBS, CESR (Committee of European Securities Regulators) and CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) signed a joint protocol to foster co-operation and coordination in the areas of regulation, information exchange and other tasks in which the three committees take a common interest. The main elements of the joint protocol have been developed in more detail in the CSSF's Annual Report 2005 (Chapter XI, point 2.1.1.).

Co-operation between CESR, CEBS and CEIOPS has become increasingly important with the sectoral market integration and cross-sector business activities within the European Union. The members of the three committees emphasise the importance of the consistency of the work done in the three sectors at Level 3 of the Lamfalussy procedure.

On 6 February 2006, the three Level 3 committees (3 Level 3, 3L3) have published their working programme focusing in particular on financial conglomerates, outsourcing of operational tasks, internal governance and reporting requirements.

The 3L3 exchange views in order to develop a consistent approach with respect to capital requirements developed under Solvency II and Basel II.

2.1.1. CEBS – *Groupe de contact*

Created in 1972, the *Groupe de Contact* was used from the outset as forum for informal co-operation between banking supervisory authorities on EU level. Following the enlargement of the European Union, it now also comprises the representatives of the authorities of the new Member States. Mr Helmut Bauer of the Bundesanstalt für Finanzdienstleistungsaufsicht (Germany) has been chairing the *Groupe* since the end of 2006.

Within the new European structure of banking supervision, the *Groupe* henceforth acts as general working group of the Committee of European Banking Supervisors. In that capacity, it assists CEBS with a view to achieve convergence of the prudential supervisory practices in the European Union. The *Groupe* also continues to be a body appreciated for informal co-operation concerning the situation of individual credit institutions, particularly in the event of problems. It follows the development of national regulations, discusses practical aspects of prudential supervision of credit institutions and conducts general comparative studies.

In 2006, the *Groupe* has welcomed two new members within the context of EU enlargement process, namely the supervisory authorities of Bulgaria and Rumania.

The *Groupe* continued to focus on the implementation of the supervisory review process, Pillar II of the new capital adequacy framework which is being adopted at Community level.

In this area, the continuation of the works on the different categories of risk set forth under Pillar II, as well as the establishment of guidelines as regards stress testing need to be mentioned. Indeed, the documents dealing with concentration risk under Pillar II and guidelines concerning stress testing were published by CEBS in December 2006. Furthermore, a document setting forth guidelines on

interest rate management in the banking portfolio was published in October 2006 following the works of the *Groupe de contact*.

As regards outsourcing of credit institutions' business activities, the *Groupe* has finally submitted a document to CEBS detailing the best practices in this field, following a public consultation that was closed in July 2004. CEBS released this document in December 2006. Consistency of these principles with the requirements regarding outsourcing laid down in Directive 2006/73/EC on the implementing measures of the MiFID Directive was guaranteed as far as possible.

Another important part of the *Groupe's* responsibilities concerns the exchange of information on particular problems encountered by one or several authorities and topical issues. This exchange of information between members, as well as between the *Groupe* and CEBS, continued during 2006.

- ***CEBS - Groupe de contact - Internal Governance Task Force***

The mandate of the task force is twofold. The main purpose is to integrate into a comprehensive document the parts dealing with internal governance of credit institutions, based on different recommendations approved by CEBS (among others the recommendations relating to the validation of models and the supervisory review process within the scope of the implementation of Basel II and the standards regarding outsourcing). Other sources are the recommendations of other international bodies and institutions such as the document "Enhancing Corporate Governance for Banking Organisations" published by the Basel Committee and the document "High-level Principles for Business Continuity" approved by the Joint Forum.

Secondly, the group's works concentrated, in the context of 3L3 co-operation, on drawing-up an analytical report concerning the requirements laid down by the banking supervisory authorities, the securities sector and the insurance sector. The purpose of the report is to identify the differences in treatment and to deepen the work on this subject to achieve convergence between the different business sectors as regards internal governance.

2.1.2. CEBS - Expert Group on Capital Requirements (EGCR)

EGCR's tasks consist in assisting CEBS in all areas relating to capital requirements, including notably:

- drawing-up advice relating to new initiatives of the European Commission in this area;
- continuing to strive for convergence in the implementation and application of the new European capital adequacy framework;
- following the development of market practices as regards credit risk, market risk and operational risk management.

In 2006, the works of EGCR focused mainly on "own funds" and "large exposures" within the sub-working groups Working Group on Own Funds and Working Group on Large Exposures that are presented below. Following the request of the European Commission, the group has also created a sub-working group to reflect on an appropriate capital adequacy regime for investment firms active in commodities business. The CSSF is not represented in this sub-group.

In addition, the group prepared responses to transposition and implementation questions concerning the new Directives 2006/48/EC and 2006/49/EC that have been raised either by members of the group itself in the context of internal procedures, or to the Capital Requirements Directive Transposition Group (CRDTG) of the European Commission.

The group continued its works on the possibility of mutual recognition of national discretions set forth in Directives 2006/48/EC and 2006/49/EC in order to determine in which cases and on which

conditions the home authority would recognise the options chosen by the host authorities and *vice-versa*.

Finally, the group has set up expert networks (networks on validation issues – NOVI) to deal with subjects relating to the validation of advanced approaches for credit risk (NOVI-C) and operational risk (NOVI-O).

- ***EGCR Working Group on Own Funds***

In June 2005, the European Commission issued a mandate relating to own funds to CEBS with the request to:

- take stock of the implementation of the current rules on own funds in the different Member States of the European Union;
- analyse the capital instruments recently created by the industry;
- develop guidelines on own funds;
- make a quantitative analysis of own funds currently held by credit institutions in the European Union.

A working group on own funds was set up within EGCR to draw up the technical advice requested by the European Commission under this mandate. The working group tackled the first two points of the mandate by collecting data through questionnaires addressed to the competent authorities and to the industry. CEBS published its advice on 23 June 2006. In general, CEBS concluded that national regulations on own funds are quite similar; differences are mainly due to the flexibilities granted by European Directives, local market specificities, as well as the differences with regard to tax regimes, commercial companies regimes and the prudential approach. Moreover, the report stresses the differences as regards the treatment of hybrid capital instruments, resulting from the fact that this issue is not covered by European texts.

In August and October 2006, the European Commission specified the scope of the fourth point of the above-mentioned mandate. Thus, it requested CEBS to quantitatively analyse, at a quite detailed level of the different components, own funds held by European credit institutions and investment firms. Particular attention must be attached to hybrid instruments accepted as original own funds. To this end, an own funds taxonomy was drawn up by the working group. Authorities refer as far as possible to the regular prudential reporting to collect the necessary data. Additional data were requested from certain institutions as regards the use of prudential filters under the IAS/IFRS framework. The expiry dates for this exercise, which concerns the figures of the end of 2006, are end of February 2007 for the data on hybrid instruments and end of May 2007 for the general quantitative analysis.

- ***EGCR Working Group on Large Exposures***

The Working Group on Large Exposures was set up at the beginning of 2006 in response to the mandate received by CEBS in December 2005 in the context of the review of the regulations relating to large exposures.

To respond to the mandate, the working group first took stock of the EU Member States' national regulations on large exposures. In order to prepare this part of its advice, CEBS carried out a set of surveys with the competent authorities. CEBS concluded in its final report that the provisions of the European texts relating to large exposures are applied by all Member States; remaining differences result from the flexibility granted by the Directives.

Secondly, the working group analysed the industry's practices and approaches with respect to large

exposures, including its credit risk mitigation techniques. CEBS organised a public consultation by means of a detailed questionnaire and completed the results obtained by sending this questionnaire to a sample of institutions that are representative of the financial sector of each Member State. At domestic level, four credit institutions, as well as one financial sector professional association have been asked by the CSSF to take part in the survey. CEBS released its report on industry practices with respect to large exposures on 31 August 2006. The report underlines the wide range of methods used by institutions to measure and manage concentration risk. Approaches mostly diverge in complexity when comparing small and medium-sized institutions with larger institutions.

Following CEBS reports on large exposures, EU Member States and the European Commission decided to review the European rules regarding large exposures thoroughly by 2009. Consequently, the European Commission mandated CEBS to express its opinion on a wide range of subjects, ranging from analysing the purpose of the current regulations governing large exposures, to issues such as indirect concentration risk, intragroup risk or the appropriateness of a single regime applicable to all institutions. The mandates will expire at the end of September 2007 and end of February 2008.

2.1.3. CEBS – Working Group on Common Reporting (COREP)

In order to meet the requirements of the industry and the European institutions to reduce the administrative burden and harmonise the reporting requirements for credit institutions, CEBS mandated the Working Group on Common Reporting to develop a common reporting framework for the supervision of capital adequacy.

The common reporting framework, which aims to promote convergence at European level with respect to financial reporting, was published on CEBS's website (www.c-ebs.org) on 13 January 2006. The CSSF decided to use this framework to recast the prudential tables B 1.4 and B 6.4, which has become necessary with the entry into force of European Directives 2006/48/EC and 2006/49/EC.

2.1.4. CEBS – Supervisory Disclosure Task Force (SDTF)

The task force, established in 2004 by CEBS, is responsible for the definition of elements falling within the scope of disclosure by EU supervisory authorities in accordance with article 144 of Directive 2006/48/EC. It has published its proposals concerning the physical aspect of disclosure and the definition of CEBS's role regarding its implementation in 2005. These proposals were the object of a public consultation. The public's response having been positive, SDTF finalised the new disclosure framework.

Supervisory authorities will use this framework as from 2007 to disclose prudential information, including texts of laws, prudential regulations, national options and discretions, supervisory methodologies and statistical data on banks and investment firms. The information published in the form of standardised tables are available for consultation on the websites of the relevant supervisory authorities and on CEBS's website (www.c-ebs.org).

2.1.5. CEBS - Expert Group on Financial Information (EGFI)

In the context of simplifying CEBS structures, the former working group Expert Group on Accounting and Auditing (EGAA) was renamed Expert Group on Financial Information (EGFI). Its scope has been extended, owing notably to the inclusion of the works of the Working Group on Common Reporting (COREP). Henceforth, the working group is in charge of assisting CEBS in achieving its working programme as regards financial information, including in the fields of accounting, auditing and prudential reporting.

The main activities of the working group are exposed hereinafter according to three sub-working groups.

- ***CEBS – EGFI Sub-Working Group on Accounting***

The tasks of the sub-group consist in monitoring and assessing the developments at European and international level of accounting standards and in drawing up proposals and comments on developments that are of interest for the prudential supervision of the banking sector. On the other hand, the sub-group monitors the developments as regards prudential filters for the calculation of capital adequacy, whose application by the supervisory authorities of the European Union is recommended by CEBS.

As regards accounting standards, comment letters were sent to the International Accounting Standards Board (IASB) concerning the discussion paper on the setting up of an improved "Conceptual framework"[1], the discussion paper on "Management Commentary", the proposed amendments to IAS 1[2] and the draft "Due Process Handbook" for IFRIC[3]. Another comment letter was drawn up on the discussion paper of the Canadian Accounting Standards Board on "Measurement bases on initial recognition"[4]. On the other hand, comment letters were sent to the Basel Committee concerning the consultation papers "Supervisory Guidance on the use of the fair value option by banks under International Financial Reporting Standards" and "Sound credit risk assessment and valuation for loans". These comment letters are available for consultation on CEBS's website (www.c-ebs.org/comment_letters/intro.htm).

As regards prudential filters, CEBS published in February 2006 the key findings of the survey "The impact of IAS/IFRS on banks' regulatory capital and main balance sheet items" carried out in 2005 by the sub-group in order to measure the impact of the introduction of IAS/IFRS on regulatory capital and to assess the efficiency of prudential filters recommended by CEBS.

- ***CEBS – EGFI Sub-Working Group on Auditing***

The tasks of the sub-group consist in monitoring the developments at Community and international level in the area of audit and statutory audit and in assessing the consequences thereof from a banking supervisory standpoint in order to assist CEBS in advising the European Commission with respect to European regulations in audit matters.

For this reason, the sub-group followed in particular the developments as regards international accounting standards and has drawn up comment letters for the International Auditing and Assurance Board (IAASB) concerning the "Clarity Project"[5] and proposed amendments to ISA 550 "Related Parties" and ISA 600 "The Audit of Group Financial Statements". These comment letters are available for consultation on CEBS's website (www.c-ebs.org/comment_letters/intro.htm).

- ***CEBS – EGFI Sub-Working Group on Reporting***

The sub-group sees to the proper transposition of the guidelines and standards published by CEBS on common European reporting frameworks FINREP and COREP, including the development of XBRL taxonomies, and proposes, if necessary, updates of the reporting schemes. As regards the common framework FINREP, the sub-group assesses in particular the impact of the amendments to the relevant international accounting standards on the banking sector. The 2006 versions of the common reporting frameworks FINREP and COREP were published by CEBS on 16 December 2006 and 16 October 2006 respectively and are available on CEBS's website (www.c-ebs.org/standards.htm).

[1] IASB discussion paper "Preliminary views on an improved conceptual framework for financial reporting: the objective of financial reporting and qualitative characteristics of decision-useful financial reporting information".

[2] IASB exposure draft "Proposed amendments to IAS 1 – Presentation of Financial Statements – A revised Presentation".

[3] IASC Foundation Draft "Due Process Handbook for the IFRIC".

[4] Canadian Accounting Standards Board's discussion paper "Measurement bases for financial accounting - measurement on initial recognition".

[5] Proposed amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services and the four proposed redrafted ISAs (The Clarity project).

The sub-group also answers questions concerning the practical application resulting from the implementation of the FINREP and COREP frameworks.

In response to the industry's expectations regarding the harmonisation of the requirements on financial reporting to reduce the administrative burden that could result from diverging reporting frameworks, the sub-group participated in the fact-finding questionnaire of the European Central Bank. This questionnaire was drawn up by the European Central Bank to determine to what extent the financial information reported to the supervisory authorities under the reporting framework FINREP may be used to manage money supply.

Moreover, the sub-group prepared the format for the national implementation of the FINREP and COREP frameworks to be published by the supervisory authorities of the European Union on CEBS's website and on their national website under the supervisory disclosure.

2.1.6. CEBS Convergence Task Force

During the last quarter of 2006, CEBS mandated a new working group to implement the recommendations of the Francq report on supervisory review in the financial sector. The group was notably responsible for preparing the implementation of a mediation mechanism among supervisory authorities within CEBS, making recommendations to promote a pan-European supervisory culture, notably through the intervention of joint staff training and an exchange infrastructure, and proposing to CEBS a mechanism to assess the economic impact of these measures. The group is expected to submit its recommendations in 2007.

2.2. Committee of European Securities Regulators (CESR)

Established by the European Commission Decision of 6 June 2001, CESR (Committee of European Securities Regulators) took over from FESCO (Forum of European Securities Commissions) in September 2001. CESR is one of the two committees proposed in the Committee of Wise Men's report, which was endorsed by the Stockholm resolution of 23 March 2001. Composed of representatives of 29 supervisory authorities of securities markets in the European Economic Area (Member States of the European Union, Norway and Iceland), CESR is an independent body, which assists the European Commission in preparing technical measures relating to Community legislation on transferable securities, and is entrusted with ensuring harmonised and continued application of Community legislation in Member States. CESR also works towards strengthening co-operation between the supervisory authorities. Since January 2007, Mr Eddy Wymeersch (Commission bancaire, financière et des assurances, Belgium) chairs CESR, replacing Mr Arthur Docters van Leeuwen (Autoriteit Financiële Markten, Netherlands). Mr Carlos Tavares (Comissão do Mercado de Valores Mobiliários, Portugal) was appointed Vice-chairman replacing Mr Kaarlo Jännäri (Financial Supervision Authority, Finland).

CESR carried on with its work related to the initiatives concerning the Financial Services Action Plan (FSAP) by notably finalising the mandates concerning the drafting of implementing measures within the scope of the Directive on the harmonisation of transparency requirements concerning the information on issuers whose securities are admitted to trading on a regulated market and Directives 2001/107/EC and 2001/108/EC (UCITS III Directives) amending Directive 85/611/EEC (UCITS I Directive).

In addition to the work performed under Level 2 of the Lamfalussy process under the mandates received by the European Commission within the scope of the Directives, CESR continued Level 3 work by drawing up recommendations, standards, common interpretations and procedures to implement co-operation within different areas in order to strengthen regulatory convergence within the EU.

CESR finished its works in accordance with the decision of the meeting of chairmen that was held on 28 and 29 January 2005 with a view to developing proposals on the introduction and the functioning of a CESR mediation mechanism. The final mediation Protocol and the Feedback Statement were released in August 2006. The mediation mechanism is operational since September 2006.

On 12 May 2006, CESR presented its report on the measures to be taken to improve supervisory convergence in the European Union. In June 2006, CESR created the expert group ECONET consisting of economist experts in financial markets. The main objectives of ECONET are to enhance CESR's capability to undertake economic analysis of market trends and risks in the financial markets, and evaluate impact analysis methodologies regarding financial regulation and supervision. In August 2006, ECONET published its report "Financial stability issues related to key financial market infrastructures in the credit derivatives market and other EU wholesale markets and risk update" used by CESR to present its contribution to the Financial Stability Table (FST) in September 2006. A sub-group on impact assessment (IA) was created in September 2006. Members of CEBS and CEIOPS take part in plenary meetings and the meetings of the sub-group ECONET.

CESR does not exclude the possibility to exchange personnel between its members in order to develop a common approach among supervisory authorities. Furthermore, CESR will hold regular larger-scale meetings with private investors in order to take better account of their standpoints.

In May 2006, CESR set up CESR-Tech which is in charge of handling the European IT projects resulting from the European legislation. The works of CESR-Tech are set out in more detail below.

CESR has also continued its contacts with CEBS and CEIOPS in accordance with the common protocol signed on 24 November 2005 in order to take into account the sectoral market integration and the interdependence of financial activities within the European Union.

Finally, CESR continued discussions with the US regulatory authorities, i.e. CFTC (Commodities and Futures Trading Commission) and SEC (Securities and Exchange Commission) in different areas. In order to promote transparency in the transatlantic derivatives market, the joint task force of CESR and CFTC published the document "Frequently Asked Questions" which should provide guidance in this field. CESR and SEC set up a common programme concentrating mainly on the companies active at international level with respect to GAAP (US Generally Accepted Accounting Principles) and IFRS (International Financial Reporting Standards).

The Market Participants Consultative Panel, a committee comprised of fifteen market participants appointed in a personal capacity, established in June 2002 following a suggestion of the European Parliament and the Committee of Wise Men, is charged with assisting CESR in carrying out its tasks. Both meetings of this committee in 2006 mainly addressed the protection of private investors and the consistency of regulations in the financial sector, regulatory issues and supervision within the European Union and the United States, including more particularly US GAAP and IFRS, issues concerning investment funds, and notably hedge fund activities, as well as issues arising within the scope of the Market Abuse Directive.

2.2.1. Groups established within CESR

- ***CESR MiFID Level 3 Expert Group***

In order to guarantee an efficient and convergent implementation of the framework Directive and its implementing measures in accordance with the Lamfalussy procedure, CESR set up an expert group MiFID Level 3, chaired by Mr Arthur Philippe, Director of the CSSF.

CESR identified the following streams of MiFID Level 3 work:

- technical Level 1 and 2 issues for which a consistent and convergent interpretation and application must be achieved before the implementation of the Directive to provide European participants with strategies with greater certainty. These issues largely relate to the functioning of the European passport for investment firms and regulated markets;
- issues of operational and technical nature to ensure a convergent implementation of MiFID, not necessarily to be finalised before the implementation of the Directive. Priority is given to the best execution requirement and notably to the assessment of execution compliance in practice by supervisory authorities;
- work to foster convergence among European supervisory authorities, to be conducted with CEBS and CEIOPS. Examples of such analyses notably include outsourcing, as well as internal governance rules of financial intermediaries in order to rule out any duplication.

MiFID requires the European Commission to provide, among others, a certain number of analyses and reports on instruments and financial markets, such as for example a review of the possible extension of the transparency regime to transactions in classes of financial instruments other than shares. It is likely that the European Commission will request CESR's advice on a number of these issues.

The expert group is assisted by two working groups in drawing up guidelines, namely the Intermediaries group and the Markets group. An Implementation forum was set up to assist the relevant authorities in the implementation of MiFID regulations.

The **Intermediaries group** has drawn up three consultation papers:

- a paper on the use of the European passport (Ref. CESR/06-699) which sets out practical proposals to facilitate, among other things, the notification procedures for cross-border services, as well as for the establishment of branches. The paper also presents proposals on the future collaboration of host and home authorities to ensure adequate supervision of the proper application of the rules of conduct and the organisational requirements of investment firms that use the passport.
- a paper on inducements (Ref. CESR/06-687), which allows to clarify the relation of this regime with the rules governing conflicts of interest. It also allows to define the circumstances in which investment firms may receive from third parties fees or other benefits in relation to the provision of investment services and, finally, to illustrate *via* concrete examples, the compatibility of certain practices with MiFID requirements.
- a paper proposing a list of minimum records to be kept by investment firms (Ref. CESR/06-552) in order to enable, among other things, supervisory authorities to monitor compliance with MiFID requirements.

The **Markets group** drew up a paper on the publication and consolidation of trade information that trading systems must publish in accordance with MiFID in order to preclude impediments likely to jeopardise information consolidation at European level. This paper was submitted to a public consultation that closed on 15 December 2006.

Furthermore, within the scope of the European Commission's works relating on possible extension of the scope of the MiFID provisions laying down pre- and post-trade transparency requirements for transactions on categories of financial instruments other than shares, the group turned its attention to the first call for assistance of the European Commission in this field which is limited to bonds at this stage. CESR submitted its response to the European Commission in November 2006.

Finally, the group started works in respect of reporting transactions, and more specifically on transaction reports to be made by branches of investment firms, on the definition of the execution

of a transaction and on the approval of the transaction reporting system. These works imply the co-operation of the group with CESR-Tech which deals with the technical aspect of transaction reports.

- ***CESR Expert Group on Investment Management***

In 2006, the expert group, chaired by the Chairman of the Italian Commissione Nazionale per le Società e la Borsa (Consob), has notably continued its works in the following two areas:

- clarification of definitions concerning eligible assets for UCITS;
- guidelines for supervisory authorities as regards the notification procedure of UCITS.

Two working groups studied these subjects in particular. The CSSF took part in the work of the expert group as well as in that of the two sub-working groups. All in all, these groups met eleven times in 2006.

The expert group is assisted by a consultative group consisting of sixteen industry experts, including one representative of the Luxembourg investment fund sector. In 2006, one meeting was held between the expert group and the consultative group.

Working group dealing with the clarification of the definitions concerning eligible assets for UCITS

The works of this group, which have been coordinated by the British Financial Services Authority (FSA) and the French Autorité des Marchés Financiers (AMF), led to the adoption of CESR's technical advice on the clarification of definitions concerning eligible assets for investments of UCITS. This advice, which includes Level 2 and Level 3 provisions, can be downloaded from CESR's website (www.cesr-eu.org, reference 06-005).

Based on this technical advice, which aims at a common interpretation of the UCITS Directive, the European Commission finalised the draft implementing Directive on the clarification of certain definitions of eligible assets for UCITS. This draft Directive comprises the Level 2 provisions of CESR's technical advice.

The Level 3 provisions of the technical advice will be included in CESR's guidelines, which will be published at the same time as the aforementioned implementing Directive.

The working group also addressed the question whether derivative financial instruments on hedge funds indices may constitute eligible assets for UCITS. CESR's standpoint regarding this question is planned to be published at the same time as the implementing Directive and CESR's guidelines. Until that date, the CSSF and the other CESR members committed not to authorise UCITS whose investment policy allows the investment in derivative instruments on a hedge fund index.

Working group on guidelines for supervisory authorities as regards the notification procedure of UCITS

This working group, coordinated by the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) finalised CESR's guidelines to simplify the notification procedure of UCITS. These guidelines constitute Level 3 rules of the Lamfalussy procedure.

CESR's guidelines aim to present a common approach to the administration by host authorities of the notification procedures set out in article 46 of the amended Directive 85/611/EEC. They seek to bring greater simplicity, transparency and certainty to the notification process and to achieve a speedier handling of files. These guidelines are available on CESR's website (www.cesr-eu.org, Ref. 06-120b).

Based on these guidelines, the CSSF has issued circular CSSF 07/277 concerning the new notification

procedure in line with the CESR guidelines regarding the simplification of the UCITS notification procedure. The circular is composed of three parts:

- the first part focuses on certain sections of CESR's guidelines;
- the second part describes the approach adopted by the CSSF with respect to the European passport for UCITS, from the standpoint of UCITS incorporated under Luxembourg law marketing their units/shares in another EU Member State, as well as from the standpoint of UCITS under foreign law located in another EU Member State and marketing their units/shares in Luxembourg;
- the third part sets out the marketing rules and the other specific domestic rules.

In the context of UCITS and the works of the Expert Group on Investment Management, the European Commission has organised two workshops on the simplified prospectus on 15 May 2006 and 13 July 2006 for supervisory authorities, investors/consumers and the industry (promoters, managers and distributors). CESR decided that a very limited number of its members should participate in the workshops as active members; the other ones would take part as observers. The CSSF participated in both workshops as an active member.

Based on the responses received following the publication of the green paper on the improvement of the framework governing investment funds in the European Union, the European Commission considered that the simplified prospectus did not bring about the expected improvements. The Commission is of the opinion that the deficiencies observed are notably due to a disparate implementation of its recommendation 2004/384/EC. The purpose of both workshops was thus to collect ideas and opinions in order to enable the European Commission to form an opinion on the best way to improve the simplified prospectus regime.

Finally, the European Commission informed CESR that it intended to start procedures as from February 2007 to amend the UCITS Directive with respect to the following five points: notification process, cross-border mergers, pooling and master/feeder UCIs, simplified prospectus and passport for management companies.

- ***CESR Expert Group on Transparency***

The expert group continued its work under the mandate received in July 2005 under Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive). This mandate required CESR to provide to the European Commission:

- by June 2006, its opinion on possible implementing measures concerning the interoperability agreement necessary to allow the interconnection of national central storage mechanisms in a European network and the costs resulting from the creation of such a network;
- by June 2006, technical advice on the minimum quality standards that should apply to central storage mechanisms. Moreover, CESR was invited to advise on the role of the competent authorities (notably with regard to their supervisory powers concerning central storage mechanisms), as well as on the minimum quality standards applicable to the transmission of regulated information to the competent authorities;
- by April 2006, an intermediary report on the impact in terms of costs related to the implementation and compliance of central storage mechanisms with the above-mentioned standards.

A public consultation on this subject was organised from the end of January until the end of March 2006.

The expert group was assisted for these works by an external expert group which included one professional of the Luxembourg financial sector.

CESR submitted its intermediary report on costs to the European Commission in May 2006. CESR's technical report and opinion were released on 6 July 2006. This report presents four possible models for a European network of central storage mechanisms. The preferred model of CESR consists of the different national storage mechanisms and of a central element containing a list of all European issuers, as well as of the hyperlinks of the storage mechanisms holding regulated information on a given issuer. This model has the advantage of providing investors with a single access point for the complete European regulated information, of being relatively easy to set up and to have lower costs.

As the expert group responded to all mandates it had received, CESR's works under the Transparency Directive now rather focus on "implementation". Thus, a first Implementation forum was held in December 2006 to take stock of the progress made with respect to the transposition of the Transparency Directive into national legislations. CESR is also considering areas in which Level 3 measures would be suitable.

- ***CESR-Tech***

The purpose of CESR-Tech is to strengthen CESR's information technology governance structure. This group enables CESR to work on IT-related issues more quickly and efficiently and to manage IT projects that CESR undertakes in conjunction with its members. CESR-Tech has thus been established to deal with any form of pan-EU IT projects stemming from EU legislation (either current or future) and any other area where CESR members consider it necessary or useful to work together on IT issues.

CESR-Tech is composed of senior CESR representatives who have experience, knowledge and expertise in IT project management, financial markets and supervisory related issues.

The main tasks of CESR-Tech are:

- allocation and use of IT budget on a project-by-project basis;
- operational issues related to the management and running of IT projects;
- technical issues that arise during the course of specific projects;
- setting-up of operational working methods necessary to achieve its objectives.

CESR-Tech's first major IT project is a project for the exchange of transaction reporting between CESR members in accordance with article 25 of MiFID. This project started in June 2006 and the exchange mechanism will be up and running in autumn 2007.

Further to the main project for the exchange of transactions, the group's works will concern in 2007 the adaptation of existing databases and the development of new operational databases for CESR members. CESR will also undertake an in-depth recast of its website to reflect the nature of the convergence of Level 3 works.

- ***Prospectus Contact Group***

The Prospectus Expert Group finalised its technical advice and recommendations on the implementation of Directive 2003/71/EC (Prospectus Directive) by sending to the European Commission its technical advice on financial information to be included in the prospectus where the issuer has a complex financial history. Regulation (EC) No 211/2007 amending Regulation (EC) No 809/2004 (Prospectus Regulation) which takes this advice into account was published on 28 February 2007. As a consequence, CESR decided to dissolve this expert group and to set up a Prospectus contact group which aims to ensure a consistent and convergent implementation of the European provisions relating to prospectuses for securities by agreeing on common positions and to facilitate the proper functioning of the European passport granted to issuers.

In 2006, the members of the contact group met on a quarterly basis to discuss issues relating to the practical application of the Prospectus Directive and its implementing Regulation. The members have adopted common positions on many interpretation issues raised by market participants or certain regulators themselves which have been published for the first time on 18 July 2006 as FAQs on CESR's website (www.cesr-eu.org) and updated in February 2007 with new questions and answers.

The purpose of this publication is to provide market participants with precise, efficient and quick responses to everyday questions (cf. examples below). Responses have not been conceived as principles or recommendations and may, at any time, be subject to changes or updates if necessary. Market participants are invited to continue to post new questions relating to the application of the Prospectus Directive and the Prospectus Regulation either to the relevant Home authority or directly to CESR.

Examples of "Q and A" published by CESR

Q) Is it possible to incorporate by reference the translation of a document that has been approved by the competent authority in a different language?

A) The translation of a document may be incorporated by reference as long as it complies with articles 11 and 19 of the Prospectus Directive.

Q) Articles 25 and 26 of the Prospectus Regulation provide that the elements of a prospectus shall be structured in the following order: 1) the table of contents, 2) the summary, 3) the risk factors, 4) the other information required. Would it be possible to have certain items not following this order? For example, issuers asked whether the responsibility statement could be inserted before the table of contents; whether the section "general description of the programme" could be inserted between the table of contents and the summary, or whether disclaimers could be inserted before the table of contents.

A) The order prescribed by articles 25 and 26 of the Prospectus Regulation is mandatory. This does not mean that the issuer may not include general information about the issuer before the items prescribed in articles 25 and 26 of the Prospectus Regulation in the prospectus.

Note: The CSSF has elaborated more particularly on both questions above, in question no. 27 and no. 30 respectively of the "40 Questions and Answers relating to the new prospectus regime" published on its website (www.cssf.lu).

Q) Are non-transferable options granted to employees covered by the Prospectus Directive? Even if they are not, would the exercise of those options constitute an offer of the underlying shares?

A) CESR members agreed that non-transferable options granted to employees do not fall under the Prospectus Directive as the Prospectus Directive only applies to transferable securities (article 2.1(a)). Concerning the exercise of non-transferable options, CESR members considered that at the time of the conversion or exercise, there is no public offer within the meaning of article 2.1(d) of the Prospectus Directive since it is just the execution of a previous offer.

Moreover, CESR initiated assessment works concerning the functioning of the Prospectus Directive. In this context:

- the participants have been invited to respond to a call for evidence published on 13 November 2006, notably on possible obstacles to the functioning of passports and/or divergent practices applied in Member States that pose a risk for the proper functioning of the single market, on the contribution of the new regime to a wider range of investment opportunities and to an improved transparency and investor protection, as well as on the usefulness of CESR's Q&A on prospectuses;

- the market participants have been invited to take part in an open hearing in Paris on 16 January 2007 to collect comments on these topics;
- the outcome of the assessment exercise on the regulators' powers under the Prospectus Directive undertaken by CESR's Review Panel will by analysed by the contact group; and
- CESR members have been requested to establish statistics relating to prospectuses and to passports in their countries.

The first impressions collected by CESR already demonstrated that most market participants are satisfied with the application of the new prospectus regime and more particularly of the passport system provided for by the Prospectus Directive. However, they stated specific points that need improvement in certain areas, notably as regards the observed diverging approaches of the competent authorities, and requested more harmonisation works within CESR. Moreover, the participants welcomed CESR's efforts to improve the functioning of the single market and stressed the importance of this work to significantly reduce the divergent practices among Member States. They notably welcomed the publication of the Q&A on CESR's website and requested the regular update of this document.

- ***CESR Review Panel***

Established following the decision of CESR Chairmen in December 2002, the Review Panel is responsible for assisting CESR in its task to ensure consistent and harmonised implementation of EU legislation in the Member States.

On 10 May 2006, the Review Panel released a summary of the members' self-assessments of CESR principles concerning the financial information to be provided by issuers and the competences and powers of the authorities in this respect (standard no. 1). The final report on the Review Panel's implementation report of standard no.1 was published on 2 August 2006.

The Review Panel continued its works within the scope of the mandate received from CESR's Chairmen to assess the transposition of the guidelines concerning the transitional provisions of the UCITS III Directive. In this context, the Review Panel published a summary report on the assessment of the transposition by its members of the transitional provisions on 23 May 2006.

Moreover, the Review Panel received the mandate by the Chairmen to compare the powers of the supervisory authorities under the scope of the Market Abuse Directive and the Prospectus Directive. The reports will have political significance since, following ECOFIN's conclusions of 5 May 2005, ECOFIN requested the Financial Services Committee (FSC) to ensure that the supervisory competences are adequate in order to achieve supervisory consistency throughout Europe. The FSC requested CESR to submit a report relating to the competences of the supervisory authorities within the scope of both Directives in question.

These reports are available on the CESR website (www.cesr.eu).

2.2.2. Operational groups established within CESR

- ***CESR-Fin***

As CESR member, the CSSF takes part in the meetings of CESR-Fin, the permanent operational committee that coordinates CESR's work in all financial reporting areas in Europe.

In August 2006, CESR-Fin was reorganised following a change to its mandate. Different subcommittees, such as SISE, SCE and ATF have thus been abolished and replaced by working groups (PG – Project Group) that are activated in case of need. As these committees are of smaller size and consist of experts, they are more flexible, efficient and less costly.

In 2006, CESR-Fin met five times and its activities can be summarised as follows.

Joint CESR-SEC sessions

CESR-Fin activities include regular meetings with SEC, the financial reporting supervisory authority of the United States. As many European companies are also listed in the United States, co-operation and discussion with SEC are essential in order to avoid diverging interpretations of the IAS/IFRS standards. To this end, a co-operation protocol between SEC and CESR-Fin members is being drawn up. Yearly mutual visits of representatives of both authorities are also planned.

Equivalence and convergence of accounting standards

The year 2006 saw the continuation of the project for the equivalence of certain third country GAAP with IAS/IFRS.

As the European Commission did not comment on the technical advice submitted by CESR on 30 June 2005 as regards equivalence of Canadian, Japanese and US GAAP with IFRS standards, it did not have any other option than to amend the requirements set out by the Prospectus and Transparency Directives and Regulations concerning financial reporting issued by third country issuers that granted third country issuers a deadline until 1 January 2007. On certain conditions, the decision of the European Commission extends this deadline until 1 January 2009.

Nevertheless, third country issuers that wish to take advantage of this extension must have a convergence programme for their accounting standards to IFRS standards and a relating, detailed work plan. Moreover, this convergence project must have been made public by whatever means possible. CESR-Fin will establish the list of standards to examine, the criteria used to consider a convergence programme as satisfactory, as well as a procedure to inform the other members of the decisions taken by a CESR member on the accounting standards of a third country.

European Enforcers Coordination Sessions (EECS)

EECS, which met eight times in 2006, continued to discuss the practical and technical questions that emerge from the day-to-day supervisory practice of financial reporting in every jurisdiction. Throughout 2006, the authorities competent for the supervision of the implementation of the IFRS standards fed the database with decisions taken or accounting topics that gave rise to discussions. In November 2006, CESR approved its "Guidelines for publication of enforcement decisions".

The following Project Groups (PG) operate under EECS: Cross border listing (CBL) PG, Check-list PG and Powers PG whose works have been postponed. As CBL PG received a new mandate, EECS approved a survey on the role of the market authorities in the supervision of financial reporting of third country issuers.

Moreover, in December 2006, CESR-Fin approved a questionnaire on the first experiences with the control of IFRS implementation in 2005.

CESR-Fin activities at EU level

CESR-Fin continued to closely follow the discussions of the European Commission at ARC level (Accounting Regulatory Committee) on subjects such as accounting of small and medium-sized enterprises (SMEs) and the paper on the consolidation issue, as well as the discussions at AuRC/EGAOB level in the field of audit.

Moreover, CESR-Fin took an active part in the meetings of the temporary Round table set up by the European Commission and acting as informal Forum of professionals and European accounting experts to rapidly identify the emerging accounting aspects and potential issues requiring the intervention of the regulator (International Accounting Standards Board – IASB, International Financial Reporting Interpretations Committee – IFRIC).

Finally, CESR-Fin created a prospectus working group dealing with all prospectus issues.

Audit

CESR-Fin closely follows the developments of the legislation relating to auditing of companies listed in the European Union and in the other main jurisdictions.

Following the meeting of the Audit Regulatory Committee (8th Directive), a Project Group was set up to work on the assessment of the equivalence of auditor supervision in third countries. Another Project Group works on a questionnaire concerning the transparency of the auditor work.

The report on the survey relating to the market authorities' role in the supervision of auditors was submitted to CESR for approval and publication. Another report was published on the survey on the responsibility of auditors.

CESR-Fin activities in the area of endorsement

In 2006, CESR-Fin continued to closely monitor the developments of new standards or adjustments of standards relating to existing financial reporting, notably through its observers at the level of the European Financial Reporting Advisory Group (EFRAG), the Standard Advisory Committee (SAC), IFRIC or IASB.

IFRS activities on which CESR-Fin concentrated in particular concerned:

- the discussion paper on the Management Commentary;
- the discussion paper on the Conceptual framework;
- IAS 23 adjustments on borrowing costs;
- IFRIC D20 – Customer loyalty programmes;
- two discussion papers regarding Proactive Accounting Activities in Europe (PAAinE): discussion elements on the framework, discussions on the state of performance;
- the status of IFRIC refusals.

- ***CESR-Pol***

CESR-Pol's purpose is to enhance sharing of information, co-operation and coordination of supervision and enforcement activities between CESR members. A major priority of CESR-Pol is to ensure the effective day-to-day implementation of the Market Abuse Directive at Level 3 of the Lamfalussy process. As a result of the mandate received by CESR's Chairmen, CESR-Pol continued the works started in 2005 and published, on 2 November 2006, a document containing detailed guidance on the following subjects:

- the definition of inside information and the moment as of which an information becomes an inside information;
- legitimate reasons to delay the publication of an inside information;
- questions on insider dealings relating to book-building and pre-marketing mechanisms;
- the moment as of which large customer orders may become an inside information;
- assessment criteria of a rather illiquid market;
- the establishment and maintaining of insider lists, notably where financial instruments of an issuer are admitted to several regulated markets of different countries and where the registered office of the issuer is located in a country different from that of the person acting for the account of the issuer.

As Directive 2003/6/EC on insider dealing and market manipulation (Market Abuse Directive) and the implementing measures had to be transposed since 12 October 2004, CESR-Pol took the opportunity to launch a call for evidence in order to collect comments on the experience, benefits and problems encountered under the implementation of the Market Abuse Directive and its implementing measures. Similarly, CESR-Pol organised an open hearing on 17 October 2006. CESR-Pol's works

were welcomed and the market encouraged CESR-Pol to provide additional guidelines concerning the implementation of the Market Abuse Directive.

In order to make the decision taken in 2005 to give CESR-Pol a more operational structure concrete, the terms of reference on the organisation and functioning of CESR-Pol were revised and adapted. CESR-Pol members as plenary will deal with policy issues and general cooperation issues, adopt the proposals for more technical measures under the mandate given to CESR-Pol by CESR Chairmen and strive for a common approach in the implementation of the European Directives and international texts falling under CESR-Pol missions.

The permanent work group **Surveillance and Intelligence Group** (S & I Group), set up in 2005, allowed to exchange practical experience in co-operation, daily supervision of investment firms and financial markets and unauthorised offers of financial services by persons and investment firms that have not been granted adequate authorisation. CESR-Pol has also continued to establish an **Urgent Issues Group** every time several authorities of different Member States are involved in an investigation and it is necessary to ensure swift co-operation and to take prompt measures in cases of threats to one or several securities markets.

Furthermore, CESR-Pol continued to develop its network for the dissemination of warnings relating to illicit offers of financial services by investment firms or individuals that have not been granted the required authorisations thereto. Warnings have also been transmitted to CEBS members.

Finally, CESR-Pol has also continued to enhance dialogue with IOSCO in order to improve co-operation and exchange of information with non-co-operative countries and to coordinate the measures to be taken in this respect. Moreover, CESR-Pol continued discussions with Liechtenstein and provided assistance for the transposition of the Market Abuse Directive.

2.3. Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) comprises high level representatives from the insurance and occupational pensions supervisory authorities from EU Member States. The Committee's objectives are to advise the European Commission, either at the European Commission's request or on the Committee's own initiative, as regards the preparation of implementing measures in the fields of insurance, reinsurance and occupational pensions, to contribute to the consistent implementation of EU Directives and to the convergence of Member States' supervisory practices and to constitute a forum for supervisory co-operation, including the exchange of information on supervised institutions.

Additional explanations on the works performed in 2006 by CEIOPS are given in Chapter 3 "Supervision of pension funds".

2.4. Capital Requirements Directive Transposition Group

Established in December 2005, the purpose of the group is to provide all interested parties with responses as regards the implementation and interpretation of Directives 2006/48/EC and 2006/49/EC that transpose Basel II into European legislation. To this end, the European Commission and its working group co-operate closely with CEBS.

Until March 2007, the group prepared responses to 190 of the 220 questions asked. These answers have been published on the website of the European Commission (http://ec.europa.eu/internal_market/bank/regcapital/transposition_en.htm). Further information on the functioning of the process, which aims at ensuring a certain consistency in the transposition of both Directives, is available on CEBS's website at www.c-ebs.org/crdtg.htm.

2.5. Committee on the prevention of money laundering and terrorist financing

The Committee on the prevention of money laundering and terrorist financing was established by Directive 2005/60/EC of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. This new committee assists the European Commission in relation with the implementing measures that can be taken to ensure the implementation of Directive 2005/60/EC in accordance with article 40 thereof. It replaces the Contact committee on money laundering established by Directive 91/308/EEC.

The first meeting of the committee was held in January 2006; a total of eight meetings were held during the year. The committee notably concentrated on the implementing measures of Directive 2005/60/EC that have been introduced by Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC as regards the definition of politically exposed persons and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis. The committee also follows the work of the Financial Action Task Force (FATF).

2.6. CEBS-CEIOPS-CESR Task Force on Anti-Money Laundering Issues

The task force on anti-money laundering issues was created in accordance with an agreement reached after CEBS's plenary meeting on 27 September 2006. The task force met for the first time in November 2006. It is an inter-sectoral group called to assist the three Level 3 committees (CEBS, CEIOPS and CESR) in helping the supervisory authorities in implementing Directive 2005/60/EC of 26 October 2005 on the prevention of the use of the financial sector for the purpose of money laundering and terrorist financing. The task force mainly focuses on issues regarding the practical implementation of the risk-based approach in the field of know your customer and customer due diligence.

2.7. Accounting Regulatory Committee / Contact committee on accounting directives

The objective of the Accounting Regulatory Committee, established by the European Commission in accordance with Article 6 of the IAS Regulation, is to provide advice on the proposals of the European Commission in order to adopt one or several international accounting standards IAS/IFRS of the International Accounting Standards Board (IASB).

In 2006, the Accounting Regulatory Committee met five times, jointly with the Contact committee on accounting directives, instituted under article 52 of the fourth Company Law Directive (Directive 78/660/EEC). These meetings mainly addressed the adoption of the IASB standards, the draft IASB standards in progress, discussions of the Round Table for a consistent application of the IAS/IFRS standards within the European Union, as well as the convergence and equivalence between the IAS/IFRS standards and third country GAAP, in particular US GAAP.

The current situation of the approval process of the international accounting standards in the European Union, as well as the works of the Accounting Regulatory Committee are available on the website of the European Commission at http://europa.eu.int/comm/internal_market/accounting/ias_en.htm.

2.8. European Group of Auditors' Oversight Bodies (EGAOB)

The European Group of Auditors' Oversight Bodies (EGAOB) was established by Decision 2005/909/EC of 14 December 2005 of the European Commission. The expert group advises the European Commission on any issue relating to the preparation of measures implementing the modernised

eighth Directive on statutory audit of annual accounts and consolidated accounts and amending Directives 78/660/EEC and 83/349/EEC. Its role consists in facilitating co-operation between the public oversight systems of statutory auditors and audit firms of the Member States. It also provides technical assistance for the setting up of comitology measures, in particular with respect to issues relating to the assessment and approval of international audit standards with a view of their adoption at Community level, to the assessment of third country public oversight systems, as well as to the international co-operation between Member States and third countries in this area.

The expert group has set up sub-working groups whose main activities are set forth below.

2.8.1. EGAOB - Sub-Group on Co-operation

The objective of this sub-group is to facilitate co-operation between public auditors' oversight bodies at Community, as well as at international level.

The sub-group has prepared a consultation paper entitled "Consultation on implementation of articles 45-47 of the directive on statutory audit (2006/43/CE)" which sets out the future strategy and priorities of the European Commission on statutory audit in relation to non-EU countries, and how the European Union and third countries could co-operate in this area. The document was released for public consultation in January 2007 and is available on the European Commission's website at http://ec.europa.eu/internal_market/auditing/docs/relations/third_country_consultation_en.pdf.

Article 46 of the modernised eighth Directive provides for exemptions from the registration requirement for third country auditors if these third countries' audit regulations are found to be equivalent to the requirements set out in the modernised Directive. Considering the objective of promoting a standardised Community approach to avoid an over-regulation of the audit sector likely to increase the costs of supervision, the sub-group started to analyse the equivalence of public oversight systems for auditors whose issuers have issued securities admitted to trading on European regulated markets in September 2006.

2.8.2. EGAOB - Sub-Group on International Auditing Standards (ISAs)

The modernised eighth Directive requiring the application of international audit standards within the scope of statutory audit, this sub-group analyses the international audit standards and the developments in this field, with a view to their adoption at Community level.

2.8.3. EGAOB - Sub-Group on Quality Assurance

While article 34 of the modernised eighth Directive provides for mutual recognition of quality assurance systems of Member States, this sub-group prepares organisational principles based on best practice in order to promote the establishment by Member States of quality assurance systems that meet high quality standards. The purpose is to lay the foundations for an efficient and balanced co-operation between EU regulators and third-country regulators, notably the Public Company Accounting Oversight Board (PCAOB) of the United States. The works of this sub-group are in line with recital 17 of the modernised Directive that encourages Member States to agree on a coordinated European approach in order to avoid undue administrative procedures for the networks of international audit firms and to contain supervisory costs stemming from quality assurance.

At a first stage, the sub-group worked out a score board listing the current EU quality assurance systems and the initiatives taken or to be taken by Member States in order to meet the provisions of the modernised eighth Directive.

The sub-group is currently discussing the different options available to Member States to set up a quality assurance system that fulfils the requirements of the modernised eighth Directive to define

the minimum requirements to fulfil in terms of regulator independence, practical organisation of the quality assurance systems (without however developing control methodologies), scope of the quality assurance reviews and co-operation among European regulators. In this context, the sub-group proposes to update the Recommendation of the European Commission 2001/256/EC on minimum requirements with respect to quality assurance for the statutory audit in the European Union.

2.9. Banking Supervision Committee of the European Central Bank

The Banking Supervision Committee (BSC) of the European Central Bank is a committee made up of high level representatives of the banking supervisory authorities and the central banks of Member States. It is chaired by Mr Meister, member of the Board of Directors of Deutsche Bundesbank. The missions concerning prudential supervision conferred by the Treaty and the statutes of the European Central Bank on the ESCB (European System of Central Banks) are carried out by the Banking Supervision Committee on behalf of the ESCB. The Committee is a forum for the exchange of opinions on the supervisory policies and practices in Member States. It should also be consulted on proposals for Directives and bills tabled by Member States on matters within its competence.

Two working groups comprising members of the central banks and national supervisory authorities, i.e. the Working Group on Macro-Prudential Analysis and the Working Group on Developments in Banking, mainly assisted the Banking Supervision Committee in carrying out its mandate in 2006.

In order to systematise the analysis of macro-economic data with a view to identifying, as far as possible in time, the factors likely to weaken the financial institutions as a whole and therefore the financial system, the Working Group on Macro-Prudential Analysis monitors the macro-economic environment and reports to the Committee on trends and facts likely to be relevant to the prudential supervision of the financial sector.

Every year, the working group draws up a report on the stability of the financial sector. This report is discussed by the Executive board of the European Central Bank. It has also been published under the aegis of the Banking Supervision Committee for five years now. In 2006, the group prepared a study on the potential risks that exposures to private equity represent for the stability of the banking sector. This report will be released at the beginning of 2007. As regards its own tools, the group focused on the issue of profitability and solvency indicator migration under the new IFRS framework and the strengthening of the liquidity risk indicators.

As in the previous years, the Working Group on Developments in Banking focused on the drawing up of its structural report during the first half of 2006. This annual report aims at identifying and monitoring the structural trends marking the European banking sector as a whole. The 2006 report deals in particular with the impact of the demographic ageing on the European banking sector and the refinancing structure of European banks. In the second half of the year, the group dealt with the management of liquidity within European credit institutions.

The joint working group on crisis management established together with CEBS at the end of 2004, finalised a document in 2006 on the guidelines for prudential supervisory authorities and central banks to manage financial crises within the banking sector or the securities markets. Examples of information that authorities should exchange in case of a crisis have also been listed and transmitted to the founding committees. Moreover, the group took an active part in a crisis simulation exercise with the purpose to promote the strengthening of international co-operation among supervisory authorities in case of cross-border financial sector crises.

3. MULTILATERAL CO-OPERATION

3.1. Basel Committee on Banking Supervision

In 2006, the Basel Committee's work mainly concentrated on monitoring the new capital adequacy framework (New Basel Accord or Basel II) and on the recasting of the Core principles for effective banking supervision initiated in 2005.

As regards the New Accord, a consolidated text "Basel II: International convergence of capital measurement and capital standards: a revised framework – comprehensive version" was published in July 2006. This text includes the New Basel Accord of 2004 with the 2005 additions, as well as the parts of the 1998 Accord and of the 1996 "Market Risk Amendment" that have not been changed.

Moreover, in the context of the implementation of the advanced approaches of the new capital adequacy rules, the following documents were published:

- the consultative paper "Principles for home-host supervisory cooperation and allocation mechanisms in the context of advanced measurement approaches (AMA)" whose main objectives are the clarification of key elements of the co-operation and exchange of information between supervisory authorities for the implementation of an AMA approach by a cross-border banking group and the establishment of principles relating to the implementation and assessment of the slotting mechanism (hybrid AMA) (February 2006);
- the newsletter "The IRB use test: background and implementation" (September 2006).

The documents "Core Principles for Effective Banking Supervision" and the "Core Principles Methodology" were published in October 2006 following their adoption at the ICBS in Merida, Mexico.

The first document is the revised version of the Core Principles for Effective Banking Supervision originally published in September 1997 by the Basel Committee. These Principles, along with the Core Principles Methodology (the second document), have been used by countries to assess the quality of their supervisory systems and to identify future work to be done to achieve a baseline level of sound supervisory practices. They have also been used by the IMF and the World Bank in the context of the Financial Sector Assessment Program (FSAP) to assess countries' banking supervisory systems and practices. However, significant changes have occurred since 1997 in banking regulation, much experience has been gained with implementing the Core Principles in individual countries and new regulatory issues and gaps in regulation have become apparent, often resulting in new Committee publications. These developments have made it necessary to update the Core Principles and the associated assessment Methodology.

In conducting this review, the Committee was motivated by the will to ensure continuity and comparability with the 1997 framework, which has functioned well and is seen to have withstood the test of time. Thus the intention was not to radically rewrite the Core Principles, but rather to focus on those areas where adjustments to the existing framework were required to ensure their continued relevance. The documents thus focus to a greater extent on sound risk management and internal governance practices. An "umbrella" principle, covering all common aspects across all risk types, has been added. Moreover, the criteria for assessing interest rate, liquidity and operational risk have been specified and enhanced.

Another aim of the review was to strengthen fraud prevention, as well as the fight against money laundering and terrorist financing.

At the end of 2006, the Committee reorganised the structure and tasks of its working groups. This reorganisation became necessary following the finalisation of the work on the New Accord and Core principles.

These are the working groups that are now reporting to the Basel Committee:

- the Accord Implementation Group (AIG) that continues the works relating to the implementation of the New Accord;
- the Policy Development Group (PDG), replacing the Capital Task Force (CTF), that handles issues relating to prudential own funds, as well as sharing of information regarding risk management, prudential supervision and strengthening of prudential standards;
- the Accounting Task Force (ATF), which continues the works relating to the accounting standards and auditing;
- the Non-G-10 Liaison Group, replacing the Core Principles Liaison Group, which acts as forum for the contacts of the Basel Committee with non-G-10 jurisdictions.

The existing working sub-groups and the new sub-groups that have started their activities at the beginning of 2007 (including notably the Definition of Capital Group and the Liquidity Group) all depend on one of these four working groups.

On 1 July 2006, Mr Nout Wellink (De Nederlandsche Bank, Netherlands) took over from Mr Jaime Caruana (Banco de España, Spain) as Chairman of the Basel Committee.

3.1.1. Accord Implementation Group (AIG)

The Accord Implementation Group was created to promote a consistent implementation of the new capital adequacy rules at international level. It operates as multilateral discussion forum that allows national supervisory authorities that are members of the Basel Committee to share their experience in the field of validation of advanced approaches under Basel II. The group aims to promote consistency in the practical implementation of Basel II. Concerned about extending these consistent solutions to States that are not members of the Basel Committee, the Accord Implementation Group associates the International Liaison Group in this endeavour. In this context, the Basel Committee published, in June 2006, under the title "Home-host information sharing for effective Basel II implementation", an amended version of the general guidelines for the co-operation between home and host authorities.

During its four meetings in 2006, the Accord Implementation Group has closely followed the implementation works of the Basel II rules of the main banking groups that operate cross-border. It also endeavoured to consider the opinions of the different professional associations and their concrete issues concerning the practical implementation of Basel II. The specific topics tackled in 2006 concerned the estimation of LGD (Loss Given Default), stress-testing, conditions for the authorisation of advanced approaches, as well as the supervisory review process (Pillar II).

- ***AIG - Validation Subgroup (AIGV)***

In 2006, the Basel Committee released two documents drawn up by AIGV. The first document specifies the criteria to be observed by credit institutions when they use vendor models. The second document clarifies the requirements with respect to the use of internal ratings in the commercial and risk management process (use test). Other subjects handled by the group included internal control as well as stress-testing by banks adopting the IRB approaches.

Moreover, AIGV gathered the documents produced by the Basel Committee and its working groups, as well as by the national supervisory authorities on the validation of IRB approaches in an electronic library. These documents are now also available to a larger community of banking supervisory authorities.

- ***AIG - Operational Risk Subgroup (AIGOR)***

AIGOR focuses on the challenges associated with the development, implementation and maintenance of the operational risk management framework meeting the requirements of Basel II, particularly as they relate to the advanced measurement approaches (AMA). Four meetings take place annually gathering the experts of Member States.

In recognition of the evolutionary nature of operational risk management, the Basel II framework intentionally provides a significant degree of flexibility for banks wishing to use the advanced measurement approaches. It is not surprising therefore that the range of practice tends to be quite broad. In this context, AIGOR published mid-October 2006 the document "Observed range of practice in key elements of Advanced Measurement Approaches (AMA)" using information obtained from members' supervisory work, benchmarking exercises, discussions with banks, as well as other sources. This paper describes specific practices that have been observed in relation to some of the key challenges AMA banks are currently facing.

This paper is sub-divided in three subject areas dealing with internal governance issues, data issues and modelling/quantification issues. Each subject area defines key issues. Moreover, relevant references to the Basel II framework are included for each point, discussing the significance of and challenges raised by individual issues and concluding with the practices observed.

On 7 February 2006, AIGOR released the consultation paper "Principles for home-host supervisory co-operation and allocation mechanisms in the context of Advanced Measurement Approaches".

3.1.2. Accounting Task Force (ATF)

The Accounting Task Force works to ensure that international accounting and auditing standards and practices promote sound risk management at financial institutions, support market discipline, and reinforce the safety and soundness of the banking system. To fulfil this mission, the Accounting Task Force develops prudential reporting guidance and takes an active role in the development of international accounting and auditing standards.

In June 2006, the Basel Committee thus published the final versions of the two documents "Sound credit risk assessment and valuation for loans" and "Supervisory guidance on the use of the fair value option for financial instruments by banks" drawn up by the Accounting Task Force and released for consultation in 2005.

The document "Sound credit risk assessment and valuation for loans" which replaces the document "Sound practices for Loan Accounting and Disclosure" of July 1999, states the principles that are intended to be consistent with the provisions of IAS/IFRS concerning loan impairment. It notably explains how common data and processes may be used for credit risk assessment, accounting and capital adequacy purposes. It also highlights provisioning concepts that are intended to be consistent with prudential and accounting frameworks.

The document "Supervisory guidance on the use of the fair value option for financial instruments by banks" informs the banks that use the fair value option[6] about appropriate and sound risk management and control processes and provides recommendations to supervisory authorities on the prudential approach to adopt. Based on these recommendations, the CSSF will assess whether the banks that choose to use this option do so appropriately.

As far as accounting standards are concerned, the Accounting Task Force has set up comment letters for the International Accounting Standards Board (IASB) with respect to two consultation documents that have proved relevant from a prudential standpoint, i.e. the discussion paper

[6] Such as the fair value option for financial instruments of IAS 39, Financial Instruments: Recognition and Measurement, as amended in June 2005.

on an improved "Conceptual framework"[7] and the IASB discussion paper on the "Management Commentary". Another comment letter was drawn up on the discussion paper of the Canadian Accounting Standards Board on "Measurement bases on initial recognition"[8]. As regards audit standards, the group issued comment letters on the exposure drafts of the International Auditing and Assurance Standards Board (IAASB) in the context of the consultation on ISA 550 "Related Parties" and "Improving the Clarity of IAASB Standards". These comment letters are available on the website of the Basel Committee (www.bis.org/bcbs/commentletters/commentletters.htm).

In the context of reorganising the Basel Committee's sub-groups in October 2006, the Accounting Task Force has also revised the structure of its sub-groups. Three sub-groups are now reporting to the Accounting Task Force, namely the Conceptual Framework Issues Subgroup, the Financial Instruments Practices Subgroup and the Audit Subgroup. Moreover, *ad hoc* working teams will deal with specific issues on an *ad hoc* basis.

3.1.3. Capital Monitoring Group

The mission of this working group, established in May 2006 and which met for the first time in November 2006, consists in analysing the development of regulatory own funds under Basel II regulations compared to the level of regulatory own funds under Basel I regulations. Apart from explaining the reasons for a possible cyclic trend of regulatory own funds, the working group's purpose is to study and monitor the appropriate calibration of regulatory own funds.

3.1.4. Risk Management and Modelling Group

The main objective of the Risk Management and Modelling Group is to monitor the advances made in internal risk management within credit institutions. It informs the Basel Committee of these advances and, where applicable, submits proposals to maintain the consistency of prudential requirements and internal risk management practices. In this context, the group concentrated in 2006 on internal credit risk management and notably updated the 1999 document "Credit Risk Modelling: Current Practices and Applications". The Basel Committee can also submit common questions concerning risk management techniques to the group. During the year under review, the group thus dealt with counterparty risk associated with credit derivative financial instruments.

3.2. International Organisation of Securities Commissions (IOSCO)

3.2.1. XXXIst Annual Conference of IOSCO

The securities and futures regulators and other members of the international financial community met in Hong Kong from 5 to 8 June 2006, on the occasion of the XXXIst Annual Conference of IOSCO.

As regards IOSCO's strategic direction, improvements have been made to strengthen the organisation's efficiency. The stated objective is to maintain the role of IOSCO as the international standard setter for securities regulation by improving enforcement-related cross-border co-operation and fully implementing the Objectives and Principles of Securities Regulation (IOSCO Principles).

IOSCO continues to emphasise more strongly IOSCO's Multilateral MoU[9]. Adopted in May 2002, the IOSCO MMoU represents one of the organisation's most significant contributions in the area of

[7] IASB discussion paper "Preliminary views on an improved conceptual framework for financial reporting: the objective of financial reporting and qualitative characteristics of decision-useful financial reporting information".

[8] Canadian Accounting Standards Board's discussion paper "Measurement bases for financial accounting - measurement on initial recognition".

[9] Multilateral Memorandum of Understanding (MMoU) concerning consultation and co-operation and the exchange of information.

regulatory co-operation and effective cross-border enforcement. There are currently 34 members who have signed the MMoU. Nine members have expressed their commitment to sign the MMoU in accordance with its Appendix B.

Members also took the opportunity to confirm the importance of the ongoing programme of training and technical assistance in pursuance of the strategic direction objectives.

As regards cross-border co-operation, IOSCO adopted a new resolution that encourages members to examine the legal framework under which they operate and to enable the freezing of assets derived from violation of securities or derivatives regulations. In this way, those who break the laws will be unable to benefit from any proceeds of their illegal actions. The resolution was adopted in response to the growing challenge posed by the increase in cross-border fraudulent and illicit activities and proceeds of fraud that cross borders, along with the general absence of powers to freeze assets internationally.

IOSCO in consultation with the Financial Stability Forum has been engaged in a confidential dialogue with certain jurisdictions with which specific co-operation issues have been experienced. Particular attention is being given to those jurisdictions that play an important role in the international financial system. The objective is to assist each of the identified jurisdictions to make genuine improvements to co-operation they are able to offer their international counterparts in relation to information sharing.

In collaboration with the Organisation for Economic Co-operation and Development (OECD), IOSCO is examining how different jurisdictions address important issues relating to the corporate governance of companies listed on stock exchanges.

IOSCO has also set up a task force on non-audit services that analyses a range of issues related to quality audits and auditor independence. The task force also focuses on the issue of non-audit services offered to publicly listed audit clients and the potential impact of these services on auditor independence. The objective is to recommend reforms that might facilitate cross-border convergence of best practices.

Finally, IOSCO has constituted a new task force on credit rating agencies to review the codes of conduct that have been released by credit rating agencies.

As regards external relations, IOSCO re-affirmed its commitment to working closely with other international financial institutions and groupings, including the Basel Committee on Banking Supervision, International Association of Insurance Supervisors (IAIS), Bank for International Settlements (BIS), International Monetary Fund (IMF) and World Bank. Recently, IOSCO has also held discussions with the Islamic Financial Services Board and is involved in the works of the Financial Stability Forum.

IOSCO has also been active in the area of implementation of the International Financial Reporting Standards (IFRS), the international debt disclosure principles, regulation of secondary markets and bond markets, the compliance function at market intermediaries, conflicts in securities offerings and capital adequacy requirements.

IOSCO continued its works in the area of boiler rooms, governance for investment funds and hedge funds. In this area, IOSCO decided to adopt a set of principles in terms of valuation and administration.

3.2.2. IOSCO groups

The CSSF is a member of two IOSCO groups, i.e. the Standing Committee n° 1, dealing with subjects concerning accounting, and the Standing Committee n° 5 concerning UCIs and collective management.

- ***Standing Committee n° 1 (SC1)***

As member of the permanent committee SC1, the CSSF takes part in the meetings of the subcommittees on disclosure, accounting, auditing, as well as the implementation of IAS/IFRS.

Disclosure Subcommittee

Besides working on the project on International Debt Disclosure Principles, the final version of which is due to be approved by the technical committee (TC) at the beginning of 2007, the subcommittee continued its works on the periodic disclosure principles by issuers.

It developed two joint projects with the Accounting Subcommittee, namely the special purpose entities (SPEs), whose survey results are included in a draft report, and the IASB discussion paper on the Management Commentary.

Auditing

In the field of auditing, SC1 continued its review of the standard-setting activities of the International Auditing and Assurance Standards Board (IAASB) on auditing, notably the Clarity project, the Related Parties, Group Audits and materiality. The subcommittee is also reviewing the standard-setting activity regarding ethics and independence of the Ethics Committee.

Other subjects in close relation with auditing that SC1 works in are:

- PIOB (Public Interest Oversight Body) and the Monitoring Group;
- the auditing committee of the chairmen of the Technical Committee (TC), notably the study on non-audit services; and
- the IOSCO report on financial fraud.

Discussions on a potential recognition, even endorsement, of the International Standards on Auditing (ISA) by IOSCO continue simultaneously.

Among the other projects that SC1 tackled in 2006 is the survey on the internal control requirements for issuers. The survey results will be presented in a report for the Technical Committee.

Accounting

As in the previous years, SC1 continued to follow the works of the International Accounting Standards Board (IASB), the International Financial Reporting Interpretations Committee (IFRIC) and the Standard Advisory Committee (SAC) on accounting regulation through the Accounting Subcommittee. In this context, the subcommittee gave its advice to SC1 on discussion papers and projects. It reviewed the following IASB activities and projects:

- IASB and IFRIC updates;
- accounting evaluation standards – measurement at the first recognition;
- operational segments;
- IFRS 2 amendments for vesting conditions and cancellations;
- IFRIC draft interpretation D18 Interim financial reporting and impairment;
- exposure draft of amendments to IAS 23, borrowing costs;

- proposed amendments to IAS 32, presentation of financial instruments, and IAS 1, presentation of financial statements: financial instruments puttable at fair value and obligation arising on liquidation;
- preliminary views on a conceptual framework for financial statements.

Moreover, the members of the subcommittee take part in working groups, including the working group on insurance and the Joint International Group on the presentation of financial statements.

IFRS Regulatory Interpretation and Enforcement

The subcommittee continued to develop its database and made demonstrations and presentations.

On the initiative of the Technical Committee, SC1 has created a Task Force on Risk Mapping whose purpose is the development of a process, i.e. a risk "map" to be used by IOSCO to take decisions and set down priorities for its future works on common interests or the perception of risks.

- ***Standing Committee n° 5 (SC5)***

The CSSF is a member of the permanent committee SC5 Investment Management that dealt with the following topics in 2006: Hedge funds valuation and administration, Point of sale disclosure to retail investors, Collective investment schemes governance, Soft commissions' arrangements, Distribution issues and Risk-based analysis.

Following the publication in March 2006 of the consultation paper "The regulatory environment for hedge funds: a survey and comparison", IOSCO published the final version of this report in November 2006. Moreover, the final report "Examination of governance for collective investment schemes" was published in June 2006. IOSCO also published the consultation report "Soft commissions" in November 2006. The documents concerned are available on the IOSCO website (www.iosco.org).

3.3. Informal groups

Extended contact group "Undertakings for collective investment"

The CSSF attended the annual meeting of the extended contact group "Undertakings for collective investment" that was held from 27 to 29 September 2006 in Oslo. The subjects discussed were the following: questions relating to prudential supervision, conflicts of interest/code of conduct, legal issues, financial issues, reporting and disclosure, management and administration of investment funds, UCITS and special investment funds.

3.4. Institut Francophone de la Régulation Financière (IFREFI)

The *Institut Francophone de la Régulation Financière* (IFREFI, Francophone institute for financial regulation), gathering the financial markets regulatory authorities of fifteen French-speaking countries (Algeria, Belgium, Cameroon, France, Guinea, Luxembourg, Moldavia, Monaco, Morocco, Quebec, Rumania, Switzerland, Tunisia, the West African Monetary Union, the Economic and Monetary Community of Central Africa) was created in 2002 by a charter. IFREFI is a flexible structure of co-operation and dialogue and aims at furthering the exchange of knowledge and experience, drawing up studies and exchanging essential information relating to the financial markets between the Member States of the Institute. According to the charter, IFREFI also aims at promoting professional training by organising training seminars on specific topics.

The annual meeting of IFREFI chairmen, which took place in Bucharest in September 2006, concentrated on sharing the recent regulatory progress within each Member State and at

international level (IOSCO works). It was also the occasion to summarise the current economic and financial international situation and to address the subject of demutualisation of exchanges, allowing to compare the relevant experience of regulators in this field.

The following is noteworthy as well:

- the renewal of the IFREFI bureau: Mrs Zeineb Guellouz, Chairwoman of the Conseil des marchés financiers of Tunisia, and Mr Georges Carton de Tournai, Director of the Commission bancaire, financière et des assurances of Belgium have been appointed Chairwoman and Vice-Chairman respectively for a period of two years;
- the admission of the Commission des valeurs mobilières of Moldavia as fifteenth member of IFREFI;
- the launch of IFREFI's website (www.ifrefi.org) consisting of a public section and a section restricted to IFREFI members and contributing to enhancing the links between the teams of the different commissions.

The meeting was followed by a training seminar on the enforcement of financial information.

CHAPTER 12

12 BANKING AND FINANCIAL LEGISLATION AND REGULATIONS

1. Directives under discussion at Council level

2. Directives adopted by the Council and the European Parliament but not yet implemented under national law

3. Laws passed in 2006

4. Circulars issued in 2006

5. Circulars in force

1. DIRECTIVES UNDER DISCUSSION AT COUNCIL LEVEL

The CSSF participates in the groups examining the following proposals for Directives:

1.1. Proposal for a Directive on the new legal framework for payment services

In December 2005, the European Commission presented a proposal for a Directive on payment services in the internal market and amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC. This initiative aims to achieve an integrated and efficient European payments market and is one of the key actions of the Lisbon programme.

This proposed Directive has been discussed in detail in the CSSF's Annual Report 2005.

1.2. Proposal for a Directive aiming to improve the supervisory approval process for mergers, amending Directives 92/49/EC, 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector

This proposal aims to considerably improve the legal certainty, clarity and transparency of the supervisory approval process with regard to acquisitions and increase of shareholdings in the banking, insurance and securities sectors. This amending proposal thus substantially modifies the existing framework with respect to the procedure, as well as to the criteria to be examined by the competent authorities when assessing the suitability of a proposed acquirer or of a person seeking to increase a holding in a supervised entity in one of the afore-mentioned sectors.

The amended sectoral Directives will define a consistent set of procedures that the competent authorities must apply to assess acquisitions and increases in shareholdings from a prudential standpoint. A clear and transparent notification and decision-making process for competent authorities will have to be introduced. The deadlines for supervisory authorities have been reduced and any "stopping of the clock" by competent authorities is only possible if the criteria set out in the proposed Directive are not complied with or if the information provided by the acquirer is incomplete.

The amended Directives will provide for a closed list of criteria to assess the suitability of the acquirer and thus for a full harmonisation for the purposes of a suitability assessment of the persons seeking to acquire or increase a holding throughout the European Union. These criteria are the reputation of the acquirer, the reputation and experience of any person that may run the resulting institution or firm, the financial soundness of the proposed acquirer, the ongoing compliance with the relevant sectoral Directives and the risk of money laundering and terrorist financing.

2. DIRECTIVES ADOPTED BY THE COUNCIL AND THE EUROPEAN PARLIAMENT BUT NOT YET IMPLEMENTED UNDER NATIONAL LAW

This section presents the Directives adopted by the Council and the European Parliament for which a bill has been submitted to the Luxembourg Parliament or for which a preliminary draft is under discussion in the committees operating within the CSSF or which are being implemented by the CSSF.

2.1. Directive 2004/39/EC of 21 April 2004 on markets in financial instruments, amending Directives 85/611/EEC, 93/6/EEC and 2000/12/EC and repealing Directive 93/22/EEC (MiFID Directive)

MiFID is an essential element in the implementation of the financial services action plan. Its general objective is to create an integrated financial market where investors enjoy appropriate protection

and where market efficiency and integrity are ensured. It gives investment firms a "single passport" allowing them to operate throughout the European Union on the basis of a single authorisation granted in the home Member State. It lays down a set of rules aiming to enhance investor protection where investors employ investment firms wherever they are located in the European Union, and to improve investor confidence in financial markets. The Directive establishes an overall regulatory framework governing the execution of orders to foster competition across the European Union as well as within each Member State, between regulated markets, multilateral trading facilities (MTF) and credit institutions or investment firms respectively. Moreover, the Directive strengthens co-operation between the competent authorities of the Member States. The objectives of the Directive are detailed in the CSSF's Annual Report 2003.

In accordance with the final report of the Committee of Wise Men on the regulation of European securities markets, the European Commission published two working papers in February 2006 relating to implementing measures based on the technical advice given by CESR on 31 January 2005 and 30 April 2005. The mandates and the ongoing relating works have been described in detail in the CSSF's Annual Report 2004, Chapter X, point 1.1.2.. The working papers led to the publication of Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, as well as to the publication of Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading and defined terms for the purposes of that Directive.

A bill proposing to transpose the Directive into Luxembourg legislation and a draft Grand-ducal regulation relating to the keeping of the official listing for financial instruments and notably repealing Grand-ducal regulation of 31 March 1996 concerning the concession and the general terms and conditions of the Société de la Bourse de Luxembourg, were submitted to the Parliament. The abrogation of the concession underpins MiFID's objective which is to promote competition between the different order execution regimes in order to enhance the efficiency of European financial markets. It also confirms the fact that the operation and management of a regulated market is a commercial activity on the same account as the operation of an MTF or the performance of any other investment activity.

2.2. Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (Transparency Directive)

The Directive is an essential element in the implementation of the financial services action plan. Its main objective is to impose a transparency and information level consistent with the objectives of investor protection and market efficiency. More detailed information on the Directive has been provided in the CSSF's Annual Report 2004.

In accordance with the procedure decided upon in the Stockholm Resolution adopted by the European Council in March 2001, which aims at improving the decision-making process as regards securities, the European Commission had given a mandate to CESR in July 2005 to draw up a technical advice on the storage of regulated information and electronic filing of such information with the authorities. This technical advice was published on 6 July 2006. The relating works are set out in detail in Chapter XI "General supervision and involvement of the CSSF in international groups".

Moreover, on 24 October 2006, following the positive CESR vote and the approval of the European Parliament, the European Commission adopted measures extending by two years the transitional

exemption granted to foreign companies that present financial statements in accordance with domestic accounting standards for the issue of securities on EU stock markets.

These measures resulted in Regulation (EC) No 1787/2006 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC on prospectuses for securities, and in the Decision of the European Commission of 4 December 2006 on the use, by third country issuers of securities, of information prepared under internationally accepted accounting standards, taken in accordance with Directive 2004/109/EC on the transparency requirements.

Pursuant to these measures, an issuer that has its registered office in a third country can draw up its consolidated accounts according to third-country GAAP if one of the following conditions is met:

- the financial information includes an explicit and unreserved statement of compliance with IFRS;
- the financial information is drawn up in accordance with Canadian, Japanese or US GAAP;
- the financial information is drawn up in accordance with the accounting principles generally admitted in a third country and all the following conditions are fulfilled:
    - the third country authorities responsible for these accounting standards have made a public commitment to converge those standards with IFRS;
    - these authorities have established a work programme which demonstrates the intention to progress towards convergence before 31 December 2008; and
    - the issuer provides evidence satisfying the competent authorities that the previous two conditions are met.

The bill aiming to transpose Directive 2004/109/EC into Luxembourg law was adopted by the Government Council of 7 March 2007 and submitted to the Parliament.

Finally, Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC was published on 9 March 2007 (cf. point 2.9. below).

2.3. Directive 2005/60/EC of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

The third Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing aims to incorporate the June 2003 revision of the Forty Recommendations of the Financial Actions Task Force (FATF) into EU legislation. More detailed information on the Directive has been provided in the CSSF's Annual Report 2005.

2.4. Directive 2006/43/EC of 17 May 2006 on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC (modernised eighth Directive)

The new 8th Company Law Directive on the statutory audit aims at reinforcing and harmonising the statutory audit function throughout the European Union. It sets out principles for public supervision in all Member States, introduces a requirement for external quality assurance and clarifies the duties of statutory auditors.

Moreover, the Directive defines sound and harmonised principles of independence applicable to all statutory auditors in the EU. The Directive further improves the independence of auditors by requiring listed companies to set up an audit committee (or a similar body) with clear functions to perform. It also foresees the use of international standards on auditing for all statutory audits conducted in the EU. Adoption of these standards will be subject to strict conditions such as their quality and whether they are conducive to the European public good.

The Directive provides a basis for effective and balanced co-operation between regulators in the EU and with regulators in third countries, such as the US Public Company Accounting Oversight Board (PCAOB). Finally, it includes the creation of an Audit Regulatory Committee to complement the revised legislation and allow the speedy adoption of necessary implementing measures.

2.5. Directive 2006/46/EC of 14 June 2006 amending Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

The Directive includes the four key revisions of the EU Accounting Directives that are part of the action plan of the European Commission concerning the modernisation of company law as published on 21 May 2003. It confirms the collective responsibility of the members of the administrative, management and supervisory bodies towards their company for drawing up and publishing annual accounts and the annual report presented in a reliable manner, as well as drawing up consolidated accounts and essential non-financial information. The main objective consists in enhancing public confidence in these publications.

Moreover, the Directive aims to make transactions with related parties more transparent by imposing the disclosure requirement not only on transactions between a parent company and its subsidiaries, but also on other types of related parties, such as key management members and spouses of members of administrative, management and supervisory bodies. This requirement only applies to material transactions not carried out at arm's length. It also requires all companies to disclose all off-balance sheet arrangements. Appropriate information concerning material risks and advantages must be provided in the annexe to the annual accounts and consolidated accounts for transactions related to the use of specific, potentially offshore, financial structures.

Finally, the Directive ensures better information on corporate governance practices by requiring all listed EU companies to provide a corporate governance statement as a specific and clearly identifiable section of the annual report. This statement should include information on existing risk management systems and internal controls of the group.

2.6. Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.
Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms and credit institutions

Bill No 5664 purposes to transpose into Luxembourg law the provisions on internal governance (article 22 of Directive 2006/48/EC) and on the CSSF's powers (article 136 of Directive 2006/48/EC), as well as the different provisions relating to consolidated supervision, including notably article 129 of Directive 2006/48/EC. The other provisions, which are of a technical nature, such as the calculation of capital requirements for credit risk, operational risk and market risk, or the definition of own funds, are transposed by means of circulars issued by the CSSF based on article 56 of the law of 5 April 1993 on the financial sector as amended. Circular CSSF 06/273 of 22 December 2006 thus transposed the new technical provisions as concerns credit institutions into Luxembourg legislation. The provisions that should be introduced by the bill concerned are not really material amendments of the existing requirements, insofar as they are already applied in the supervisory process as practiced in Luxembourg.

However, two major changes to the current situation should be pointed out. Firstly, Directive 2006/48/EC strengthens the co-operation between competent authorities involved in the supervision of European banking groups. Secondly, article 15 of the bill provides, in accordance with article 129 of Directive 2006/48/EC it transposes, that the Luxembourg supervisory authority must implement the decisions taken by a EU supervisory authority competent for the prudential supervision of the parent undertaking of a credit institution or investment firm authorised in Luxembourg, in the event of disagreement on the validation of a model used by a bank or an investment firm for the purpose of calculating capital requirements.

2.7. Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC as regards the definition of "politically exposed persons" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis

The purpose of this Directive is to implement Directive 2005/60/EC of 26 October 2005 on the fight against money laundering and terrorist financing which provides for this possibility in order to ensure a consistent implementation and to take into account the technical development in the field of combating money laundering and terrorist financing. Directive 2006/70/EC thus specifies the notion of "politically exposed persons" (already defined in Directive 2005/60/EC) by introducing a list of prominent political functions and by specifying the concept of family and close associates of politically exposed persons. The other provisions of the Directive set out information on customers presenting a low risk of money laundering and terrorist financing and on persons carrying out a financial activity, but who, based on specific criteria, do not fall within the scope of Directive 2005/60/EC.

2.8. Regulation (EC) No 1781/2006 of 15 November 2006 relating to the information on the payer accompanying transfers of funds

The purpose of the Regulation is to transpose the Special Recommendation VII on wire transfers (SR VII) of FATF into EU legislation. SR VII was drawn up to prevent terrorists and other criminals from having unfettered access to wire transfers for moving their funds and to detect such misuse when it occurs. The Community's intervention in this field (instead of measures adopted at the sole level of Member States), including the use of the Community Regulation directly applicable in every Member State, aims to ensure consistent transposition of the FATF recommendation throughout the European Union. This new EU regulation entered into force on 1 January 2007.

The Regulation sets down rules relating to information on the originator that must accompany transfers of funds sent or received by a payment service provider in the European Union. It distinguishes transfers of funds within the European Union subject to a simplified regime and those made to payees whose payment service provider is situated outside the European Union.

2.9. Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC

Directive 2007/14/EC specifies the publication of the choice of the home Member State, the content of the half-yearly report, the provisions relating to related parties' transactions, the length of the short settlement cycle, the control as regards market makers by competent authorities, the calendar of trading days, the provisions relating to notification of major holdings, the dissemination of regulated information and the equivalence of transparency requirements of third-country issuers. The Member States are required to have this Directive transposed into their national regulations within one year of its adoption.

3. LAWS PASSED IN 2006

3.1. Law of 16 March 2006 relating to the introduction of the international accounting standards for credit institutions

The law of 16 March 2006 transposes into the law of 17 June 1992 on the accounts of credit institutions as amended, the Community regulations on international accounting standards[1], namely:

- Directive 2001/65/EC of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies, as well as of banks and other financial institutions;
- articles 5 and 9 of Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting rules;
- Directive 2003/51/EC of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions as well as insurance undertakings.

The law gives the option to banks to publish their consolidated accounts and/or annual accounts under the IAS framework. The banks may thus prepare only one set of statements and use IAS as their reference.

Moreover, the law allows the banks, that do not use IAS, to apply certain provisions of the IAS standards. The banks may thus migrate progressively to the IAS standards.

In order to improve the comparability of financial information and ensure a level playing field among Luxembourg banks, the law requires that all options for banks shall be submitted for prior approval to the CSSF. The CSSF's approval can be given on a case-by-case basis or by means of general instructions containing implementation rules for the use of the IAS standards.

It should also be noted that the banks that apply the IAS standards, namely those that are required to do so under the IAS Regulation, as well as those that are authorised thereto by the law on bank accounts, remain submitted to certain provisions of the law concerned which are not covered by the IAS.

Finally, the law implements the transitional provisions of the IAS Regulation and postpones the implementation of its compulsory regime in certain cases until the end of 2007.

3.2. Law of 9 May 2006 on market abuse

For further information on this law, please refer to Chapter VII "Supervision of securities markets", as well as to circulars CSSF 06/257 of 17 August 2006 on the coming into force of the law of 9 May 2006 on market abuse and CSSF 07/280 of 5 February 2007 on the implementation rules of the law of 9 May 2006 on market abuse.

3.3. Law of 19 May 2006 concerning takeover bids

The law of 19 May 2006 implementing Directive 2004/25/EC of 21 April 2004 concerning takeover bids is explained in detail in Chapter VII "Supervision of securities markets", as well as in circular CSSF 06/258 of 18 August 2006 on the coming into force of the law of 19 May 2006.

[1] International Accounting Standards "IAS" or International Financial Reporting Standards (IFRS) according to the denomination of the new international accounting standards endorsed by the International Accounting Standards Board "IASB".

3.4. Law of 5 November 2006 on the supervision of financial conglomerates

The law transposes Directive 2002/87/EC of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate into Luxembourg law and amends the law of 6 December 1991 on the insurance sector and the law of 5 April 1993 on the financial sector as amended.

The notion of financial conglomerate is defined in detail in articles 51-9(5) and 51-10 of the law of 5 April 1993 on the financial sector as amended. In any case, in order to qualify as a financial conglomerate, a group must include at the same time and at least one important regulated entity within the banking or investment firms sector and one important entity within the insurance sector. There is currently no financial conglomerate in Luxembourg.

The law introduces a supplementary supervision on financial conglomerates into Luxembourg law. While the prudential supervision over a group so far exercised by the CSSF was limited to the banking and/or investment firms sector, the supplementary supervision is, under the new legal provisions, extended to the insurance sector as well. The law aims at taking into account the emergence in recent years of groups operating both in the banking and investment services sector and in the insurance sector, by introducing a cross-sectoral prudential supervision. This supplementary supervision shall however not affect, in any way, the sectoral prudential supervision, both on the individual and consolidated level, by the competent authorities on their respective sectors.

Supplementary supervision at the level of the financial conglomerate covers the following aspects:

- capital adequacy;
- risk concentration;
- intra-group transactions;
- internal control and risk management;
- management.

In accordance with articles 51-13 (capital adequacy), 51-14 (risk concentration) and 51-15 (intra-group transactions) of the amended law of 5 April 1993, the CSSF determined in circular CSSF 06/268, on the basis of article 56 of this law, the calculation and notification procedures regarding own funds, risk concentration and intra-group transactions that financial conglomerates, for which it exercises the role of coordinator, should respect.

The role of coordinator was introduced by the law of 5 November 2006, the coordinator being the authority responsible for the coordination and supplementary supervision at the level of the financial conglomerate. The coordinator is appointed according to the modalities laid down in article 51-17 of the law of 5 April 1993 as amended. In order to ensure appropriate supplementary supervision of the financial conglomerate, a single coordinator is appointed for each financial conglomerate.

Finally, the law requires close consultation and co-operation between the supervisory authorities in charge of regulated entities in a financial conglomerate. To this end, it introduces the notion of "relevant competent authority" (article 51-9). Relevant competent authority shall mean the coordinator, any competent authority responsible for the consolidated sectoral supervision of regulated entities in a financial conglomerate and, in certain cases, other authorities concerned, where relevant in the opinion of the coordinator and competent authorities responsible for the consolidated sectoral supervision.

3.5. Law of 18 December 2006 on financial services provided at distance

The law of 18 December 2006 transposes into Luxembourg law Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services whose purpose is to define a harmonised legal framework for the conclusion of distance contracts relating to financial services in order to establish an adequate consumer protection level in every Member State and thus to promote cross-border financial services and products commerce. Furthermore, this law amends the law of 27 July 1997 on insurance contracts, the law of 14 August 2000 relating to electronic commerce and article 63 of the amended law of 5 April 1993 relating to the financial sector.

The scope *ratione personae* of the law consists of all professionals that provide financial services. The notion of financial services covers any service of a banking, credit, investment and payment nature, excluding services relating to insurance or to personal pension. The insurance part is covered by the law of 27 July 1997 on insurance contracts as amended. The law only deals with the distance marketing of financial services, irrespective of the means of communication used (electronic, post, fax or phone).

In order to ensure transparency, the law lays down requirements aiming to ensure adequate consumer information, both before and after the conclusion of a distance contract. The consumers have a right of withdrawal, except for a certain number of specific services. The law also protects the consumer against unsolicited financial services. Finally, the law sets down disciplinary fines to sanction those that do not comply with the provisions governing distance marketing of financial services.

3.6. Law of 13 February 2007 on specialised investment funds

The law of 13 February 2007 on specialised investment funds replaces the law of 19 July 1991 relating to undertakings for collective investment the securities of which are not intended to be placed with the public. While the law of 19 July 1991 refers mainly to the provisions of the law of 30 March 1988 relating to undertakings for collective investment with respect to the rules applicable to UCIs created under its regime, its replacement became necessary following the abrogation of the 1988 law as from 13 February 2007, owing to the transitional provisions set down in the law of 20 December 2002 relating to undertakings for collective investment, which transposed the provisions of the amended Directive 85/611/EC concerning UCITS into Luxembourg law.

The law on specialised investment funds establishes a legal framework to promote the development in Luxembourg of investment products reserved to "well-informed investors".

In order to allow UCIs subject to the law of 19 July 1991 to continue to perform their activities, the law of 13 February 2007 provides that these UCIs fall *ipso jure* under the new regime relating to specialised investment funds.

4. CIRCULARS ISSUED IN 2006

In 2006, the CSSF issued 46 circulars, 31 of which dealing with the fight against money laundering and terrorist financing.

The following circulars should be pointed out in particular, some of which being covered more specifically in the relevant Chapters of the Annual Report:

- Circular CSSF 06/241 on the concept of risk capital under the law of 15 June 2004 relating to the investment company in risk capital (SICAR);
- Circular CSSF 06/251 describing the new prudential reporting scheme regarding capital adequacy applicable as from 2008 and transitional provisions for 2007;
- Circular CSSF 06/260 concerning the implementation, validation and assessment of the internal ratings-based approach (IRB approach) and the advanced measurement approaches (AMA) within the framework of the new capital adequacy rules;
- Circular CSSF 06/265 concerning the draft law 5627 relating, *inter alia*, to the transposition into Luxembourg law of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID Directive);
- Circular CSSF 06/273 defining capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended (application to credit institutions);
- Circular CSSF 07/277 on the new notification procedure in line with the guidelines of the Committee of European Securities Regulators (CESR) regarding the simplification of the UCITS notification procedure.

5. CIRCULARS IN FORCE (AS AT 1 MARCH 2007)

5.1. Circulars issued by the *Commissariat au Contrôle des Banques*

Number	Date	Subject
B 79/2	07.05.1979	European Code of Conduct on securities transactions
B 83/6	16.03.1983	Participating interest held by credit institutions

5.2. Circulars issued by the *Institut Monétaire Luxembourgeois*

Number	Date	Subject
84/18	19.07.1984	Futures markets (law of 21 June 1984)
86/32	18.03.1986	Control of the annual accounts of credit institutions
88/49	08.06.1988	New legal provisions concerning controls carried out by auditors
91/75	21.01.1991	Revision and re-casting of rules governing Luxembourg undertakings covered by the law of 30 March 1988 on undertakings for collective investment
91/78	17.09.1991	Terms of application of Article 60 of the amended law of 27 November 1984 regulating private portfolio managers
91/80	05.12.1991	Staff numbers (PFS)
92/86	03.07.1992	Law of 17 June 1992 concerning the accounts of credit institutions
93/92	03.03.1993	Computerised transmission of periodic data
93/94	30.04.1993	Entry into force for banks of the law of 5 April 1993 on the financial sector

93/95	04.05.1993	Entry into force for other professionals of the financial sector of the law of 5 April 1993 on the financial sector
93/99	21.07.1993	Provisions for Luxembourg credit institutions wishing to exercise banking activities in other EEC countries through the establishment of branches or under the freedom to provide services
93/100	21.07.1993	Provisions for credit institutions of Community origin exercising banking activities in Luxembourg through branches or under the freedom to provide services
93/101	15.10.1993	Rules concerning the organisation and internal control of the market activity of credit institutions
93/102	15.10.1993	Rules concerning the organisation and internal control of the activities of brokers or commission agents exercised by other financial sector professionals
93/104	13.12.1993	Definition of a liquidity ratio to be observed by credit institutions
94/109	08.03.1994	Allocation of responsibilities for the establishment of equipment for transmitting computerised data to the IML
95/116	20.02.1995	Entry into force of: - the law of 21 December 1994 amending certain legal provisions concerning the transfer of claims and pledging; - the law of 21 December 1994 concerning repurchase agreements transacted by credit institutions
95/118	05.04.1995	Customer complaint handling
95/119	21.06.1995	Rules for the management of risks linked to derivatives transactions
95/120	28.07.1995	Central administration
96/123	10.01.1996	Staff numbers (new table S 2.9.)
96/124	10.01.1996	Staff numbers (new table S 2.9. for PFS)
96/125	30.01.1996	Supervision of credit institutions on a consolidated basis
96/126	11.04.1996	Administrative and accounting organisation
96/129	19.07.1996	Law of 9 May 1996 on the netting of claims in the financial sector
96/130	29.11.1996	Calculation of a simplified ratio in application of circular IML 96/127
97/135	12.06.1997	Transmission of supervisory data and statistics by telecommunications media
97/136	13.06.1997	Financial information for the IML and Statec
98/143	01.04.1998	Internal control
98/147	14.05.1998	Provisions for EC investment firms exercising their activities in Luxembourg through branches or under the freedom to provide services
98/148	14.05.1998	Provisions for Luxembourg investment firms wishing to exercise their activities in other EC countries through the establishment of branches or under the freedom to provide services

5.3. Circulars issued by the Commissariat aux Bourses

Number	Date	Subject
93/4	04.01.1993	Law of 4 December 1992 on reporting requirements concerning the acquisition or disposal of major holdings in a listed company

5.4. Circulars issued by the *Commission de Surveillance du Secteur Financier*

Number	Date	Subject
99/1	12.01.1999	Creation of the Commission de Surveillance du Secteur Financier
99/2	20.05.1999	Entry into force of three new laws dated 29 April 1999
99/4	29.07.1999	Entry into force of the law of 8 June 1999 creating pension funds in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep)
99/7	27.12.1999	Declarations to be sent to the CSSF in accordance with articles 5 and 6 of the law of 23 December 1998 on the supervision of the securities markets
00/10	23.03.2000	Definition of capital ratios pursuant to article 56 of the amended law of 5 April 1993 on the financial sector (application to credit institutions)
00/12	31.03.2000	Definition of capital ratios pursuant to article 56 of the amended law of 5 April 1993 on the financial sector (application to investment firms)
00/13	06.06.2000	Sanctions against the Federal Republic of Yugoslavia and the Taliban in Afghanistan
00/14	27.07.2000	Adoption of the law of 17 July 2000 amending certain provisions of the law of 30 March 1988 on undertakings for collective investment
00/15	02.08.2000	Rules of conduct for the financial sector
00/17	13.09.2000	Entry into force of the law of 27 July 2000 transposing Directive 97/9/EC concerning investor compensation schemes into the amended law of 5 April 1993 on the financial sector
00/18	20.10.2000	Bank accounts of the State of Luxembourg
00/22	20.12.2000	Supervision of investment firms on a consolidated basis carried out by the Commission de Surveillance du Secteur Financier
01/26	21.03.2001	Law of 12 January 2001 transposing Directive 98/26/EC on settlement finality in payment and securities settlement systems into the amended law of 5 April 1993 and supplementing the law of 23 December 1998 creating a supervisory commission for the financial sector
01/27	23.03.2001	Practical rules on the role of external auditors
01/28	06.06.2001	Verification by banks and PFS that the legal requirements on domiciliation are satisfied
01/29	07.06.2001	Minimum content required for an agreement on the domiciliation of companies
01/32	11.07.2001	Publication of information on financial instruments
01/34	24.09.2001	Entry into force of a series of laws concerning the financial sector
01/42	19.11.2001	Mortgage bond banks: rules on real estate valuation
01/46	19.12.2001	Repeal of Circular CSSF 01/35
01/47	21.12.2001	Professional obligations of domiciliation agents of companies and general recommendations Amendment of Circular CSSF 01/28
02/61	04.06.2002	Identification and declaration of business relations with terrorist circles
02/63	01.07.2002	Cross-border payments in euros
02/65	08.07.2002	Law of 31 May 1999 governing the domiciliation of companies; precisions as regards the concept of "seat"

02/71	01.10.2002	Law of 3 September 1996 concerning the involuntary dispossession of bearer securities
02/77	27.11.2002	Protection of investors in case of miscalculation of NAV and the compensation following non-compliance with investment rules applicable to undertakings for collective investment
02/80	05.12.2002	Specific rules applicable to Luxembourg undertakings for collective investment (UCIs) which adopt alternative investment strategies
02/81	06.12.2002	Practical rules regarding the tasks of external auditors of undertakings for collective investment
03/87	21.01.2003	Coming into force of the law of 20 December 2002 regarding undertakings for collective investment
03/88	22.01.2003	Classification of undertakings for collective investment governed by the provisions of the law of 20 December 2002 regarding UCIs
03/95	26.02.2003	Mortgage bond banks: applicable minimum requirements regarding management and control of the mortgage register, cover assets and the limit of circulating mortgage bonds
03/97	28.02.2003	Publication of the simplified and complete prospectuses as well as annual and half-yearly reports of UCIs in the database of the financial centre
03/100	01.04.2003	Publication on the Internet of CSSF instructions: - *Recueil des instructions aux banques* of the CSSF - Schedule of Conditions for the technical implementation of the CSSF reporting requirements - SOC/CSSF
03/108	30.07.2003	Luxembourg management companies subject to Chapter 13 of the law of 20 December 2002 concerning undertakings for collective investment, as well as Luxembourg self-managed investment companies subject to article 27 or article 40 of the law of 20 December 2002 concerning undertakings for collective investment
03/113	21.10.2003	Practical rules concerning the mission of external auditors of investment firms
03/122	19.12.2003	Clarifications on the simplified prospectus
04/132	24.03.2004	Abrogation of circular CaB 91/3
04/140	13.05.2004	Amendment of circular CSSF 2000/12 applicable to investment firms incorporated under Luxembourg law and to branches of non-EU investment firms to transpose Directive 2004/69/EC of the European Commission of 27 April 2004 amending Directive 2000/12/EC of the European Parliament and of the Council as regards the definition of "multilateral development banks"; Amendment of the list of zone A countries
04/143	24.05.2004	Abrogation of circulars IML 90/67, 90/68 and 91/77
04/146	17.06.2004	Protection of undertakings for collective investment and their investors against Late Trading and Market Timing practices
04/154	24.08.2004	New capital requirements regime
04/155	27.09.2004	Compliance function
04/156	01.10.2004	Circular CSSF 2000/10 - Abrogation of the communication of the detailed calculation of the capital requirement (tables B 3.2 and B 7.3) - List of currencies of EU Member States not participating in the Euro

05/176	05.04.2005	Rules of conduct to be adopted by undertakings for collective investment in transferable securities in relation to the use of financial derivative instruments
05/177	06.04.2005	Abolition of any prior control by the CSSF of advertising material used by persons and companies supervised by the CSSF; abrogation of point II. of Chapter L. of circular IML 91/75; abrogation of the two last sentences of point IV. 5.11 of circular CSSF 2000/15
05/178	11.04.2005	Administrative and accounting organisation; outsourcing of IT services; abrogation of point 4.5.2. of circular IML 96/126 and replacement by point 4.5.2. of this circular
05/185	24.05.2005	Luxembourg management companies subject to Chapter 13 of the law of 20 December 2002 concerning undertakings for collective investment, as well as Luxembourg self-managed investment companies subject to article 27 or article 40 of the law of 20 December 2002 concerning undertakings for collective investment
05/186	25.05.2005	Guidelines of the Committee of European Securities Regulators (CESR) regarding the application of transitional measures resulting from Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611/EEC (UCITS I)
05/187	26.05.2005	Financial information to be submitted to the CSSF by the "other professionals of the financial sector" (PFS) on a periodic basis
05/197	19.07.2005	Reporting of periodic financial information to the CSSF by the "other professionals of the financial sector" (PFS) by electronic means
05/201	29.07.2005	Coming into force of the law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep)
05/210	10.10.2005	Drawing-up of a simplified prospectus within the scope of Chapter 1 of Part III of the law on prospectuses for securities
05/211	13.10.2005	Combating money laundering and terrorist financing and the prevention of the use of the financial sector for the purpose of money laundering and terrorist financing
05/224	15.12.2005	Choice of the home Member State for third country issuers whose securities are admitted to trading on 1 July 2005 and notification by these issuers of their choice by 31 December 2005
05/225	16.12.2005	Notion "offer to the public of securities" as defined in the law on prospectuses for securities and the "obligation to publish a prospectus" that may ensue
05/226	16.12.2005	General overview of the law on prospectuses for securities and technical specifications regarding communications to the CSSF of documents for the approval or for filing and of notices for offers of securities to the public and admissions of securities to trading on a regulated market
05/227	16.12.2005	Introduction of a new prudential reporting in 2008
06/240	22.03.2006	Administrative and accounting organisation; IT outsourcing and details regarding services provided under the status of support PFS, articles 29-1, 29-2 and 29-3 of the law of 5 April 1993 on the financial sector as amended; modification of IT outsourcing conditions for branches located abroad
06/241	05.04.2006	Concept of risk capital under the law of 15 June 2004 relating to the investment company in risk capital (SICAR)
06/251	13.07.2006	Description of the new prudential reporting scheme regarding capital adequacy applicable as from 2008 and transitional provisions for 2007

06/257	17.08.2006	Coming into force of the law of 9 May 2006 on market abuse
06/258	18.08.2006	Coming into force of the law of 19 May 2006 on the implementation of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 concerning takeover bids
06/260	27.09.2006	Implementation, validation and assessment of the internal ratings-based approach (IRB approach) and the advanced measurement approaches (AMA) within the framework of the new capital adequacy rules
06/265	09.11.2006	Draft law 5627 relating, *inter alia*, to the transposition into Luxembourg law of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MIFID Directive)
06/267	22.11.2006	Technical specifications regarding the communication to the CSSF, under the law on prospectuses for securities, of documents for the approval or for filing and of notices for offers to the public of units/ shares of Luxembourg closed-end UCIs and admissions of units/shares of Luxembourg closed-end UCIs to trading on a regulated market
06/268	29.11.2006	Supplementary supervision of financial conglomerates and defining structure coefficients to be observed by these financial conglomerates in accordance with article 56 of the law of 5 April 1993 on the financial sector as amended
06/269	06.12.2006	Statistics on guaranteed deposits and instruments
06/270	14.12.2006	Breakdown of value corrections made by the credit institutions at 31 December 2006
06/272	21.12.2006	Technical specifications regarding the communication to the CSSF, under the law on prospectuses for securities, of documents for the approval or for filing and of notices for offers to the public of securities issued by SICARs and admissions of securities issued by SICARs to trading on a regulated market
06/273	22.12.2006	Definition of capital ratios pursuant to article 56 of the amended law of 5 April 1993 on the financial sector (application to credit institutions)
06/274	22.12.2006	Entry into force of Regulation (EC) No 1781/2006 of the European Parliament and of the Council of 15 November 2006 relating to the information on the payer accompanying transfers of funds
06/275	22.12.2006	Update of table B 4.6 *"Responsables de certaines fonctions"*
07/277	09.01.2007	New notification procedure in line with the guidelines of the Committee of European Securities Regulators (CESR) regarding the simplification of the UCITS notification procedure
07/279	01.02.2007	Description of the new financial reporting scheme applicable as from 1 January 2008
07/280	05.02.2007	Implementation rules of the law of 9 May 2006 on market abuse
07/281	27.02.2007	Entry into force of the law of 18 December 2006 on financial services provided at distance
07/283	28.02.2007	Entry into force of the law of 13 February 2007 relating to specialised investment funds

The circulars listing the persons and entities to which restrictive measures apply within the scope of the fight against terrorism and money laundering, are mentioned hereunder, and do not appear in the table above.

The changes to the list of countries and territories considered as non co-operative by the Financial Action Task Force (FATF) are the subject of circular CSSF 06/263.

The amendments to Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban published on 4 June 2002 in Circular CSSF 02/61 are the subject of circulars CSSF 02/62, 02/68, 02/70, 02/72, 02/74, 02/75, 02/79, 03/89, 03/91, 03/92, 03/96, 03/98, 03/99, 03/101, 03/102, 03/103, 03/105, 03/109, 03/110, 03/111, 03/112, 03/116, 03/117, 03/119, 04/125, 04/126, 04/127, 04/130, 04/131, 04/134, 04/138, 04/141, 04/148, 04/150, 04/152, 04/157, 04/160, 04/164, 04/166, 05/169, 05/170, 05/173, 05/183, 05/184, 05/190, 05/198, 05/202, 05/204, 05/206, 05/207, 05/209, 05/213, 05/215, 05/216, 05/220, 05/229, 06/232, 06/234, 06/235, 06/238, 06/242, 06/253, 06/254, 06/255, 06/256, 06/259, 06/262, 06/266, 06/271 and 07/278.

The specific restrictive measures against certain persons and entities within the scope of the fight against terrorism are the subject of circulars CSSF 02/59, 2/75, 03/111, 04/246 and 06/276.

The freeze of funds in relation to Mr Milosevic and those persons associated with him is the subject of circulars CSSF 00/20 and 03/102.

The measures against UNITA (União Nacional para a Independência Total de Angola) are the subject of circular CSSF 03/90.

The restrictive measures concerning certain Iraqi assets are the subject of circulars CSSF 03/110, 03/114, 03/118, 04/136, 04/142, 04/145, 05/194, 05/205 and 06/245.

The restrictive measures in relation to the persons indicted by the ICTY are the subject of circulars CSSF 04/159, 04/163, 04/168, 05/172, 05/180, 05/181, 05/189, 05/208, 06/231, 06/239 and 06/252.

The restrictive measures concerning Burma / Myanmar are the subject of circulars CSSF 06/248 and 06/261.

The restrictive measures in relation to Liberia are the subject of circulars CSSF 04/137, 04/147, 04/153, 04/158, 05/193 and 05/223.

The restrictive measures in respect of Zimbabwe are the subject of circulars CSSF 04/128, 05/192 and 05/203.

The restrictive measures in view of the situation in Côte d'Ivoire are the subject of circulars CSSF 05/179, 06/236 and 06/249.

The restrictive measures against Sudan are the subject of circulars CSSF 05/199 and 06/243.

The restrictive measures against the Democratic Republic of Congo are the subject of circulars CSSF 05/200, 05/218, 06/218, 06/233 and 07/282.

The restrictive measures in connection with the assassination of former Lebanese Prime Minister Rafiq Hariri are the subject of circular CSSF 06/237.

The restrictive measures against President Lukashenko and certain officials of Belarus are the subject of circulars CSSF 06/244 and 06/264.

The warning concerning business relationships and transactions with natural or legal persons of North Korea is the subject of circular CSSF 06/247.

CHAPTER 13

13 INTERNAL ORGANISATION OF THE CSSF

1. Functioning of the CSSF

2. Human resources

3. Information Technology

4. Staff members

5. Internal committees

1. FUNCTIONING OF THE CSSF

The CSSF's administrative and management organisation is described in detail in the sub-section "Corporate governance and functioning" of the CSSF website (www.cssf.lu, section "About the CSSF").

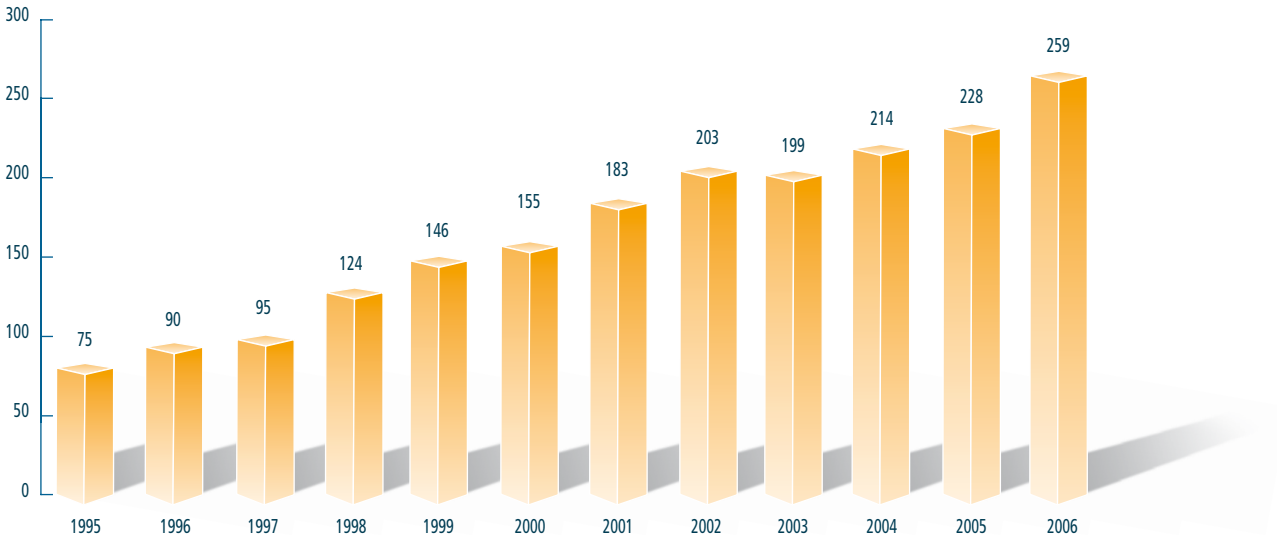
2. HUMAN RESOURCES

On 1 January 2006, following the transposition into Luxembourg law of Directive 2003/71/EC on prospectuses to be published when securities are offered to the public or admitted to trading (Prospectus Directive), fourteen employees of the Luxembourg Stock Exchange have been transferred to the CSSF. The competitive exams organised in autumn 2005 allowed to hire fourteen additional agents beginning of 2006.

In addition, five secretaries have been employed to cope with the additional administrative workload of the different CSSF departments. Considering the three departures during the year (two retirements and one resignation) and one change of administration to the CSSF, the total number of people employed reached 259 units as at 31 December 2006, representing 224.75 full-time positions.

In order to manage the growth in the financial sector, the CSSF organised a competitive exam for the *carrière supérieure* on 21 October 2006, which allowed to hire twelve agents, namely eleven economists and one person with a degree in foreign languages beginning of 2007. A second competitive exam organised on 11 November 2006 for the *carrière moyenne* resulted in 5 agents being hired as at 1 January 2007 and two agents as at 1 February 2007.

Movements in staff numbers (at the end of the year)



Within the scope of continuing training, 105 trainings have been organised for the personnel of the CSSF in 2006, against 98 in 2005. The majority of these trainings concerned the areas of economics and finance. Other trainings were attended in subjects as for example information technology, law, accounting, management, human resources management, personal development and security. The attendance to the different training sessions rose from 565 in 2005 to 833 in 2006. In total, 226 agents attended at least one training in 2006.

3. INFORMATION TECHNOLOGY

The IT department of the CSSF is in charge of the installation, maintenance and development of the internal IT infrastructure of the CSSF.

Considering its very specific activity, the CSSF uses a "tailor-made" software to manage the reporting data received from the financial institutions subject to its supervision. Indeed, the data which is transmitted to the CSSF in various formats through different channels has to be controlled. On 1 January 2007, the CSSF implemented a new software to replace an older application which was already used by the *Institut Monétaire Luxembourgeois*. The new software has been developed in its major part internally since 2004. It integrates as well a module for the management of the supervised entities' identification data and for the management of the taxes levied by the CSSF on these entities. All old data was migrated without major problems.

The new software centralises the reporting data of the different types of reporting, such as banks, UCIs, PFS, pension funds, etc. The reporting of other entities can be integrated easily. The software also allows to adapt the received reporting format to the new developments planned for 2007 and 2008, as for example COREP (CRD) and FINREP (IFRS) in XBRL format.

Beginning 2006, the CSSF published a new online version of its Internet website with a completely new graphic identity and the possibility to choose between the French and English version. Further to international requirements, a module including detailed information on "Supervisory disclosure" has been added to the website. The new subscription functionality which allows automatic notification of newly published documents has been a major success. Currently, 1,700 people have already subscribed to this service.

In 2006, the team responsible for the operating systems was in charge of the IT installation for the newly recruited agents. It has also taken this opportunity to change part of the PCs and PC screens and to update the telephone exchange of the CSSF.

4. STAFF MEMBERS (AS AT 1 MARCH 2007)

EXECUTIVE BOARD

Director General	Jean-Nicolas Schaus
Directors	Arthur Philippe, Simone Delcourt
Executive Secretaries	Marcelle Michels, Monique Reisdorffer, Joëlle Deloos, Karin Frantz
Internal audit	Marie-Anne Voltaire
Director General's advisors	Marc Weitzel, Jean-Marc Goy, Geneviève Pescatore
IT coordination	Pascale Damschen
Systems security	Constant Backes

GENERAL SUPERVISION

Head of function	Claude Simon
Deputy head	Romain Strock

Division 1 – International files

Head of division	Romain Strock
	Guy Haas, Nadia Manzari, Karin Weirich, Ngoc Dinh Luu, Vincent Thurmes, Judith Meyers

Division 2 – Accounting, reporting and audit

Head of division	Danièle Goedert
	Marguy Mehling, Martine Wagner, Christina Pinto, Diane Seil, Ana Bela Ferreira, Stéphanie Weber
Division 3 – Special functions	Joëlle Martiny, Davy Reinard, Didier Bergamo, Edouard Reimen, Claude Wampach, Alain Hoscheid, Ronald Kirsch, Pierrot Rasqué, Marco Lichtfous, Joé Schumacher
Secretary	Micheline de Oliveira

DEPARTMENT SUPERVISION OF BANKS

Head of department	Frank Bisdorff
Deputy head of department	Ed. Englaro

Division 1 – Supervision of credit institutions 1

Head of division	Ed. Englaro
	Jean Ley, Claudine Tock, Isabelle Lahr, Anouk Dondelinger, Jacques Streweler

Division 2 - Supervision of credit institutions 2

Head of division	Jean-Paul Steffen
	Jean Mersch, Joan De Ron, Michèle Trierweiler, Alain Weis, Jean-Louis Duarte, Carlos Azevedo Pereira

Division 3 - Supervision of credit institutions 3

Head of division	Nico Gaspard
	Marco Bausch, Françoise Daleiden, Stéphanie Nothum, Jean-Louis Beckers, Claude Moes

Division 4 - Supervision of credit institutions 4

Head of division	Patrick Wagner
	Marc Bordet, Monica Ceccarelli, Marina Sarmento, Steve Polfer, Gilles Jank, Yves Simon

General studies and issues Marc Wilhelmus

Statistics and IT issues Claude Reiser, Romain De Bortoli

Secretaries Claudine Wanderscheid, Michèle Delagardelle, Steve Humbert

DEPARTMENT SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT

Head of department Irmine Greischer
Deputy heads of department Claude Steinbach, André Schroeder, Jean-Paul Heger

Practical studies and specific aspects
Francis Koepp

IT systems Nico Barthels, Danièle Christophory

General organisation – Management and operation of databases
Claude Steinbach
Head of division Jolanda Bos
Marie-Louise Baritussio, Géraldine Olivera, Danielle Neumann, Adrienne André-Zimmer, Nicole Grosbusch, Suzanne Wagner, Claudine Thielen, Claude Krier, Sabine Schiavo, Christiane Cazzaro, Marc Schwalen, Patrick Bariviera

Instruction and supervision of UCIs and management companies
Coordination of Divisions 1 to 6 Jean-Paul Heger

Division 1 – UCIs
Head of division Anica Giel-Markovinovic
Nathalie Reisdorff, Alain Strock, Pascale Schmit, Claude Wagner, Patricia Jost, Nathalie Wald, Paul Hansen, Alex Weber, Daniel Wadlé

Division 2 – UCIs
Head of division Charles Thilges
Francis Lippert, Joël Goffinet, Marc Siebenaler, Yolanda Alonso, Dominique Herr, Diane Reuter, Dave Reuter, Sophie Leboulanger, Christel Tana, Nathalie de Brabandere, Claude Detampel

Division 3 – UCIs
Head of division Ralph Gillen
Daniel Schmitz, Michèle Wilhelm, Carine Peller, Martin Mannes, Isabelle Dosbourg, Roberta Tumiotto, Michel Friob, Florence Winandy, David Phillips, Laurent Reuter

Division 4 – UCIs
Head of division Francis Gasché
Evelyne Pierrard-Holzem, Martine Kerger, Marc Racké, Marie-Rose Colombo, Thierry Quaring, Serge Eicher, Robert Köller, Nicole Gengler, Robert Brachtenbach

Division 5 – UCIs
Head of division Guy Morlak
Pierre Reding, Damien Houel, Nathalie Cubric, Géraldine Appenzeller, Marc Decker, Thierry Stoffel, Jean-Marc Lehnert, Jean-Claude Fraiture, Gilles Oth

Division 6 – Authorisation and supervision of management companies

Head of division	Pascal Berchem
	Pascale Felten-Enders, Anne Conrath, Eric Tanson, Roberto Montebrusco, Anne-Marie Hoffeld
Legal and economic aspects	André Schroeder
	Christiane Streef, François Hentgen, Angela De Cillia, Fabio Ontano, Joëlle Hertges, Stéphanie Bonifas, Alain Bressaglia, Christian Schaack, Jacqueline Arend
Secretaries	Carole Eicher, Sandy Bettinelli, Simone Kuehler, Sandra Ghirelli, Nadja Trausch

DEPARTMENT SUPERVISION OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR

Head of department	Sonny Bisdorff-Letsch
Deputy head of department	Denise Losch
	Gérard Brimeyer, Carlo Felicetti, Simone Gloesener, Nicole Lahire, Sylvie Mamer, Anne Marson, Claudia Miotto, Carole Ney, Luc Pletschette, Mariette Thilges
Secretary	Emilie Lauterbour

GENERAL SECRETARIAT

Head of department	Danièle Berna-Ost
Deputy head of department	Danielle Mander
	Jean-François Hein, Benoît Juncker, Carine Conté, Natasha Deloge, Nadine Holtzmer, Iwona Mastalska, Christiane Trausch, Anne Wagener, Carmela Anobile, Patrick Hommel
Secretary	Steve Humbert

DEPARTMENT SUPERVISION OF SECURITIES MARKETS

Head of department	Françoise Kauthen
Deputy head of department	Annick Zimmer
Legal issues and takeover bids	Marc Limpach

Division 1 – Approval of prospectuses

Head of division	Jean-Christian Meyer
Group 1	Fanny Breuskin, Frédéric Dehalu, David Deltgen, Patrick Fricke, Yves Hansen, Jerry Oswald, Manuel Roda
Group 2	Claude Fridrici, Joëlle Paulus, David Schmitz

Division 2 – Approval of prospectuses

Head of division	Gilles Hauben
Group 1	Olivier Ferry, Stéphanie Jamotte, Daniel Jeitz, Julien May, Marc Reuter, Cyrille Uwukuli, Olivier Weins
Group 2	Michèle Debouché, Estelle Gütlein-Bottemer
Supervision of listed companies	Pierre van de Berg, Maureen Wiwinius
Inquiries and other functions of supervision of securities transactions	Laurent Charnaut, Giang Dang, Eric Fritz, Andrea Haris, Sylvie Nicolay-Hoffmann, Martine Simon, Maggy Wampach
Supervision of persons performing stock exchange activities	Mylène Hengen
Secretaries	Christine Jung, Marie-Josée Pulcini

DEPARTMENT SUPERVISION OF PENSION FUNDS, SICARS AND SECURITISATION UNDERTAKINGS

Head of department Christiane Campill
Deputy head of department Marc Pauly

Authorisation and supervision of pension funds and securitisation undertakings

Isabelle Maryline Schmit, Natalia Radichevskaia, Son Backes, Cliff Buchholtz

Authorisation and supervision of SICARs

Daniel Ciccarelli, Josiane Laux, René Schott, Carole Lis, Martine Weber

Secretary Carla Dos Santos

DEPARTMENT SUPERVISION OF IT AND SUPPORT PFS

Head of department David Hagen
Deputy head of department Claude Bernard
Pascal Ducarn, Elisabeth Demuth, Paul Angel

DEPARTMENT ADMINISTRATION AND FINANCE

Head of department Edmond Jungers
Deputy head of department Georges Bechtold

Division 1 - Human resources and day-to-day management

Head of division Georges Bechtold
Alain Kirsch, Vic Marbach, Raul Domingues, Marco Valente, Paul Clement

Division 2 – Financial management

Head of division Jean-Paul Weber
Carlo Pletschette, Tom Ewen

Secretary Milena Calzettoni

DEPARTMENT INFORMATION TECHNOLOGY

Head of department Jean-Luc Franck
Deputy head of department Sandra Wagner

Division 1 – Analysis and development

Head of division Paul Herling
Marc Kohl, Guy Wagener, Luc Prommenschenkel

Division 2 – Management of databases

Sandra Wagner

Division 3 – Operating systems

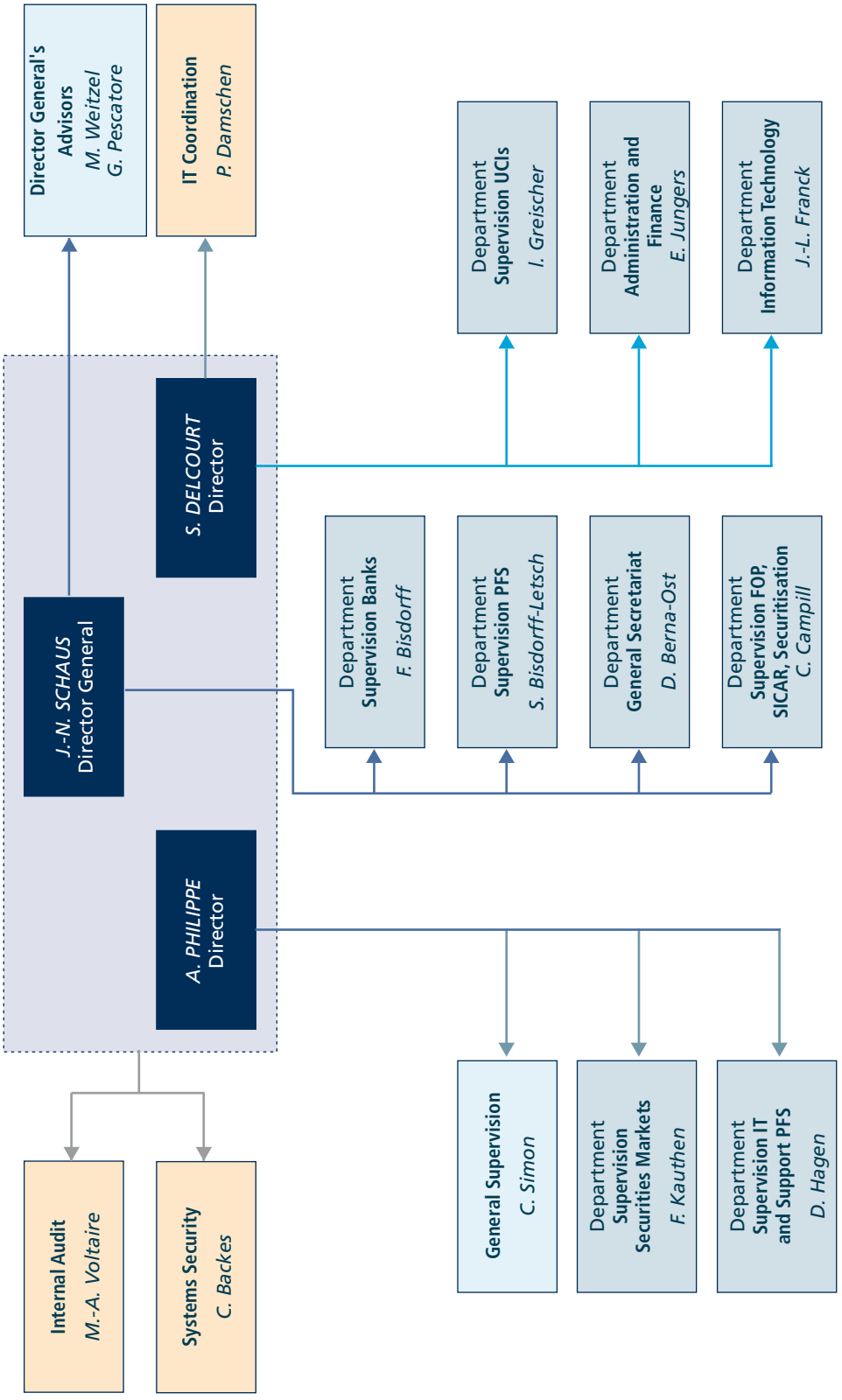
Head of division Guy Frantzen
Jean-François Burnotte, Jean-Jacques Duhr, Nadine Eschette, Steve Kettmann, Edouard Lauer, Frank Brickler

Division 4 – Dataflow management

Head of division Joao Pedro Almeida
Karin Proth, Carine Schiltz

FINANCIAL CONTROLLER KPMG

ORGANISATION CHART



5. INTERNAL COMMITTEES

Consultative committee for prudential regulation

Chairman	Jean-Nicolas SCHAUS
Members	Rafik FISCHER, Jean FUCHS, Jean GUILL, Robert HOFFMANN, Michel MAQUIL, Jean MEYER, Arthur PHILIPPE, Jean-Jacques ROMMES
Secretary	Danielle MANDER

Consultative committee Anti-Money Laundering

Chairman	Jean-Nicolas SCHAUS
Members	Claude BIRNBAUM, Pia HAAS, Charles HAMER, Roger HARTMANN, Jean-François HEIN, Jean-Luc KAMPHAUS, Pierre KRIER, Jean-Marie LEGENDRE, François PAULY, Marc PECQUET, Arthur PHILIPPE, Jean-Jacques ROMMES, Thomas SEALE, Claude SIMON, Romain STROCK, Lucien THIEL, Marc WEITZEL, André WILWERT
Secretary	Geneviève PESCATORE

Committee Other Professionals of the Financial Sector

Chairman	Jean-Nicolas SCHAUS
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Secretary	Denise LOSCH

Committee Banks

Chairman	Arthur PHILIPPE
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Secretary	Martine WAGNER

Committee Compliance

Chairman	Arthur PHILIPPE
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Committee Mortgage Bonds

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Committee Undertakings for Collective Investment

Chairman	Jean-Nicolas SCHAUS
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Secretary	Jean-Marc GOY

Committee Support PFS

Chairman	Arthur PHILIPPE
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Committee SICAR

Chairman	Jean-Nicolas SCHAUS
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Secretary	Daniel CICCARELLI

APPENDICES

1. COMMENTS ON THE GENERAL POLICY AND INTERPRETATIONS OF THE CSSF IN RELATION TO THE AUTHORISATION OF PROFESSIONALS OF THE FINANCIAL SECTOR

Pursuant to the law of 5 April 1993 on the financial sector as amended (the law), the CSSF is the competent authority to give an opinion on the requests for authorisation of persons contemplating to exercise a financial activity. The CSSF plays thus an important role in the process of taking up an activity in the financial centre and attaches a particular importance to the suitability of persons that intend to exercise a financial activity in Luxembourg.

In order to allow new developments in the financial centre, the CSSF has adopted a more liberal approach over the last years, showing a greater flexibility in relation to the appreciation of the criteria with which shareholders and directors of a credit institution or a PFS must comply. This new approach is in line with international practice and remains, at the same time, compliant with legal requirements.

Aware of its mission as a public service, the CSSF has always been concerned with being available to promoters and participants in the financial centre through a pragmatic, informal and transparent approach.

The requests for information or authorisation are handled within a short period of time and the working approach is mainly based on a close dialogue with the persons concerned. The CSSF's intention is to establish a personalised contact, in order to provide these persons with the necessary details, to allow them to present their project or to guide them during the setting-up of their approval file. 157 meetings were held in the context of information requests or setting-up of approval files of future professionals of the financial sector in 2006.

In numerous requests for information or authorisation addressed to the CSSF in 2006, the CSSF had to decide on the legal qualification of some activities considered and on the interpretation of several legal provisions relating to the requirements necessary to obtain an authorisation as a professional of the financial sector.

1.1. Interpretation of the legal qualification

In the context of the legal qualification of certain activities, it is worth pointing out several interpretations of general application.

- As regards the activity of recovery of debts owed to third parties pursuant to article 28-3 of the law, the CSSF considers that an authorisation is required even if the person offering the debt recovery service is not entitled to cash in the funds or to have them credited on its account. However, where the activity is limited to sending reminders on letterhead paper of the creditor and the fees for this service are exclusively billed to the creditor, it will not be considered as a debt recovery activity pursuant to article 28-3.

- In relation to the status of professional carrying on lending operations, whose activity consists in granting, for its own account, loans to the public, pursuant to article 28-4 of the law, the CSSF has given its interpretation of the concept of "loans to the public". The CSSF considers that "public" shall mean clients other than professional clients within the meaning of Annexe II of the Directive on markets in financial instruments (MiFID). Therefore, where loans are granted to professional clients within the meaning of Annexe II of MiFID, the entity granting such loans does not have to require an authorisation under article 28-4. This activity neither requires an agreement under the general provisions of the law (article 13).

- The CSSF has also given further specifications concerning financial leasing. Financial leasing operations involving the leasing of movables or immovables specifically purchased with a view to such leasing by the professional, who remains the owner thereof, where the contract reserves unto the lessee the right to acquire, either during the course of or at the end of the term of the lease, ownership of all or any part of the property leased in return for payment of a sum specified in the contract, qualify as lending operations pursuant to article 28-4(2)(a), without prejudice to article 28-4(3). The CSSF considers that whenever the contract does not provide for a purchase option, but a purchase obligation, the activity is not considered as a leasing activity, but as a deferred payment sale which does not fall under the scope of article 28-4.

- According to article 29 of the law, domiciliation agents of companies, who are by their nature regarded as carrying on in a professional capacity an activity in the financial sector, are natural or legal persons who agree to the establishment at their address, by one or more companies of which the domiciliation agent is not itself an associate exercising a significant influence over the conduct of business, of a registered office for the purposes of carrying on there any activity falling within the ambit of their corporate object, and who provide services of any kind connected with that activity. Considering that the law does not specify that the associate with whom the registered office is established must be a direct associate, the CSSF considers that the concept of an associate exercising a significant influence shall be interpreted as an associate with a direct or indirect holding in the capital of the company to be domiciliated.

- As regards self-managed SICAVs, the CSSF considers that providing for managing executives or for the exercise of the activity of managing executive not having the status of employee and ensuring in this manner the necessary "substance" for the exercise of supervisory and coordination functions to the concerned SICAVs, constitutes a company management service pursuant to article 29-4 of the law, upon condition that this activity be exercised in a professional capacity. This is the case where these services are provided to more than two SICAVs.

  It should be noted that the exception under the seventh indent of article 13(2) of the law concerning advisers and managers of UCI investment portfolios cannot be referred to by any such managing executive.

1.2. Interpretation of the legal provisions on authorisation conditions

In relation to the legal requirements necessary to obtain an authorisation as a PFS, the current formulation of the law allows interpretations that take into account the specificities of every file.

The CSSF has adopted for several years now a more liberal approach, reflected in Bill No 5726 implementing MiFID, which provides for several relaxed authorisation conditions, but still keeps an eye on the main objectives which consist in ensuring stability and solidity of the banking and financial system, as well as efficient investor protection.

- Concerning the legal requirement of the central administration, the CSSF allows, under certain conditions, the delegation of different activities, which are not part of the applicant's main activity, to third parties. In the IT field, the outsourcing conditions and procedures are described in circulars CSSF 05/178 and 06/240.

  The CSSF has also adopted a liberal approach in the accounting field. The CSSF allows the accounting outsourcing under the following conditions:
  - no confidential data on the PFS' clients shall be transmitted to the company to which the accounting is outsourced;
  - the copies of all accounting documents shall be available permanently at the registered office of the PFS;
  - the PFS must be in a position to answer any question from the CSSF relating to the accounting.

- The CSSF accepts that the function of internal auditor of a PFS be delegated to a third person who is not an employee of the PFS, with the sole restriction that this person shall not be an employee of the external auditor of the PFS.

- The law requires that the suitability of the shareholders, whether direct or indirect, having a qualifying holding in the PFS shall be satisfying, taking into account the need to ensure a sound and prudent management. Concerning the financial base of these shareholders, the CSSF requires it to be at least equivalent to the amount of the considered holding in the PFS. In the past, the CSSF required that direct shareholders refinanced the total participation through their capital after deduction of any other holdings or reported losses, in order to avoid that direct shareholders refinanced their participation through borrowed funds.

  While maintaining this requirement for investment firms, the CSSF has adopted a more liberal approach for all other PFS, considering that the future indirect shareholders of the PFS or the company heading the group only need to be sufficiently capitalised in order to refinance the holding through own funds.

- As regards the shareholder structure, the authorisation is subject to the condition that the structure of the direct or indirect shareholders of the PFS be transparent and organised in such a way that authorities in charge of the prudential supervision of the PFS and, where applicable, the group to which it belongs, be clearly defined. This transparency requirement aims at allowing the most efficient prudential supervision.

  In order to ensure a clear and transparent shareholder structure, the CSSF did not accept, in the past, that the capital of a PFS be held indirectly by shareholders through a holding company, unless the applicant belonged to a group operating in the financial or insurance sector supervised by a competent authority. Thus, the interposed holding companies were considered a *priori* by the CSSF as shell companies, set up with the sole aim to deliberately make the shareholding structure less transparent in order to maintain the anonymity of the actual beneficiaries.

  However, in a vast majority of cases, holding companies were interposed for fiscal reasons and were not aiming at concealing the actual beneficiaries. In other words, in the vast majority of cases, the shareholder structure remains transparent, despite the interposed holding company. Moreover, article 10 of MiFID no longer expressly provides for the transparency requirement for the shareholder structure. It is sufficient to be informed of the identity of the direct and indirect shareholders, natural and legal persons, with qualifying holdings and to be convinced of the suitability of these shareholders to ensure the sound and prudent management of the PFS. The competent authority shall also be in a position to exercise its prudential functions effectively.

  For these reasons, the CSSF has modified its position by interpreting articles 6(2) and 18(6) of the law so as to authorise that direct and indirect shareholders possess a qualifying holding in a PFS or in a credit institution through a holding company. As long as the actual shareholders of the holding company are identified and present all the guarantees to exercise a sound and prudent management of the institution and that this structure does not impede the CSSF from effectively exercising its prudential control, there are no reasons for not accepting a holding company in the shareholder structure of a PFS or of a credit institution.

- Concerning the reuse of capital, the CSSF requires that the corresponding funds be put at the permanent disposal of the PFS and be available in case of need. As a consequence, the capital cannot be used for the purpose of investing with the shareholder or financing a loan granted to the shareholder. In addition to immobilising the funds in this manner, the result would be to return to the shareholder the funds initially paid in for the capital, which is considered by the CSSF as an unacceptable practice. Nevertheless, nothing prevents these funds from being placed in investments necessary to the functioning of the PFS.

- The CSSF accepts that a PFS possesses holdings in other companies, provided that, on the one hand, these companies have activities similar to those exercised by the PFS, in order for them to be considered as an extension of the PFS activities, and that, on the other hand, the capital of the PFS amounts to at least the minimum legal capital requirement after deduction of these holdings.
- The authorisation of any PFS is subject to the condition that the latter entrusts the audit of its accounting documents to one or several auditors who prove to have an adequate professional experience. Concerning the support PFS, the CSSF evaluates the professional experience not only in relation to the competence in financial audit, but also in relation to the technical competences related to the activities exercised.

2. THE CSSF IN FIGURES

		Prudential supervision						IT matters		Matters of general interest			
	General supervision	Supervision of banks	Supervision of UCIs	Supervision of PFS	Supervision of securities markets	Supervision of pension funds, SICARs and securitisation undertakings	Administration and Finance	Information Technology	IT audit	Management	Director General's advisors	General Secretariat	TOTAL
Letters	320	1,852	26,292	1,113	3,931	609	990	285	68	54	240	2,519	38,273
Meetings	8	156	162	157*	57	32	48	50	129*		157*	5	675
On-site inspections	80	36		5					1				122
Internal committee meetings													
> Committee Banks	1												1
> Committee Banking Accounting	3												3
> Committee UCIs	5												5
> Committee Mortgage Bonds		1											1
> Committee SICAR						4							4
> Committee Support PFS									2				2
> Committee Legal experts											33		33
> Consultative committee for prudential regulation												4	4
National meetings	10				13				29			7	59
International meetings	232	6	2		31	8		2	8	11			300
Meetings with homologous authorities	8	29	7										44
Speeches at conferences	15				3				4	7	15	1	45

* Including joint meetings of the departments and functions concerned.

3. THE FINANCIAL CENTRE IN FIGURES

Situation as at 31 December 2006

BANKS

Number	156
Balance sheet total	EUR 839.574 billion
Net profit	EUR 5.685 billion
Employment	24,752 people

UNDERTAKINGS FOR COLLECTIVE INVESTMENT (UCI)

Number	2,238
Number of units	8,622
Total assets	EUR 1,844.850 billion

MANAGEMENT COMPANIES

Number	149
Employment	2,069 people

PENSION FUNDS

Number	14

INVESTMENT COMPANIES IN RISK CAPITAL (SICAR)

Number	115
Balance sheet total	EUR 11.876 billion

SECURITISATION UNDERTAKINGS

Number	11

OTHER PROFESSIONALS OF THE FINANCIAL SECTOR (PFS)

Number	196
Balance sheet total	EUR 69.854 billion
Net profit	EUR 483.896 billion
Employment	9,928 people

Total employment in supervised entities	36,749 people

4. CONTACT TELEPHONE NUMBERS

Commission de Surveillance du Secteur Financier

Address	110, route d'Arlon, L - 1150 Luxembourg	
Postal address	L - 2991 Luxembourg	
Switchboard	26 25 1	- 1
Fax	26 25 1	- 601 (executive board)
		- 603 (general supervision / banks)
		- 604 (UCI)
		- 605 (pension funds, SICAR and securitisation)
		- 606 (securities markets)
		- 607 (PFS)
		- 601 (support PFS)
		- 608 (administration / IT)

The full directory of the CSSF is available on the website www.cssf.lu under the heading "Contact".

COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER

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luxembourg.