COMMISSION
DE SURVEILLANCE
DU SECTEUR
FINANCIER

# ANNUAL REPORT 2011

Commission de Surveillance du Secteur Financier

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# PREFACE

Trust is the foundation of any financial activity. The reason why the Luxembourg financial centre was able to stay on the course in 2011 is that it succeeded in keeping the trust of its clients and players.

Thus, during a year in which the news was constantly dominated by problems concerning public finance and eurozone governance, Luxembourg - still benefiting from a good rating - continued to offer the security and stability necessary for the well-being of the financial sector.

The conclusions reached from the detailed information and figures provided in this report can be summarised in a few words: the underlying operational result of banks established in the financial centre is satisfactory and the different types of Luxembourg undertakings for collective investment, including specialised investment funds and SICARs, pension funds and securitisation vehicles were able to keep the sum of assets entrusted to their management unchanged in an environment characterised by some disenchantment amongst investors. This good performance of the financial sector as a whole also influenced the development of the three categories of PFS marked at the same time by the arrival of numerous new players and the disappearance of entities which did not reach the required size.

Since several years now, the financial centre diversified by turning to clients who are wealthier, geographically more varied and more demanding as they tend to judiciously use the whole range of financial services and products allowing them to manage their portfolio by complying with fiscal and other regulations. A lot of institutions, particularly banks, fulfilled this diversification and are thus well-prepared for the future. It is urgent that those which kept an outdated business model dependent on offshore clients abandon this approach.

The Luxembourg financial centre now seeks to strengthen its position on the markets and has solid assets therefor. Its experience in structuring diversified investment vehicles, enhanced by synergies with the banking sector, is useful at a time when the alternative fund market starts developing. The Luxembourg banks are able to rely on a long tradition of proactive reinforcement of their own funds whereas elsewhere the availability of credits is hampered by the necessary recapitalisation of the banking sector. Since Luxembourg acquired a state-of-the-art IT infrastructure, its financial centre shall also resolutely consider it as a chance to increasingly use new technologies for the provision of financial services, for example in the area of payment services.

The CSSF's approach, as a regulator of a financial sector which is staunchly, continuously changing and moreover the first pillar of the Luxembourg economy, was and will always be that of a public service acting in general interest. In line with this understanding of its role, the CSSF tries to be tuned in to the entities under its supervision, to understand their needs and to provide them with appropriate answers. The CSSF fulfils thus its legal task which includes an active participation in the orderly development of the financial sector and the improvement of the regulatory framework of the financial centre by trying to comply with the proportionality principle.

For the CSSF there is no contradiction between this approach and the main task of the CSSF which is to ensure the prudential supervision of the financial sector and the financial stability. In difficult times, the authorities are exposed to requests for authorising new players and new activities by making compromises on the quality of the law and by lowering the guard while supervising the conditions for the taking up and the pursuit of financial activities. However, nothing would be more detrimental to the stability of the financial sector and to economic interest than a slur on the reputation of the financial centre and a loss of the depositors' and investors' confidence. Using all available means, the CSSF shall try to avoid as much as possible such a damage by processing all the files with the required seriousness and efficiency and by ensuring that the regulation in force is correctly applied by all the players under its supervision.

In addition to prudential supervision itself, the CSSF will focus on the aspects of the regulation which aim to strengthen, directly or indirectly, the stability of the financial sector and the confidence it shall inspire. The cultivation of a professional approach based on the knowledge and control of risks, an increasing awareness of the challenges related to adequate corporate governance, an emulation of the sector's best practices due to a multiplying effect produced by the external auditors' contribution are among these aspects.

Financial consumer protection is part of the CSSF's as well as the European supervisory authorities' tasks. The authorities will be assessed according to the results achieved in this area. By thoroughly working in this direction, the CSSF aims to point out the importance of financial education, a precondition for the sustainable development of a financial industry which serves the depositors and investors.

The CSSF's mission requires a continuous commitment of all its agents and so the executive board would particularly like to thank these agents.

Jean GUILL

Director General

# CORPORATE GOVERNING BODIES OF THE CSSF

## Board of Directors

| | | |
|---|---|---|
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| | Claude WIRION | Member of the Executive Committee of the Commissariat aux Assurances |
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## Executive Board

| | |
|---|---|
| **Director General** | Jean GUILL |
| **Directors** | Simone DELCOURT |
| | Andrée BILLON |
| | Claude SIMON |

***Executive Board of the CSSF***
Left to right: Andrée BILLON, Jean GUILL, Simone DELCOURT, Claude SIMON

# SUMMARY

In a year marked by problems related to public finance and eurozone governance and by the aftermath of the financial crisis, the Luxembourg financial centre continued to offer a stable environment and to inspire confidence to financial players as well as investors and depositors. In a difficult context, the banking sector and the investment fund industry managed to maintain a constant sum of assets under management and to realise satisfactory year-end results. These results also show a succeeded transition in the financial sector, and particularly banks, towards an onshore approach and a greater diversification of the financial centre which allows seizing development opportunities, among others, in the use of new technologies regarding financial and payment services.

## International aspects of supervision

The harmonisation of existing regulations remains of utmost importance at international level, notably as regards risk management and coverage. Moreover, the activity of the new European supervisory authorities EBA, ESMA and EIOPA and the functioning of the colleges of supervisors for cross-border banking groups has strengthened the cooperation between the national supervisory authorities and enhanced the European and international dimensions of prudential supervision.

## 143 credit institutions

## Balance sheet total: EUR 794.0 billion

## Net profit: EUR 2,828 million

The number of banks decreased by four entities and reached 143 entities as at 31 December 2011. During the year, three banks started their activities while three banks merged with other banks of the financial centre and three banks terminated their activities. One bank changed its status to become an electronic money institution.

The aggregate balance sheet total reached EUR 794.0 billion at the end of 2011, i.e. an increase of 4.2% compared to 2010. The main part of the increase is explained by the establishment or development of specific competence centres that several banks operate in Luxembourg for the account of their group. However, 40% of the financial centre's banks registered a decrease in the balance sheet total year-on-year, notably in a context of restructuring of the activities in response to the financial crisis.

Net profit of the Luxembourg banking sector reached EUR 2,828 million (-25.9%) in 2011. This significant decline is nevertheless to be qualified. Indeed, in a difficult economic and financial context, Luxembourg banks succeeded in increasing their recurrent operational income. However, despite the growth in the interest rate margin and in the net commission income, net results decreased, notably due to an extraordinary effect, namely value adjustments concomitant with the participation of the banking sector in the restructuring of the Greek debt. It is also important to point out that 46% of banks ended their financial year with an increased net result compared to the previous year.

**322 PFS (116 investment firms, 118 specialised PFS, 88 support PFS)**

**Balance sheet total: EUR 12.96 billion**

**Net profit: EUR 693.6 million**

With 38 new entities authorised during 2011 and 17 withdrawals, the PFS sector continued to attract new promoters. The net development in the number is positive for investment firms, specialised PFS and support PFS, the latter registering the most important increase.

The aggregated total balance sheet of PFS reached EUR 12.96 billion as at 31 December 2011, as against EUR 11.42 billion at the end of 2010. This increase of 13.46% mainly results from the development of the activities of one professional performing securities lending newly authorised in 2011 and from the important increase in the balance sheet total of an investment firm authorised in 2010. The CSSF notices that support PFS registered a slight contraction of their aggregate balance sheet total during 2011 whereas investment firms and specialised PFS experienced an upward trend in their aggregate balance sheet totals.

The PFS' net results significantly declined (-54.34%). However, this development conceals differences between the PFS categories: the aggregate net results of investment firms decreased by 17.9% whereas those of support PFS slightly rose (+5.2%). The negative development of the specialised PFS' results is attributable to one important player and does not reflect a general trend noticed for this PFS category.

**4 payment institutions**

**1 electronic money institution**

Following the entry into force of the law of 10 November 2009 introducing the new status of financial institutions, i.e. payment institutions providing payment services, three Luxembourg payment institutions and one branch of a German payment institution established in Luxembourg.

Since the entry into force of the law of 20 May 2011 on payment services and the activity of electronic money institution, electronic money institutions are no longer assimilated to credit institutions but are considered as a separate category of financial sector players. One electronic money institution is registered in the official list as at 31 December 2011.

**3,845 UCIs**

**13,294 units**

**Total net assets: EUR 2,096.5 billion**

**179 management companies**

In 2011, the UCI sector recorded a decrease of 4.7% in net assets under management mainly due to the negative effect of the performances of the main financial markets. The net capital investment in Luxembourg UCIs, amounting to EUR 5.3 billion in 2011, was largely lower than the new capital inflow observed in 2010 and, thus, was not able to reverse this trend.

The number of UCIs grew by 4.9% during the year. This growth largely results from the continuing boom of the specialised investment funds which represent 35.8% of the total number of UCIs (assets managed by SIFs total 11.4%). Taking into account umbrella funds, a total of 13,294 economic entities were active on 31 December 2011, which represents a new record.

The number of management companies authorised pursuant to Chapter 15 of the law of 17 December 2010 relating to UCIs remained stable with 179 active entities. The 11 new authorisations were counterbalanced by 11 withdrawals due to restructuring or rationalisation of the Luxembourg structures initiated by the promoters.

**276 SICARs**

**Balance sheet total: EUR 30.6 billion**

The number of investment companies in risk capital (SICAR) continued to grow with 43 new authorisations against 14 withdrawals during 2011. Most initiators of SICARs are from France, followed by Switzerland, Germany and Luxembourg. As regards the investment policy, the SICARs prefer private equity.

**28 authorised securitisation undertakings**

The slow but ongoing development of the securitisation activity, at least as regards the part subject to authorisation and supervision, continued with three new securitisation undertakings authorised in 2011.

**15 pension funds**

The pension funds sector stagnated in 2011 since no new pension fund was authorised during the year.

**Total employment in the supervised entities: 43,428 people**

**(of which banks: 26,695 people, PFS: 14,217 people, management companies: 2,516 people)**

Total employment in the financial sector improved by 1.6%, i.e. 676 people. However, depending on the category of financial players, the situation diverges.

After two consecutive years of decline, employment in the banking sector increased by 1.7% in 2011. However, this growth does not mean a net creation of jobs in the financial sector as a whole. Indeed, the banking employment decreased throughout 2011, except for the third quarter where banking staff increased due to a bank taking over a specialised PFS. This takeover had no impact on the number of jobs in the financial sector as a whole, but modified only the distribution by decreasing the PFS staff for the benefit of the banking staff. Without this effect, employment in the banking sector would have remained almost unchanged over a year.

The number of jobs in PFS slightly rose (+0.4%). The positive development in investment firms (+2.2%) and support PFS (+5.2%) was counterbalanced by a decrease of the employment in specialised PFS following the transfer of a specialised PFS' staff to the banking sector (cf. above). However, the CSSF would like to point out that the increase in support PFS employment does not correspond to the creation of as many jobs. Indeed, a large part of this rise is attributable to support PFS newly authorised in 2011, among which are companies already active before. The existing staff of these companies is included, as from the date of the authorisation, in the statistics regarding support PFS.

Employment in management companies increased in 2011 (+7.6%).

**1,446 prospectuses, base prospectuses and other approved documents**

**678 supervised issuers**

**1.1 million reported transactions in financial instruments**

The number of files submitted in Luxembourg for the approval of prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market slightly rose compared to 2010 (+4.03%).

The CSSF supervises issuers whose transferable securities are admitted to trading on a regulated market and for which Luxembourg is the home Member State for the purposes of the Transparency l aw. Their number reached 678, of which 248 Luxembourg issuers. The supervision involves a general follow-up of regulated information to be published by issuers as well as the enforcement of the financial information, i.e. the assessment of compliance of the financial information with the relevant reporting framework, namely the applicable accounting standards.

As regards its supervision of markets and market operators, the CSSF received about 1.1 million transaction reports in 2011 which allow following the market trends and detecting possible offences. In the framework of the law on market abuse, the CSSF opened six investigations in relation to insider dealing and/or market manipulation and dealt with 61 requests from foreign authorities.

**Public oversight of the audit profession**

The public oversight of the audit profession covered 65 *cabinets de révision agréés* (approved audit firms) and 224 *réviseurs d'entreprises agréés* (approved statutory auditors) as at 31 December 2011. The oversight also includes 53 third-country auditors and audit firms duly registered in accordance with the law of 18 December 2009 concerning the audit profession.

As regards missions performed in the framework of statutory audits and other missions exclusively entrusted to them by the law, the *réviseurs d'entreprises agréés* and *cabinets de révision agréés* are subject to a quality assurance review, organised according to the terms laid down by the CSSF in its capacity as supervisory authority.

**443 customer complaints**

By virtue of its specific task of mediating as regards handling of customer complaints, the CSSF received 443 complaints in 2011. Most of the complaints concerned e-banking. Complaints in relation to private banking also represented a great part of the files dealt with by the CSSF.

**406 agents**

**Operating costs of the CSSF in 2011: EUR 46.1 million**

2011 was marked by the ongoing increase in the CSSF's staff (+44 agents) in order to face the growing workload resulting notably from the introduction of new prudential requirements, the cooperation between supervisory authorities, the active participation in international forums and, in general, the increase in volume and complexity of the financial products. In addition, numerous on-site inspections, which became an important pillar of the prudential supervision exercised by CSSF, are carried out.

*CSSF's heads of department*

Left to right: Sonny BISDORFF-LETSCH, Carlo FELICETTI, Jean-Marc GOY, Françoise KAUTHEN, Marc LIMPACH, Christiane CAMPILL, David HAGEN, Danielle MANDER, Marc WEITZEL, Geneviève PESCATORE, Alain OESTREICHER, Marie-Anne VOLTAIRE, Frank BISDORFF, Jean-François HEIN, Danièle BERNA-OST, Romain STROCK, Irmine GREISCHER, Frédéric TABAK

# GENERAL SUPERVISION AND INTERNATIONAL COOPERATION



# 1. GENERAL SUPERVISION

The department "General supervision" deals transversally with issues relating to prudential supervision, accounting and reporting common to all CSSF's departments. The department is divided into four divisions of which 1 to 3 are more specifically responsible for international groups as well as the development and interpretation of national and international regulations. In accordance therewith, the agents of these divisions attended 148 meetings of international groups in 2011. As in previous years, they were also asked to draft circulars or preparatory texts for new laws.

Each division of the department is responsible, within its given area, for the development and interpretation of the regulation, rules of conduct and professional obligations in the financial sector as well as for the treatment of general methodological issues related to prudential supervision.

## 1.1. Division 1: International matters

The division deals with a large amount of international files relating to the CSSF's mission, including, in particular, those dealt with by the following bodies: European Commission, Council of the EU, EBA, ESMA, IOSCO and Basel Committee. In addition, the division is responsible for the coordination of preparatory meetings which define the positions held by the CSSF during meetings, at the highest level, of the above-mentioned bodies.

The division prepares the transposition of international regulations into national law and monitors national and international developments in the areas within the CSSF's mission and competences. In this context, the division works closely with the departments responsible for prudential supervision. It provides these departments with its expertise, assists them in matters falling within its competence and organises trainings for the relevant agents.

In particular, the division cooperates with the departments "Supervision of banks" and "Supervision of securities markets" on questions about the CSSF's general policy regarding international cooperation and, where necessary, more practical aspects of this matter. In the context of the EBA and ESMA Review Panel's missions, the division closely works with the relevant departments on issues which are subject to peer reviews.

In 2011, the work of division 1 has been mainly devoted to:

- the participation in international groups which it follows up on;
- the transposition of European directives and guidelines, particularly from the EBA and ESMA in the form of circulars or laws; and
- the provision of information and support to the departments in charge of prudential supervision or directly to the supervised entities in relation to issues on the implementation and application of new laws and regulations.

In 2011, the agents of division 1 worked in particular on the following:

- the active participation in ESMA-Pol, ESMA's Review Panel, the ESMA Post Trading Standing Committee, the ESMA CRA Technical Committee and the EBA Standing Committee Regulation and Policy;
- negotiations under way at the Council of the EU relating to draft directives and/or regulations on CRD IV, Market Abuse and EMIR (cf. Chapter XV "Banking and financial laws and regulations").

The publication in 2010 of a series of circulars amending Circulars CSSF 06/273 and 07/290 in respect of the solvency ratio (Circulars CSSF 10/496 and 10/497 of 22 December 2010, 10/483 of 25 August 2010 and 10/475 of 20 July 2010, the main purpose of which was the transposition of CRD II and CRD III) as well as Circular CSSF 10/493 of 7 December 2010 on the amendments to tables B.2.3. and B.6.3., continued to raise, in 2011, many questions within the supervised entities, especially with regard to the provisions relating to the regulatory framework on large exposures and their reporting. The agents of division 1 analysed these questions and provided answers to the relevant entities.

Still in the context of the CRD, the CSSF published Circular CSSF 11/507 transposing the EBA guidelines[1] relating to Chapter 2-1 of Part X of Circular CSSF 06/273, as amended, into Luxembourg regulation. The EBA issued these guidelines in order to clarify the qualitative and quantitative requirements imposed on credit institutions in the context of securitisation and more specifically the requirement of a retained net economic interest of at least 5%. This Circular specifies that credit institutions must inform the CSSF of any new investment in a securitisation. Furthermore, the Circular reiterates that before acting as originators, sponsors or original lenders, credit institutions must provide the CSSF with relevant data allowing the verification of compliance with the provisions of Chapter 2-1 of Part X of Circular CSSF 06/273.

## 1.2. Division 2: Accounting, reporting and audit

The division deals with the follow-up of the regulations relating to accounting, prudential reporting and statutory audit of the accounts from a prudential supervisory point of view.

At national level, the division represents the CSSF at working groups set up in this respect by the *Commission des Normes Comptables* (Accounting Standards Board) and the BCL (Luxembourg Central Bank). At international level, the division ensures the follow-up in this area related to European institutions (European Commission, Council of the EU, EBA, ESMA) and international institutions (Basel Committee, IOSCO).

The division deals with all requests for advice and information within its area and assists the departments responsible for prudential supervision with matters within its competence and organises trainings for them. It prepares instructions, circulars and draft laws within its sphere of competence. In respect of reporting in particular, the division prepares the transposition and/or the development of new prudential tables and the review of the existing ones.

Moreover, the division cooperates with the department “Supervision of securities markets” in respect of the enforcement of financial information of companies whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange.

As regards audit, the division deals with authorisation requests for *réviseurs d’entreprises agréés* (approved statutory auditors) for statutory audits of the accounts of the financial sector entities and issuers governed by Luxembourg law whose shares or units are admitted to trading on a regulated market authorised in Luxembourg. In this respect, it analyses the experience of the audit professional in the financial sector and the suitability of its audit approach proposed for a given mandate. In this context, the division centralises the information made available to it by the departments responsible for prudential supervision and relating to the execution of the mandate of the *réviseurs d’entreprises agréés* in the financial sector. It also exchanges information with the department “Public oversight of the audit profession”.

More generally, the division follows the development of the legal and regulatory framework of the audit profession in order to analyse the impact from a prudential supervisory point of view. Thus, it contributes to the development of a consistent approach notably for the analytical reports (long form reports) prepared by the *réviseurs d’entreprises agréés* within their statutory audit mandates.

As regards accounting, the CSSF published in March 2011 Circular CSSF 11/503 entitled “Reminder on the obligations applicable to the transmission and publication of financial information and relating deadlines”. The purpose of this circular is to remind the supervised entities, other than banks, of the obligations that have to be complied with regarding both the transmission and publication of financial information and in particular the relevant deadlines. In November 2011, the CSSF also published Circular CSSF 11/526 relating to the use of the lump sum provision as at 31 December 2011, the purpose of which is, as already referred to in Circular CSSF 08/386, to remind credit institutions publishing their annual accounts under Lux GAAP, accounting standards used by most credit institutions of the financial centre, that they must use their existing lump sum provision at the end of the financial year 2011 in order to cover the unrealised losses resulting from the turmoil in the financial markets.

[1] Guidelines to Article 122a of the CRD.

## 1.3. Division 3: Rules of governance, electronic payments and crisis management

The mission of division 3 concentrates on the methodology, global studies and on assisting other departments with matters which require specific knowledge and expertise. Within the context of its mission, the division ensures the follow-up of principles and standards generally accepted in corporate governance and compliance with rules of conduct which stem, *inter alia*, from Community texts.

In 2011, division 3 carried out four on-site inspections in relation to MiFID rules of conduct. In three cases, it was found that the client suitability test consisted of assigning investor profiles (for example: defensive, conservative, balanced, dynamic or aggressive) to clients. Ultimately, these investor profiles were just abstract descriptions of investment profiles of no real value for investors in the context of investment decision-making. The CSSF requested the relevant entities to provide clients with information on the asset allocation associated to each investment profile and, when providing the service of discretionary portfolio management services, the breakdown of the financial instruments composing the model portfolio. In one case, the CSSF enjoined an institution concerned to include this requirement in its procedures.

The division is also responsible for questions relating to payment institutions and electronic money institutions governed by the law of 10 November 2009 on payment services. In this context, it examines the application files for obtaining a licence as payment institution or electronic money institution. During the review of these files in 2011, the CSSF noticed that the application files are often incomplete and require further information and documents in order to be accepted. Moreover, the number of application files for a licence as electronic money institution increased substantially with the revision of the rules governing the business of electronic money issuance in May 2011.

During 2011, division 3 continued analysing the remuneration policies of credit institutions and investment firms which had to disclose their remuneration policy to the CSSF in accordance with Circular CSSF 10/437. While assessing the remuneration policies, Circulars CSSF 10/496 and CSSF 10/497 of 22 December 2010 and Circular CSSF 11/505 of 11 March 2011 relating to the application of the principle of proportionality when establishing and applying remuneration policies were taken into account. As regards credit institutions and most investment firms, these three circulars, including the CEBS guidelines relating to the remuneration policies and practices of 10 December 2010, as well as the law of 5 April 1993 on the financial sector are the body of rules governing the establishment of a sound remuneration policy.

The implementation of these regulations generated strong reactions and concerns with the professionals of the financial sector. Indeed, the principle of proportionality as laid down in Circulars CSSF 10/496 and 10/497 and which enables the institutions to apply the requirements with respect to remuneration in a more or less sophisticated way, subject to the provision of evidence that a proportional application is justified, was often misunderstood. For such reasons and upon the express request of the financial sector, the CSSF drafted a "supplementary" circular, i.e. Circular CSSF 11/505 aiming to clarify the application of the principle of proportionality when establishing and applying remuneration policies in accordance with Circulars CSSF 10/496 and 10/497. This circular thus provides for quantitative thresholds below which the specific requirements on risk alignment may be neutralised either for the institution (entire staff) or certain persons who were identified as material risk-takers within the institution. Accordingly, the CSSF has adopted a similar approach to that of several authorities of other EU Member States.

It should also be noted that the CSSF participated in many conferences the aim of which was to present, emphasise or remind the regulatory framework in relation to remuneration policies and that it pursued throughout 2011 its bilateral meetings on remuneration policies with any institution soliciting such a meeting or whose draft remuneration policies required discussion.

In the context of its assessment of remuneration policies, the CSSF reviewed compliance with the general and specific requirements of the applicable circulars. This general review, which is being finalised, gives rise to the following observations.

If, pursuant to Circular CSSF 10/437, credit institutions and investment firms have been required to disclose their remuneration policy to the CSSF, the remuneration policies and practices form part of Pillar 2 of the CRD since 1 January 2011, which is the date of entry into force of Circulars CSSF 10/496 and 10/497. The establishment, implementation and review of the remuneration policies are first the "internal" responsibility of all concerned credit institutions and investment firms. The CSSF is vested with the mission of assessing and supervising the remuneration policy within the context of the supervisory review process.

Point 1.4 of Circular CSSF 10/437 provides for an exemption from the application of all provisions of that circular where the material risk-takers are exclusively granted a fixed remuneration. It is important to specify that such an exemption is no longer possible since the entry into force of Circulars CSSF 10/496 and 10/497. Credit institutions and most investment firms shall from then on always establish and implement a remuneration policy allowing and promoting a sound and effective risk management.

Furthermore, the CSSF noted certain shortcomings or inconsistencies in respect of the implementation of the requirement to take into account financial criteria and non-financial criteria when assessing individual performance. It would therefore like to recall, with reference to paragraph 95 of the CEBS guidelines that the quantitative and qualitative criteria shall be appropriately balanced, that this mix depends on the tasks and responsibilities of the person concerned, and especially that the quantitative and qualitative criteria as well as their balance shall be specified and clearly documented in the remuneration policy for each staff level and category.

Regarding the disclosure of the remuneration policies, minimum information that each institution concerned should disclose internally as well as externally was already included in Circular CSSF 10/437. Since the publication of Circulars CSSF 10/496 and 10/497, the concerned credit institutions and investment firms shall refer to the requirements provided for in Part XIX of Circulars CSSF 06/273 and 07/290.

## 1.4. Division 4: On-site inspections

Division 4 of the department "General supervision" is responsible for the planning, coordination and conduct of on-site inspections. It includes a general unit as well as a AML/CFT unit (fight against money laundering).

### 1.4.1. General Unit

In 2011, the General Unit carried out 52 on-site inspections. The following table breaks down these on-site inspections according to the type of controlled entity and the type of mission.

| **Type of controlled entity** | **Type of mission** | | | | | |
|---|---|---|---|---|---|---|
| | Introductory visit | Corporate governance | Credits | Internal audit | CA/DB[2] | *Ad hoc* mission |
| Credit institutions | | 6 | 2 | 2 | 4 | 4 |
| Electronic money institutions | 1 | | | | | |
| Investment firms | 6 | | | | | |
| Support PFS | 1 | | | | | |
| Specialised PFS | 15 | | 1 | | | 4 |
| Securitisation, pension funds | | | | | | 3 |
| Management companies | 1 | | | | | 2 |
| **TOTAL** | **24** | **6** | **3** | **2** | **4** | **13** |

[2] CA/DB: Central administration and depositary bank.

The introductory visits highlighted recurring weaknesses in the establishment of the audit plan or the handbook of procedures as well as errors in the periodic reporting to be addressed to the CSSF.

The "corporate governance" controls aimed to control the influence of the corporate governing bodies of the bank over the business management, to obtain an indication of the level of integration of the Luxembourg bank into the supervision by its parent company and, where appropriate, to assess the efficiency of the group head function exercised by the Luxembourg bank.

The "internal audit" controls based on compliance of the internal audit function with the regulations currently in force.

The "credit" controls aimed to determine the credit risk of the institution and to assess the appropriateness of the organisation of the management of this risk.

The "central administration and depositary bank" controls aimed to obtain a better understanding of the operational procedures and workflows of this activity for the important service providers of the financial centre and to ensure the efficiency of the internal control systems put in place.

The *ad hoc* controls were conducted by the CSSF after the occurrence of specific organisational or procedural problems within an entity.

Out of the 52 missions carried out, two missions resulted in the initiation of the injunction procedure or of the administrative non-litigious procedure in order to impose an administrative sanction, within the meaning of Articles 59 and 63 of the law of 5 April 1993.

### 1.4.2. AML/CFT Unit

Since 2010, the CSSF has been concentrating on on-site inspections as regards the fight against money laundering and terrorist financing. The controls cover both private banking business (portfolio management, domiciliation, etc.) and transfer agency.

In 2011, the AML/CFT Unit of the division 4 carried out 47 control missions divided according to the type of controlled entity as follows:

| Type of controlled entity | AML/CFT missions |
|---|---|
| Credit institutions | 22 |
| Investment firms | 5 |
| Specialised PFS | 7 |
| SICARs | 10 |
| Management companies | 3 |
| **Total** | **47** |

For 12 of the 47 missions, the CSSF has decided to initiate the injunction procedure or the administrative non-litigious procedure in order to impose an administrative sanction, within the meaning of Articles 59 and 63 of the law of 5 April 1993. In five cases, this procedure led the CSSF to impose an administrative fine. It should be noted that certain files which are likely to give rise to an injunction procedure or a non-litigious administrative procedure are still being processed.

In five cases, a suspicious transaction report pursuant to Article 23(3) of the Code of Criminal Procedure or a notification pursuant to Article 9-1 of the law of 12 November 2004 on the fight against money laundering and terrorist financing was served by the CSSF to the Financial Intelligence Unit.

## 2. COOPERATION WITHIN EUROPEAN INSTITUTIONS

Article 3 of the law of 23 December 1998 establishing a financial sector supervisory commission (*Commission de surveillance du secteur financier*) states that the CSSF's mission is, *inter alia*, to deal with the files and to participate in the negotiations in respect of financial sector issues, at both EU and international level. In accordance therewith, the CSSF participates in the work of the following fora.

With effect from 1 January 2011, Regulations (EU) No 1092 to 1095 established the European Systemic Risk Board (ESRB) and the three new European supervisory authorities: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) which together form the new European System for the Financial Supervision (ESFS). The three new authorities replaced the former Level 3 committees, i.e. CEBS, CESR and CEIOPS.

The CSSF participates as a non-voting member in the European Systemic Risk Board.

As regards the European cooperation, these three new European authorities, each run by a board of supervisors which includes a high representative of the national supervisory authorities of each Member State, replaced CEBS, CESR and CEIOPS, including the different expert groups which used to work under these committees. However, they have additional competences and they are, in particular, able to draw up proposals for binding technical standards and to act as a mediator (in some cases with a decision-making power) in case of disagreement among national supervisory authorities. The functions and powers of the three new authorities are described in detail under item 2.6 of Chapter I "General supervision and international cooperation" of the CSSF's Annual Report 2010.

### 2.1. European Banking Authority - EBA

The EBA was established by Regulation (EU) No 1093/2010 of 24 November 2010 and is operational since 1 January 2011. The EBA is chaired by Mr Andrea Enria (Italy) and the functions of Executive Director are performed by Mr Adam Farkas (Hungary). Mr Claude Simon, Director, represents the CSSF in the Board of Supervisors.

During 2011, the CSSF participated as a member in the work of the EBA and its four permanent working groups, including their sub-working groups (permanent or *ad hoc*).

All publications of the EBA are available on the website www.eba.europa.eu. For 2011, the following topics should be pointed out in relation to the activities of the EBA, its working groups and sub-working groups.

#### 2.1.1. Standing Committee on Regulation and Policy (SCRePol)

SCRePol contributes to the EBA's work in the areas related to the drawing-up of rules regarding the financial sector (including payment services and electronic money) as well as regarding early intervention and bank resolution.

Thus, the tasks of SCRePol are performed within the context of the CRD Directives and the single rule book for banking supervision (follow-up on the national implementation of the CRD III, development of binding technical standards in the context of the CRR/CRD IV proposals[3]) as well as of future European regulations relating to prior intervention, bank resolution and deposit guarantee schemes.

[3] Proposal for a Directive on the taking up, pursuit and prudential supervision of the business of credit institutions amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV) and proposal for a regulation on the prudential requirements applicable to credit institutions and investment firms (CRR regulation).

In 2011, SCRePol dedicated some of its work to the drawing-up and prioritisation of the work plan on proposals for binding technical standards which the EBA shall provide to the European Commission in the context of the draft CRR regulation and the proposal for the CRD IV. Indeed, the proposal for CRR/CRD IV includes about a hundred binding technical standards delegated to the EBA, of which 70% will be under the responsibility of SCRePol. These technical standards, which will be adopted and published by the European Commission in the form of European regulations, will be of direct and mandatory application and will supplement the CRR/CRD IV framework on more technical issues.

In 2012, SCRePol and its subgroups shall concentrate most of their efforts on the drafting of these binding technical standards. In this context, an exchange of views took place with the working group on CRD IV at the Council of the EU.

Exchanges also took place with ESMA (in respect of the rating agencies) and with the European Commission (in respect of the retention requirement in the context of securitisations, as referred to in Article 122a of the CRD). The works relating to the retention requirement have been prepared by the Subgroup on Securitisation and Covered Bonds which has also drawn up an FAQ document on the guidelines regarding Article 122a.

In addition, the following works carried out by the relevant subgroups of SCRePol can be mentioned.

### • Credit risk

A new *ad hoc* sub-working group, the Task Force on Model Validation (TFMV) was created in 2011 in order to develop the future binding technical standards provided for in the draft CRR/CRD IV and the EBA guidelines regarding the technical review of the internal ratings systems (IRB) and models used for the calculation of the regulatory capital requirements for credit risk. Moreover, this working group is responsible for coordinating work on the binding technical standards in respect of all advanced approaches of the draft CRR/CRD IV. The subgroup is chaired by the CSSF.

The Subgroup on Credit Risk (SGCR) is responsible for developing the future binding technical standards provided for in the draft CRR/CRD IV and the EBA guidelines on credit risk, in close cooperation with the TFMV for the binding technical standards relating to the internal ratings based approach. Moreover, the subgroup is responsible for the binding technical standards concerning large exposures provided for in the draft CRR/CRD IV.

### • Liquidity

The Subgroup on Liquidity (SGL) intensified its work in 2011 to develop the binding technical standards provided for in the draft CRR/CRD IV in relation to liquidity risk. Having regard to the important number of these standards, the subgroup first focused on the essential standards for the calibration of the short-term liquidity ratio (LCR). In this respect, the group created five dedicated sub-working groups which are currently developing the draft binding technical standards including, *inter alia*, the presentation of information regarding liquidity and the definition of liquid assets to be provided.

### • Own funds

Pursuant to the mandate entrusted to the EBA under Directive 2009/111/EC, the Subgroup on Own Funds analysed whether hybrid capital instruments issued by European banks comply with the requirements of this Directive. Moreover, the subgroup has started preparing the draft regulatory technical standards relating to prudential own funds which the EBA shall present by 1 January 2013, i.e. the planned date of entry into force of the CRR/CRD IV rules.

**• Remuneration**

In 2011, the Task Force on Internal Governance assessed the implementation of the CEBS Guidelines on remuneration policies and practices dated 10 December 2010. These guidelines were implemented in Luxembourg by way of Circulars CSSF 10/496 and 10/497 transposing Directive 2010/76/EU commonly referred to as CRD III. They aim to facilitate the setting-up, in credit institutions and investment firms, of sound remuneration policies which comply with the principles laid down in points 23 and 24 of Annex V of Directive 2010/76/EU.

**• Internal governance**

The EBA guidelines with respect to internal governance were published on 27 September 2011. They amend and update the former CEBS guidelines in relation thereto after a survey carried out by CEBS in 2008 which revealed a certain number of weaknesses in terms of sound governance, risk management and internal control implementation. On the basis of this survey and in light of the works carried out by other European and international bodies on corporate governance, in particular by the Basel Committee, the EBA has decided to consolidate and update all its recommendations on internal governance within the context of these guidelines. Thus, new chapters were introduced on the transparency of a company structure, the role, tasks and responsibilities of the supervisory activity, the information systems and continuity of management.

The Subgroup on Intervention, Resolution and Deposit Guarantee Schemes (SG IR&DGS) is notably in charge of developing draft technical standards or guidelines regarding early intervention and bank resolution as well as European deposit guarantee schemes. The scope of the activities of the subgroup was limited in 2011. Indeed, the orientations as to the proposal for a directive on crisis management and resolution had first to materialise. As uncertainties remain, for example regarding the final version of the directive relating to deposit guarantee schemes, the subgroup has confined itself to proposing to work on the scope and assessment criteria of recovery plans. For these purposes, two documents have been drawn up, one on the experience acquired to date, at national level, regarding the drafting and the assessment of recovery plans and the other proposing a common template for the drafting and assessment of recovery plans.

### 2.1.2. Standing Committee on Oversight and Practices (SCOP)

SCOP's mission is to assist, advise and support the EBA (including in the development of binding technical standards) in the following areas:

- permanent risk assessment in the banking system, including development of instruments in this respect,
- promotion of the cooperation between authorities, including the strenghtening of colleges and common assessments and decisions,
- an increasing convergence of supervisory practices,
- implementation of recommendations and warnings of the ESRB.

The main topics dealt with by SCOP in 2011 are the following:

- risks and vulnerabilities in the European banking sector,
- organisation of the development of binding technical standards,
- assessment of the equivalence of the professional secrecy of third countries' authorities,
- discussions on individual problem banks.

### 2.1.3. Standing Committee on Accounting, Reporting and Auditing (SCARA)

SCARA's mission is to assist, advise and support the EBA in completing its working programme with respect to financial information in the following areas:

- accounting: monitor, assess and comment on any development in relation to the accounting field and more specifically international accounting standards,
- reporting: develop and update prudential reporting schemes as well as develop draft implementing technical standards,
- audit: monitor, assess and comment on the developments at Community and international level as regards audit,
- transparency: assess the transparency of banks in their information published *vis-à-vis* financial market participants within the context of Pillar 3 of Basel II.

In respect of the subgroups of SCARA, the following works can be noted for 2011.

#### • Reporting

As far as reporting is concerned, the CSSF participated in 2011 in the works of the EBA in relation to the consultation paper "Draft Implementing Technical Standards on Supervisory reporting requirements for institutions – (CP50)" published on 20 December 2011.

The public consultation (from 20 December 2011 to 20 March 2012) relates to a draft implementing technical standard (ITS) concerning the implementation of uniform reporting requirements for credit institutions and investment firms. This draft ITS has been developed on the basis of the current COREP and FINREP reportings as well as the CRR/CRD IV proposals, currently under discussion. According to the European Commission's proposals, the draft CRR/CRD IV would be applicable as of 1 January 2013, as would be the case for the prudential reporting relating thereto.

#### • Transparency

The CSSF contributed to the annual follow-up review of the EBA whereby the transparency of banks in the information they publish *vis-à-vis* financial market participants is assessed within the context of Pillar 3 of Basel II. The analysis was carried out on a sample of twenty European banks which operate at international level, including one Luxembourg credit institution.

The main conclusions of this analysis confirmed that banks have made efforts to improve their disclosures and to convey their risk profile in a comprehensible way to market participants. In all areas under review, better practices have been identified and the EBA encourages banks to follow them. The EBA also calls for further efforts to be made by the banks for a greater harmonisation of the content of the information and publication deadlines. The annual review ended with the publication of the report "Follow-up review of banks' transparency in their 2010 Pillar 3 reports" on 17 October 2011.

### 2.1.4. Standing Committee on Financial Innovation (SCFI)

Article 9(4) of Regulation (EU) No 1093/2010 creating the EBA requires the establishment of a financial innovation committee which resulted in the creation of the SCFI in May 2011. The EBA identified two different but complementary areas of intervention for the SCFI, namely subjects relating to consumer protection and subjects relating to innovative products and financial activities. The CSSF is a member of the SCFI and of the Subgroup on consumer protection (SGCP). Since January 2012, the CSSF is also a member of the Subgroup on innovative products of the SCFI.

The role of the SGCP is to identify the subjects relating to innovative banking activities or products likely to cause damage to retail consumers and to cooperate in establishing a coordinated system of prudential rules aiming to ensure an effective consumer protection across the Member States. The first works of the group involved launching a survey for the national authorities of the Member States, aiming to gather information on the main areas regarding consumer protection which are of current concern.

## 2.2. European Securities and Markets Authority - ESMA

ESMA was established by Regulation (EU) No 1095/2010 of 24 November 2010 and is operational since 1 January 2011. ESMA is chaired by Mr Steven Maijoor (Netherlands) and the functions of Executive Director are performed by Mrs Verena Ross (United Kingdom). Mr Jean Guill, Director General, represents the CSSF in the Board of Supervisors. He is also a member of the Board of Directors of ESMA and was re-elected in February 2012.

The Securities and Markets Stakeholder Group, which is composed of 30 market players appointed in a personal capacity, including a Luxembourg representative, aims to facilitate the consultation with the stakeholders in areas relevant to ESMA's tasks. The group is also consulted on matters covered by regulatory technical standards and implementing technical standards.

During 2011, the CSSF participated as a member in the work of ESMA and its permanent working groups with their sub-working groups (permanent or *ad hoc*).

All publications of ESMA are available for consultation on the website www.esma.europa.eu. For 2011, the following topics should be noted in relation to the activities of ESMA, its working groups and its sub-working groups.

### 2.2.1. Review Panel

The Review Panel, chaired by Mr Guill since1 September 2010, is responsible for assisting ESMA in ensuring consistent and harmonised implementation of EU legislation in the Member States. Its role was strengthened by Regulation (EU) No 1095/2010 of 24 November 2010 establishing ESMA.

With a view to aligning the existence, internal procedure and operational methods of the Review Panel, as it existed under CESR, ESMA published its decision creating the Review Panel on 19 December 2011 and the methodology describing the working procedures of the Review Panel on 25 January 2012.

The peer reviews which are usually carried out by the Review Panel relate to all or part of the activities of the competent authorities so as to reinforce the consistency of the results regarding supervision. Based on the peer reviews, ESMA may issue guidance and recommendations and disclose the best practices highlighted by the outcome of the work.

As proposed by the Review Panel, ESMA had adopted good practices in the approval process of the prospectuses, which were in particular based on work on the selective mapping with regard to certain areas of the Prospectus Directive. In 2011, the Review Panel conducted peer reviews on the effective implementation of these good practices by the national competent authorities.

On 6 July 2011, ESMA published the report "Mapping of the Transparency Directive – options, discretions and gold-plating" of the Review Panel comparing the implementation of the Transparency Directive in the different Member States.

Moreover, the Review Panel compared the use of sanctioning powers of the competent authorities as regards market abuse, and more precisely concerning insider dealing and market manipulation during 2008 to 2010. The relevant report is to be published in 2012.

### 2.2.2. ESMA-Pol

ESMA-Pol's purpose is to enhance the exchange of information, cooperation and coordination of the supervision of ESMA members and to ensure an effective day-to-day implementation of the European legislation on market abuse. In this context, ESMA-Pol continued to exchange, amongst its members, views on the practical experience in cooperation, the daily supervision of investment firms and financial markets and unauthorised offers of financial services by persons and investment firms that do not hold adequate authorisation.

Furthermore, ESMA-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. In this context, ESMA published on 9 December 2011, as proposed by ESMA-Pol, a warning regarding Forex trading which points out in particular the risks for investors in this respect.

ESMA-Pol continued its discussions on improvement and harmonisation of the transaction reports (TAF) within the context of the MiFID Directive. The works covered in particular the technical aspects of the fields to be filled in, and to a lesser extent, the political issues which depend largely on the final texts of the reviewed MiFID Directive and the regulation on financial markets (MiFIR) as they will be adopted by the Council and the European Parliament.

As a result of the works carried out within ESMA-Pol, ESMA published on 9 January 2012 a FAQ on market abuse with respect to the obligation for issuers to publish an inside information in the event of a change in the dividend payment policy.

On the basis of a mandate entrusted by the European Commission to ESMA within the context of the proposal for a regulation on short selling and certain aspects of credit default swaps, ESMA-Pol drafted a consultation paper including proposals for technical standards and regulatory standards as well as proposals for delegated acts. This paper, published on 24 January 2012, deals with the following:

- contracts, arrangements and measures ensuring that a share or sovereign debt securities will be available at the delivery date,
- information to be provided to national competent authorities and to be published,
- means of publication of short positions,
- exceptions where the principal is outside the EU and methods of calculation of short positions.

In the light of the mandate received from the European Commission and on a proposal from ESMA-Pol, ESMA started, on 15 February 2012, a second public consultation including a technical advice on possible delegated acts concerning the proposal for a regulation on short selling and certain aspects of credit default swaps (CDS). The consultation paper deals, among others, with the following:

- specification of the definitions laid down in the regulation in particular as to the question whether a person should be regarded as the owner of a financial instrument for the purposes of a short selling,
- the methods of calculating net short positions,
- the methods of calculating positions where different entities in a group or where a manager of different investment funds pursuing the same investment strategy *vis-à-vis* a particular issuer have long or short positions,
- cases in which a CDS transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt,
- methods of calculating an uncovered position,
- specification of the parameters and methods for calculating the threshold of liquidity in relation to sovereign debt for suspending restrictions on short sales, and
- specifications regarding a significant fall in value.

### 2.2.3. Corporate Reporting Standing Committee (CRSC)

As quality financial statements are important for the smooth operation of the financial markets, ESMA is involved in the process of drawing up financial information standards and cooperates in this respect, *inter alia*, with IASB (International Accounting Standards Board) and EFRAG (European Financial Reporting Advisory Group).

Thus, through its permanent committee CRSC, ESMA developed comment letters on various discussion papers and exposure drafts of IASB and EFRAG.

Moreover, through its subgroup European Enforcers Coordination Sessions (EECS), the CRSC ensures that the financial information standards are consistently applied in the EU.

Thus, ESMA took the following initiatives to ensure a consistent application of the IFRS standards.

#### • Public statement on sovereign debt in IFRS financial statements

On 25 November 2011, ESMA published a statement on the accounting treatment of exposures to sovereign debt in the financial statements drawn up in accordance with the IFRS standards. This statement comprises two distinct parts: the first part deals with accounting issues related to sovereign debt in IFRS annual financial statements ending on 31 December 2011 and highlights the main elements to be considered by issuers and their auditors; the second part sets out the outcome of the fact-finding exercise conducted by the national competent authorities on the accounting treatment of Greek sovereign debt by the main financial institutions listed on European regulated markets in their half-yearly financial statements for accounting periods ending on 30 June 2011, drawn up in accordance with the IFRS standards.

The preparation of this statement and the results of the survey gave rise to many discussions within the EECS.

In July 2011, ESMA had already published a statement encouraging the issuers to include in their financial statements information on their exposures to sovereign debt by insisting on the necessity for an enhanced transparency and on the requirements of the applicable IFRS standards in this respect.

#### • Consultation paper 2011/373: Considerations of materiality in financial reporting

On 9 November 2011, ESMA published a consultation paper on the concept of materiality to contribute to a consistent implementation of this important concept as regards financial information. Indeed, the concept of materiality describes the situation in which financial information required by the accounting standards may be omitted or misstated without having an impact on economic decisions of users of financial statements. Yet, different views appeared during discussions of the EECS in respect of the practical use of the concept of materiality amongst preparers, auditors and users of financial statements and occasionally, amongst supervisory authorities.

#### • Review of European enforcers on the implementation of IFRS 8 – Operating Segments

On 9 November 2011, ESMA published a report on the review by the EECS on the use of IFRS 8 “Operating Segments” by the issuers in their financial statements. This report describes in detail the main observations made within the context of this review and also sets out the tentative recommendations proposed by ESMA to enhance the application of this standard. On the basis of this review, the overall conclusion reached by European enforcers is that (i) the use of IFRS 8 resulted in a fairly similar level of information compared to its predecessor IAS 14 and that (ii) there is homogeneity in the issues faced by European enforcers when enforcing this standard as they stem from a combination of weaknesses in the standard and a failure to fully comply with its requirements by issuers.

#### • IFRS enforcement seminar

ESMA organised its second international seminar on the control of the correct application of financial information reporting standards on 1 and 2 December 2011 in Paris.

### 2.2.4. Corporate Finance Standing Committee (CFSC)

Within ESMA, the CFSC is in charge of the work relating to the Prospectus Directive, certain aspects of the Transparency Directive and corporate governance.

#### • Prospectus

Within the framework of the mandate sent by the European Commission to ESMA on 19 January 2011 for technical advice on possible delegated acts concerning the Prospectus Directive, as amended by Directive 2010/73/EU of 24 November 2010, the three subgroups of the Task Force[4] discussed the following main subjects:

- the form of the Final Terms of a base prospectus,
- the form of the summary of the prospectus and the specific format and detailed content of the key information to be included in the summary,
- the proportionate disclosure regime as set forth in Article 7 of Directive 2010/73/EU.

In its technical advice published on 4 October 2011, ESMA took a rather restrictive position on the subjects discussed and suggests that the European Commission should:

- clearly determine the level of information which may be included in the base prospectus and in the Final Terms;
- issue an extensive list of information to be included in the summary, which is a document intended to retail investors;
- make a limited number of reductions in the context of the proportionate disclosure regime.

Moreover, on 15 September 2011, the Task Force started dealing with the second part of the mandate relating to the review of the existing Level 2 measures (information on the withholding tax, index set by the issuer, profit forecast or estimate, audited annual historical financial information) and retail cascades. To this end, the Task Force created two sub-working groups including the subgroup relating to the review of existing Level 2 measures which is coordinated by the CSSF. On 13 December 2011, the Task Force published a public consultation paper.

Furthermore, as a result of ESMA's review of the CESR recommendations of 23 March 2011, the definition of mineral companies was the subject of a debate, in particular in respect of cement companies. A working group was created in which the CSSF participated. On 6 January 2012, ESMA published an open letter on the interpretation of the recommendation for mineral companies relating to cement companies. ESMA confirms that cement companies are not subject to the obligations of Chapters 132 and 133 of the recommendation for mineral companies until final interpretation of the definition of mineral companies, and more specifically of the materiality of mining activities.

Finally, the discussions and consultations conducted by the CFSC at the four meetings also led to the following publications:

- statistics relating to the prospectuses approved and passported into the different Member States for the period from July 2010 to December 2010;
- the setting-up of a legal framework laying down the rules under which an issuer of a third country, which drafted a prospectus in accordance with its domestic regulatory framework, may comply with the requirements of the Prospectus Directive by way of a publication of additional information; thus, a report was published concerning prospectuses drafted in accordance with Israeli laws and regulations;
- common positions on the questions arisen in the context of the implementation of the Prospectus Directive by way of an updating of "FAQ CESR" in June 2011, which relate to (1) the amendment of question 15 to clarify the re-adjustment requirements to be applied in case of application of new accounting standards, in particular in relation to financial statements of the financial years preceding the financial year concerned with the application of these new standards and (2) the implications of Regulation (EC) No 1060/2009 relating to the credit rating agencies on the disclosure regime of information to be included in the prospectuses.

[4] Specific temporary working group created by the CFSC.

**• Transparency**

In the context of the review of Directive 2004/109/EC (Transparency Directive), and more specifically within the context of the review of the obligations in respect of major holdings in companies whose shares are admitted to trading on a regulated market, it was noted that the empty voting practice, i.e. voting rights without market exposure attached to shares, would require to be analysed in detail. Thus, the CFSC decided to create a specific working group to prepare a public consultation paper in this respect. As a result of the work carried out by this Task Force, ESMA published a call for evidence in relation to the empty vote practice in September 2011.

**• Corporate governance**

In 2011, this group worked on the issues related to the proxy advisors. Questionnaires were submitted to a selection of investors, issuers and proxy advisors. As a reminder, proxy advisors issue voting recommendations intended to institutional investors. The exercise of voting rights and the active follow-up of listed companies represent key elements of a responsible portfolio management by institutional investors. ESMA has planned to publish, during the first half year of 2012, a discussion paper on proxy advisors.

### 2.2.5. Investor Protection and Intermediaries Standing Committee (IPISC)

In 2011, this committee worked on the preparation of guidelines as regards the compliance function and the assessment whether the investment services provided are suitable for the client (suitability test). On 22 December 2011, two public consultations covering these two subjects were initiated by ESMA.

The purpose of these guidelines on the suitability test is to clarify and to promote convergence in the implementation of certain aspects relating to the requirements arising from the conduct of the suitability test. For the purpose of offering investments suitable for the clients, an institution shall consider:

- portfolio diversification,
- understanding by the clients of the return on a risk-free asset,
- the ability of the clients to finance their investments and, where applicable, to bear the losses;
- degree of liquidity of the investments, and
- prevention of conflicts of interest which might adversely affect the conduct of the suitability test.

The guidelines in relation to the compliance function emphasise the importance of the proper functioning of this function within the context of the provision of investment services.

In addition to these two guidelines, the committee submitted to its members a questionnaire relating to the remuneration of the staff involved in the provision of investment services. The committee decided to develop, in 2012, the guidelines on this staff category of credit institutions and investment firms.

### 2.2.6. Standing Committee on Secondary Markets (SMSC)

The work of the SMSC mainly centred on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities. The guidelines on this topic were published on 22 December 2011 (ref.: ESMA/2011/456). These guidelines cover (1) the organisational requirements for regulated markets, MTFs and investment firms' trading systems, (2) the organisational requirements for these entities to promote fair and orderly trading in an automated trading environment and to prevent market abuse, (3) the organisational requirements for regulated markets and MTFs whose members/participants and users provide sponsored access or direct market access, and (4) the organisational requirements for investments firms which provide sponsored access or direct market access.

### 2.2.7. Post-trading Standing Committee (PTSC)

Within the context of the proposal for a regulation on OTC derivatives, central counterparties and trade repositories, the PTSC drafted a discussion paper relating to the technical standards provided for in this proposal. The CSSF participated in the Task Force on Trade Repositories which deals with the various subjects relating to the details, types, format and frequency of reporting to be carried out by financial and non-financial counterparties. The Task Force also addressed the topic on applications for registration of trade repositories and on transparency and data availability (data held by trade repositories that will be made public and to which the authorities referred to in Article 67 of the above-mentioned proposed regulation will have access).

Moreover, on 15 March 2011, the PTSC responded to the European Commission in the context of the public consultation on the central securities depositories and on the harmonisation of certain aspects of the securities settlement in the EU.

### 2.2.8. Investment Management Standing Committee (IMSC)

In 2011, the IMSC worked in particular on the following topics:

- Directive on alternative investment fund managers (AIFM Directive),
- risk measurement,
- transposition of Directive 2009/65/EC (UCITS IV),
- monetary UCIs,
- Exchange-Traded Funds (ETF) and other topics relating to UCITS,
- operational prudential supervision.

#### • AIFM Directive

As regards the AIFM Directive, the IMSC created four Task Forces which worked on the following subjects: (1) the scope of the AIFM Directive, (2) the authorisations under the AIFM Directive and general operating conditions, (3) the depositories under the AIFM Directive, and (4) the leverage effect, transparency, risk management and information to be provided under the AIFM Directive. The works of these Task Forces have been included in a coordinated document for the finalisation of the advice of ESMA on the implementing rules of the AIFM Directive.

On 16 November 2011, ESMA published its advice (ref.: ESMA/2011/379) which deals in particular with the general provisions for managers, authorisations and operating conditions, governance of AIF depositories, transparency requirements and leverage effect as well as third countries.

Finally, ESMA published on 23 February 2012 a consultation paper on the key concepts of the AIFM Directive and types of AIF. This paper is part of the initiatives of ESMA to ensure the alignment of supervisory practices among European national supervisory authorities in respect of the key concepts of the AIFM Directive and harmonised conditions for implementation of the Directive. Feedback to this consultation helps ESMA finalise the draft regulatory technical standards required by Article 4(4) of the Directive. The document focuses in particular on the definition of the concept of AIFM and AIF as well as on the treatment of UCITS management companies, investment firms and credit institutions.

#### • Transposition of Directive 2009/65/EC (UCITS IV)

On 13 October 2011, ESMA published an opinion pursuant to Article 29(1)(a) of Regulation (EU) No 1095/2010 adopted by the Board of Supervisors (BoS) in accordance with Article 44(1) of this Regulation. This opinion was necessary as the deadline for the transposition of Directive 2009/65/EC was 1 July 2011 and as most Member States had not yet entirely transposed the Directive and its implementing rules at the publication date of the ESMA opinion.

Luxembourg transposed Directive 2009/65/EC by the law of 17 December 2010 and the implementing measures by CSSF Regulations N° 10-04, N° 10-05 and N° 11-04.

In its opinion, ESMA indicates that its has identified a certain number of problematic situations and takes position by proposing practical arrangements to solve them.

**• Exchange-Traded Funds**

Since April 2011, ESMA has been analysing the possibility to strengthen the regulatory framework relating to Exchange-Traded Funds (ETF) and structured UCITS with the aim to increase the investor protection and to uphold market integrity, in relation to areas such as for example transparency, operation of the ETF secondary market and index replication (including strategy indices). On 22 July 2011, ESMA initiated a first public consultation on the possible guidelines to be adopted in this respect.

Following the comments gathered, a new proposal was submitted for an opinion to the public at the end of January 2012 in order to publish the final guidelines in the second quarter of 2012. The amendments proposed in the new version relate in particular to the extension to all UCITS of certain guidelines, concerning more specifically index replication (including leveraged indices and strategy indices), the use of efficient portfolio management techniques as well as the use of Total Return Swaps.

**• Operational prudential supervision**

The Operational Working Group on Supervisory Convergence worked on various topics, such as the presentation of costs, fees and commissions, the notification procedure of UCITS, the asset assessment procedures, the investment by UCITS in delta one financial derivative instruments or management procedures of the portfolio's liquid assets and redemptions of units/shares. The purpose of this work is to adopt a common approach or guidelines on the issues addressed.

It should also be noted that the IMSC is assisted by a consultative group consisting of 23 industry experts, including one representative of the Luxembourg investment fund sector. In 2011, two meetings were held between the IMSC and the consultative group.

### 2.2.9. Credit Rating Agencies Technical Committee

Following the publication of Regulation (EU) No 513/2011, the supervisory powers regarding credit rating agencies were transferred to ESMA on 1 July 2011. The Credit Rating Agencies Technical Committee comprises experts from national competent authorities and assists ESMA in performing certain tasks relating to the regulation on credit rating agencies, in particular in developing draft regulatory technical standards aimed to supplement the Level 1 Regulation and in assessing supervisory regimes to which credit rating agencies are subject in third countries.

Thus, in 2011, the technical committee focused a large part of its work on the development of regulatory technical standards relating, *inter alia*, to information to be provided by a credit rating agency in its application for registration, to the assessment of compliance of credit rating methodologies with the requirements set out in Article 8 of the Regulation and to the content and format of ratings data periodic reporting to be submitted from credit rating agencies. These draft technical standards some of which are largely based on the guidelines previously issued by CESR, were subject to public consultation and were submitted to the European Commission for adoption at the end of December 2011.

Based on the analyses of the technical committee, ESMA published positive opinions on the ability to endorse ratings issued by credit rating agencies subject to the regulatory regime of Australia, the United States, Canada, Hong Kong and Singapore. Moreover, ESMA took a decision on the equivalence of the regulatory regime of Japan. These decisions are crucial, also for the Luxembourg financial sector given that only the credit ratings issued by registered (or certified) credit rating agencies in the EU and credit ratings endorsed by these agencies may be used for regulatory purposes by European financial sector players as from 30 April 2012.

The European entities of the four large groups of credit rating agencies (DBRS, Fitch, Moody's and S&P) were registered in October 2011. The updated list of the credit rating agencies which are registered or certified in the EU is available on the website of ESMA (http://www.esma.europa.eu/page/List-registered-and-certified-CRAs).

### 2.2.10. IT Management and Governance Group (ITMG)

Additional explanations on the works performed in 2011 by ITMG are provided under item 1.2.1. of Chapter X "Supervision of information systems".

### 2.2.11. Article 9 Implementation Task Force / Financial Innovation Standing Committee (FISC)

The main mission of the Task Force was to assess and to make concrete proposals on the manner to include the requirements of Article 9 of Regulation (EU) No 1095/2010 in the internal procedures and organisation of ESMA.

In particular, Article 9(4) of the Regulation imposes on ESMA to establish, like the other European supervisory authorities, a financial innovation committee. Following the works performed to outline the tasks, structure and governance of this committee, the FISC was established at the end of 2011. Its role is to assist ESMA in fulfilling its tasks and responsibilities relating to investor protection. The FISC's main aim is to achieve a co-ordinated approach of the prudential treatment of new or innovative financial activities. It does this by facilitating the elaboration of coordinated policies in the area of financial innovation.

## 2.3. Joint Committee of the European supervisory authorities EBA, ESMA and EIOPA

### 2.3.1. Sub-Committee on Financial Conglomerates (JCFC)

The Sub-Committee on Financial Conglomerates was established by Regulations (EU) No 1093/2010, 1094/2010 and 1095/2010 on the new European supervisory authorities. However, European Decisions 2009/78/EC and 2009/79/EC had already provided for a cooperation between CEBS, CESR and CEIOPS as regards supervision of financial conglomerates within the Joint Committee on Financial Conglomerates (JCFC). The acronym JCFC has been kept to designate the Sub-Committee on Financial Conglomerates which aims to assist the Joint Committee in the completion of its programme relating to financial conglomerates.

The CSSF takes part in the meetings of the JCFC but it should be noted that to date, no financial conglomerate has been identified for which the CSSF should exercise the role of coordinator.

In January 2009, the JCFC presented its conclusions in response to the third call for advice of the European Commission. Subsequently, Directive 2011/89/EU on the supplementary supervision of financial entities in a financial conglomerate was adopted on 16 November 2011. In respect of "participations" in a financial conglomerate, more specifically as regards their prudential treatment, the JCFC was invited to develop guidelines on the implementation of Articles 7 (risk concentration), 8 (intra-group transactions) and 9 (internal control mechanisms and risk management processes) of said Directive. The draft guidelines, which also cover the notion of "durable link", are in the process of being finalised.

On 20 April 2011, the European Commission sent a fourth call for advice to the JCFC in the context of the fundamental review of the Directive on financial conglomerates. The five questions raised in the call for advice were taken up in three workstreams, the first one on the scope of application, the second one on the responsible parent entity and internal governance requirements and the third one on powers and sanctions. It should be noted in this context that the Joint Forum published on 19 December 2011 a consultation document entitled "Principles for the Supervision of Financial Conglomerates" which also deals with the definition of financial conglomerate. The European Commission will await the finalisation of the Joint Forum proposal before making itself a proposal for a directive in this regard.

Article 6 of the Directive on financial conglomerates deals with the problem of double gearing of own funds. As the EBA will be required, pursuant to CRD IV, to develop technical standards on the use of the technical calculation methods provided for in the Directive on financial conglomerates, by 1 January 2013, a working group was set up.

#### 2.3.2. Anti-Money Laundering Committee (AMLC)

As regards AML/CFT, the CSSF contributed in 2011 to the works of the Anti-Money Laundering Committee (cf. Chapter XIV "Fight against money laundering and terrorist financing").

### 2.4. European Group of Auditors' Oversight Bodies (EGAOB)

In 2011, the CSSF took part in the works of the European Group of Auditors' Oversight Bodies (EGAOB) and its sub-working group, the EGAOB Preparatory.

The European Commission decided on 24 January 2011 to reorganise the group and its various subgroups to improve the effectiveness of the system. Thus, the subgroups EGAOB - Subgroup on Cooperation on Third Countries, EGAOB - Subgroup on International Standards on Auditing, EGAOB - Subgroup Intra EU members and EGAOB - Subgroup on Inspections were gathered together in the subgroup EGAOB Preparatory which now deals with all issues which were previously discussed in these subgroups.

In 2011, the EGAOB Preparatory continued analysing the equivalence of public oversight systems for third-country auditors of companies established outside the EU and whose securities are admitted to trading on European regulated markets. This analysis was conducted pursuant to Article 46 of Directive 2006/43/EC which provides, under certain conditions, the option to exempt third-country auditors from public oversight requirements on the basis of reciprocity.

### 2.5. Other groups attached to the European Commission

#### 2.5.1. Capital Requirements Directive Working Group (CRDWG)

This working group, which was established by the European Commission in 2007 in order to discuss the amendments to the CRD Directives (2006/48/EC and 2006/49/EC) with the Member States, continued its work during the first half of 2011. Thus, the CRDWG deepened its discussions on Basel III (regulatory capital, new liquidity ratios and leverage ratio, etc.). Concurrently, a second project was initiated, i.e. the transformation of the CRD Directives into a regulation and the creation of a European single rule book, i.e. a set of harmonised rules addressed to entities in the EU.

These two strands of work helped the European Commission in the development of proposals for a regulation and a directive (referred to as CRR and CRD IV) intended to replace Directives 2006/48/EC and 2006/49/EC and published on 20 July 2011.

#### 2.5.2. Accounting Regulatory Committee

The CSSF participates as a member in the work of the Accounting Regulatory Committee of the European Commission.

#### 2.5.3. CPMLTF

As regards AML/CFT, the CSSF contributed in 2011 to the work of the Committee for the prevention of Money Laundering and Terrorist Financing (CPMLTF) of the European Commission (cf. Chapter XIV "Fight against money laundering and terrorist financing").

## 3. MULTILATERAL COOPERATION

### 3.1. Basel Committee on banking supervision

The Basel Committee is chaired by Mr Stefan Ingves (Sweden). Mr Claude Simon, Director, represents the CSSF in the Basel Committee.

The CSSF participates in the work of the Basel Committee and some of its subcommittees and sub-working groups.

On 16 December 2010, the Basel Committee published the final version of the new regulatory framework, commonly referred to as Basel III, whose components are set out in item 3.1 of Chapter I "General supervision and international cooperation" of the 2010 Annual Report of the CSSF.

In 2011, the Basel Committee fleshed out certain elements of the new regulation. The most important of these are the work on own funds, liquidity ratios, global systemically important banks (G-SIB) and exposures of banks to central counterparties.

The Basel Committee also wishes to remedy the fact that there is, for the time being, no global and harmonised framework for the limitation and regulation of large exposures whereas such mechanisms already exist in the EU and in a certain number of third countries. The newly created Large Exposures Group started its work in 2011. The CSSF participates therein considering the possible impact of the new rules in this area on Luxembourg banks.

In respect of the definition of own funds, the Definition of Capital Subgroup mainly focused, in 2011, on the analysis of questions on the implementation of the Basel III regulatory framework. This work led to the publication of a series of FAQs. Some clarifications contained in these FAQs will be directly included in the future European legislation transposing the Basel III framework into European law.

Pursuant to paragraph 92 of the Basel III rules, the subgroup also conducted a more in-depth analysis of disclosure requirements (Pillar 3) regarding own funds by credit institutions. This work led to a document submitted to public consultation from December 2011 to February 2012.

With the publication, in December 2010, of its two new liquidity ratios, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), the Basel Committee initiated a major process for the harmonisation of prudential rules relating to liquidity. The LCR is a short-term ratio the goal of which is to ensure that a bank has sufficient liquid assets to cope with liquidity shortfalls during crisis. The NSFR is a long-term ratio the goal of which is to limit an excessive dependency on short-term inter-bank (or market) financing by determining an acceptable minimum amount of stable financing.

These new liquidity standards are currently subject to an observation period to identify unexpected consequences or undue impacts. In more concrete terms, this observation period is especially used to monitor the impact of these new standards on small credit institutions as well as on business models of banks. Possible adjustments may thus be brought until mid 2013 as far as the LCR is concerned and until mid 2016 as far as the NSFR is concerned. The implementation of the LCR is scheduled for 1 January 2015 and that of the NSFR for 1 January 2018.

The Basel Committee re-affirmed its commitment to the introduction of these two liquidity ratios. It thus decided to accelerate the work to be able to address more quickly the various concerns of the banking sector. As regards the LCR, three main areas have thus been identified, i.e. the definition of liquid assets, the calibration of incoming and outgoing flows and the use of the liquid asset reserve in times of stress.

In 2011, the Risk Measurement Group (RMG) continued to focus on the review of the regime relating to counterpart credit risk. The work of this working group led in particular to the publication of the document entitled "Basel III counterparty credit risk - Frequently asked questions" and the consultation paper entitled "Application of own credit risk adjustments to derivatives" on the treatment of profit registrations resulting from the deterioration of own credit risk linked to exposures of derivative contracts.

In addition to the works carried out in the context of Basel III, it should be noted that the Basel Committee published on 20 December 2011 a consultative paper on the revised "Core Principles for Effective Banking Supervision" and the associated methodology. Like the IOSCO principles, these principles are in particular used by the IMF in the context of its assessments of the financial sector of different countries. The review is the result of the lessons learned from the financial crisis and aims to strengthen risk management and supervisory practices. Moreover, it aims to take into account emerging factors such as the need for a more intense supervision for systematically important banks, the taking into account of the macroprudential view and the importance of effective crisis management, recovery and resolution measures.

As regards audit, the CSSF in particular participated in the works of the Basel Committee on the consultation paper entitled "The internal audit function in banks" published on 2 December 2011. This document is intended to replace the Basel Committee document of 2001 entitled "Internal audit in banks and the supervisor's relationship with auditors". The new document reiterates the underlying principles for the organisation of an efficient internal audit function within banking and financial groups and for local entities. In line with the principles of governance of the Basel Committee, the document reiterates that the audit committees are responsible for the supervision of the work of the internal audit function. An innovative aspect of this document is that an exchange of information between the internal audit function and the prudential supervisory authority can take place provided that it is organised in a transparent manner. Finally, the document specifies the conditions under which a supervisory authority can base itself on the work of the internal audit function within the context of its supervisory approach.

All publications by the Basel Committee and information on its organisational structure are available on the website www.bis.org.

## 3.2. International Organisation of Securities Commissions (IOSCO)

### 3.2.1. 36th IOSCO Annual Conference

The securities and futures regulators, including the CSSF, and other members of the international financial community met in Cape Town from 17 to 21 April 2011, on the occasion of the 36th Annual Conference of IOSCO.

On this occasion, IOSCO examined its strategic direction to better fulfil its essential role in relation to the establishment of international standards governing financial markets. Thus, the structure of IOSCO committees and the financing system of IOSCO were reviewed and revised, the purpose being to provide IOSCO with a single Board to replace the current bicephalous Executive Committee which included the Technical Committee and the Emerging Markets Committee. Similarly, it is also planned to merge the groups which fall within the responsibility of the Technical Committee with those under the responsibility of the Emerging Markets Committee. As regards the structure of the committees, a transitional period until 2014 is foreseen.

Nine members were admitted to the signature of the IOSCO's Multilateral Memorandum of Understanding (MMoU) during the annual conference of 2011 so that the number of signatories is now 80 as regards Annexe A of this Memorandum. Thirty-six members have expressed their commitment to sign the Memorandum pursuant to its Annexe B. Only four regulators and members of IOSCO have not yet signed the MMoU, either as signatories of the Memorandum or as signatories of Annexe B. IOSCO's target is that all ordinary members and associate members, with primary responsibility for securities regulation in their jurisdiction, become full signatories of the Memorandum by 1 January 2013. The list of signatories of IOSCO's MMoU is available on IOSCO's website (www.iosco.org).

It should also be noted that the Technical Committee of IOSCO has formalised the creation of the new Standing Committee Risk and Research which deals with the role of the supervisory authorities in relation to systemic risk.

The supervisory authority of Liechtenstein was accepted as ordinary IOSCO member and two organisations were accepted as affiliate members.

The 37th annual conference of IOSCO will be held in Beijing and the 38th annual conference will be held from 15 to 19 September 2013 in Luxembourg.

### 3.2.2. IOSCO groups

**• Standing Committee SC1 on Multinational Disclosure and Accounting**

The Accounting subcommittee (ASC) closely follows the activities of the IASB (International Accounting Standards Board), especially by examining the exposure drafts and discussion papers issued by the IASB and by submitting comment letters relating thereto.

The Audit subcommittee (AuSC) follows the development of the auditing and independence standards issued by the IAASB (International Auditing and Assurance Standards Board) and IESBA (International Ethics Standards Board for Accountants) of IFAC (International Federation of Accountants).

The Disclosure subcommittee (DSC) mainly worked in 2011 on the development of the principles relating to the disclosure of periodic or ongoing information for Asset-Backed Securities (ABS). The draft principles in question will be published in the form of a consultation paper at the beginning of 2012 and the publication of "IOSCO Principles for Ongoing Disclosure for Asset-Backed Securities" is expected for the end of 2012.

**• Standing Committee SC5 on Investment Management**

Within the SC5, the CSSF participates, *inter alia*, in the following subgroups:

- the subgroup on Exchange-Traded Funds (ETF) aiming to develop sound practices as regards regulation of ETFs relating to, *inter alia*, the transparency, marketing and structuring of ETFs;
- the working group on money market UCIs aiming to analyse and develop recommendations to reduce the vulnerability of these UCIs (with a particular focus on money market UCIs with a constant NAV) to runs from investors as well as other associated systemic risks.

Moreover, the SC5 worked during 2011 on subjects such as the assessment of UCIs, the liquidity risk linked to UCIs or the suspension of redemptions by UCIs.

## 3.3. Enlarged Contact Group "Undertakings for Collective Investment"

The CSSF attended the annual meeting of the Enlarged Contact Group "Undertakings for Collective Investment" which was held from 5 to 7 October 2011 in Vaduz, Liechtenstein. The following topics were discussed: issues relating to supervision, conflicts of interest/code of conduct, legal topics, financial issues, reporting and disclosure, management and administration of investment funds and UCITS and other investment funds.

The next meeting of the Enlarged Contact Group will be held from 19 to 21 September 2012 in Luxembourg.

## 3.4. Others

In addition to the above-mentioned committees and groups, the CSSF agents also participated, in 2011, in the work of the *Institut francophone de la régulation financière* (IFREFI), the *Groupe des Superviseurs Bancaires Francophones* (GSBF, Group of francophone banking supervisors), the FSB Regional Consultative Group for Europe and the International Forum of Independent Audit Regulators (IFIAR).

Furthermore, within the context of the fight against money laundering and terrorist financing, the CSSF contributed, in 2011, to the work of the Financial Action Task Force (FATF) of the OECD and its subgroups and to those of the Wolfsberg Group (cf. Chapter XIV "Fight against money laundering and terrorist financing").

# 4. LIST OF INTERNATIONAL GROUPS IN WHICH THE CSSF PARTICIPATES

At international level, the CSSF participates as a member in the works of the following committees, working groups and subgroups.

## European Systemic Risk Board (ESRB)

- **Advisory Technical Committee**

## European Banking Authority (EBA)

- **Board of Supervisors**
- **Standing Committee on Regulation and Policy (SCRePol) and the subgroups**
  - Subgroup on Own Funds
  - Subgroup on Credit Risk (SGCR)
  - Subgroup on Intervention, Resolution and Deposit Guarantee Schemes (SG IR&DGS)
  - Subgroup on Operational Risk
  - Subgroup on Liquidity (SGL)
  - Subgroup on Internal Governance
  - Subgroup on Securitisation and Covered Bonds
  - Network on ECAIs[5]
  - Network on Supervisory Disclosure
  - Task Force on Market Risk
  - Task Force on Remuneration
  - Task Force on Interest Rate Risk
  - Task Force on Leverage Ratio
  - Task Force on Model Validations (TFMV)
  - Network on Third Country Equivalence
- **Standing Committee on Oversight and Practices (SCOP) and the subgroups**
  - Subgroup on Vulnerabilities and ongoing assessment of risk
  - Subgroup on Micro-prudential analysis tools and data
  - Subgroup on Home-host and colleges
  - Subgroup on Risk assessment systems under Pillar 2
  - Subgroup on Implementation and supervisory practices
- **Standing Committee on Accounting, Reporting and Auditing (SCARA) and the subgroups**
  - Subgroup on Accounting
  - Subgroup on Reporting
  - Subgroup on Auditing
  - Subgroup on Transparency

[5] External Credit Assessment Institutions.

Network on COREP
Network on FINREP
Network on XBRL

- **Standing Committee on Financial Innovation (SCFI) and the subgroups**
  Subgroup on Consumer Protection (SGCP)
  Subgroup on Innovative Products
- **Standing Committee on IT / IT Sounding Board and the subgroup**
  Subgroup on XBRL
- **Review Panel and the subgroup**
  Methodology Drafting Subgroup
- **Impact Study Group (ISG)**
- **Expert Group on EU-wide stress-testing**
- **Human Resources Network**
- **Press officers**

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## European Securities and Markets Authority (ESMA)

- **Board of Supervisors**
- **Board of Directors**
- **Review Panel and the subgroups**
  Subgroup on Prospectus
  Subgroup on Money Market Funds
- **ESMA-Pol and the subgroups**
  ESMA-Pol Task Force on MMOU
  ESMA-Pol Task Force on Forex
  Joint Subgroup ESMA-Pol - ITMG on Transaction Reporting Systems
- **Corporate Reporting Standing Committee (CRSC) and the subgroups**
  IFRS Project Group on IFRS
  European Enforcers Coordination Sessions
  Task Force on Audit Related Activities
  Task Force on Storage of Regulated Information
  Task Force on Periodic Information
- **Corporate Finance Standing Committee (CFSC) and the subgroups**
  Task Force Prospectus Level 2
    Subgroup on the review of the provisions of the Prospectus Regulation
    Subgroup on retail cascades

Working Group on Mineral Companies
Prospectus Agenda
Advisory Group on Corporate Governance
Consultative Working Group

- **Investor Protection and Intermediaries Standing Committee (IPISC) and the subgroup**
  IPISC Task Force
- **Secondary Markets Standing Committee (SMSC)**
- **Post-trading Standing Committee (PTSC) and the subgroup**
  Task Force on Trade Repositories
- **Investment Management Standing Committee (IMSC) and the subgroups**
  Operational Working Group on Supervisory Convergence
  Operational Working Group Subgroup on Risk Management
  Task Force on General Provisions & Authorisations
  Task Force on Depositories
  Task Force on Scope
  Task Force on Transparency, Leverage, Liquidity and Risk Management
- **Committee for Economic and Markets Analysis (CEMA) and the subgroup**
  Working Group on high frequency trading
- **IT Management and Governance Group and the subgroup**
  Task Force for the Omnibus Registers Project
- **Credit Rating Agencies Technical Committee**
- **Article 9 Implementation Task Force / Financial Innovation Standing Committee (FISC)**
- **Human Resources Network**
- **Takeover Bids Network**
- **ESMA Consumer Network**
- **Press Officers**

## European Insurance and Occupational Pensions Authority (EIOPA)

- **Occupational Pensions Committee (OPC) and the subgroup**
  Workstreams recast IORP Directive
- **Financial Stability Committee**
- **Review Panel**
- **Press Officers**

### Joint Committee of the three European Supervisory Authorities EBA, ESMA, EIOPA

- Subcommittee Financial Conglomerates
- Anti-Money Laundering Committee
- E-Money Working Group

### Council of the EU

- European Market Infrastructure Regulation (EMIR)
- Regulation on Short-Selling and certain aspects of Credit Default Swaps
- Investor Compensation Schemes
- CRD IV
- MiFID II
- Venture Capital and Social Entrepreneurship Funds
- MAD II
- Deposit Guarantee Schemes

### FIN-NET

### European Banking Committee

- EBC-PSSC Working Group Secure-Pay

### European Commission

- Capital Requirements Directive Working Group (CRDWG)
- Capital Requirements Directive Transposition Group
- Accounting Regulatory Committee (ARC)
- Audit Regulatory Committee

- **European Group of Auditors' Oversight Bodies (EGAOB) and the subgroups**
  Preparatory Subgroup
  EAIG
- **Committee for the prevention of Money Laundering and Terrorist Financing (CPMLTF)**
- **Working Party on Close-Out Netting**
- **Working Party on Financial Services-SEPA**

## European Financial Reporting Advisory Group (EFRAG)

- **Consultative Forum of Standard Setters**

## Basel Committee on banking supervision

- **Policy Development Group (PDG) and the subgroups**
  Leverage Ratio Subgroup
  Risk Management and Modelling Group
  Large Exposures Group
  Working Group on Liquidity
  Definition of Capital Subgroup
  Capital Monitoring Group
  Corporate Governance Group
  Cross-Border Bank Resolution Group
  QIS Working Group
- **Standards Implementation Group (SIG) and the subgroups**
  Operational Risk Subgroup
  Subgroup on Validation
  Network on Pillar 2
- **Accounting Task Force (ATF) and the subgroups**
  Conceptual Framework Issues Subgroup
  Financial Instruments Practices Subgroup
  Audit Subgroup
  Financial Statement Presentation Workstream
  Financial Transparency Workstream
- **Anti-Money Laundering Expert Group**

## Financial Stability Board

- **European Regional Consultative Group**

## International Organisation of Securities Commissions (IOSCO)

- **IOSCO Annual Conference**
- **IOSCO European Regional Conference**
- **Standing Committee SC1 on Multinational Disclosure and Accounting and the subgroups**
  Accounting Subcommittee (ASC)
  IOSCO IFRS Database
- **Standing Committee SC5 on Investment Management**

## Financial Action Task Force (FATF)

- **International Cooperation Review Group (ICRG)**
- **Working Group on Evaluation and Implementation (WGEI) and the subgroup**
  Subgroup on Effectiveness
- **EGA**
- **Working Group on Terrorist Financing and Money Laundering (WGTM) and the subgroup**
  Subgroup on new payment methods
- **Working Group on Typologies (WGTYP)**
- **Review Groups (ERRG)**

## Organisation for Economic Cooperation and Development (OECD)

- **Working Group on Private Pensions**

**Enlarged Contact Group "Undertakings for Collective Investment"**

**IT Supervisory Board**

**Passport Experts Network**

**Institut francophone de la régulation financière (IFREFI)**

**Groupe des Superviseurs Bancaires Francophones (GSBF - Group of francophone banking supervisors)**

**Child and Youth Finance**

# SUPERVISION OF THE BANKING SECTOR



# 1. DEVELOPMENTS IN THE BANKING SECTOR IN 2011

## 1.1. Major events in 2011

### 1.1.1. Risks in the Luxembourg banking sector

The analysis of the risk structure in the Luxembourg banking sector mainly reveals three types of risk concentration which need particular management and monitoring, namely sovereign risks, risks linked to the financing of residential real estate in Luxembourg and intra-group risks. The nature and the level of these "systemic risks" vary greatly among banks and according to the activities performed.

#### • Sovereign risks

Sovereign risks are credit exposures to the public sector which include central, regional and local administrations. With the pressure on public finance in many countries hit by the economic and financial crisis, sovereign exposures are no longer insignificant risks. In 2011, the materialisation of sovereign risk on the Greek debt caused asset depreciations of EUR 1.3 billion, representing 30% of the profit before provisions of the Luxembourg banking sector. As in the past, the use of the lumpsum provision allowed Luxembourg banks to mitigate the impact of these losses on their current result. Indeed, lumpsum provisions are constituted as a preventive measure in prosperous economic times to be used in less favourable periods to face possible losses.

Since 2008, the CSSF has been promoting the reduction in sovereign exposures considered excessive. Under the combined effect of these interventions, considered, at that time, as inappropriate by some bankers, and market developments, excessive exposures have now given way to moderate exposures representing an acceptable ratio between own funds and sovereign (risk) exposures. Certain significant concentrations remain, namely at the level of banks issuing covered bonds whose business model, i.e. issuing covered bonds linked to sovereign exposures, include, by definition, a sovereign risk concentration. At aggregated level, sovereign exposures fell by about EUR 9 billion (-16%) over a year.

#### • Risk linked to residential real estate in Luxembourg

Unlike the situation in other European countries, real estate prices in Luxembourg have not significantly fallen with the financial crisis. However, as the local market of residential real estate mortgage financing is assured only by a limited number of the financial centre's banks, the residential real estate sector constitutes a substantial concentration risk. Moreover, the market remains sustained as reflects the 8% rise year-on-year of total loans granted by these banks to their retail customers in 2011. In a context of low interest rates and a gloomier economic outlook than in the past, these banks need to maintain responsible business policies as regards loans.

When financing residential real estate, banks need to make sure that the borrower will still be in a position to service the debt, even if adverse economic conditions or social developments should occur which might reduce the borrower's available income, for instance in case of an increase of interest costs. Under a sound loan granting policy, no loan should exceed 85% of the value of the mortgaged object. In addition, with the entry into force in January 2013 of the CRR/CRD IV[1] reform, residential mortgage loans, whose amount exceeds 80% of the mortgaged property, will no longer benefit from the favourable risk weight of 35% under the current determination of capital requirements for credit risk. Weighted henceforth at 75% or 100%, these risks will require more own funds.

As regards property development, the banks must receive solid guarantees (pre-sale or pre-lease levels covering the finishing costs of the shell, personal guarantees easily realisable), require an adequate personal contribution of the developer, and set a timely deadline in the near future for the start of the building phase. After this deadline has elapsed, banks must make provisions for all unpaid accrued interest. Unpaid accrued interest cannot be capitalised or settled by a loan extension.

[1] Proposal for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV) and proposal for a regulation on prudential requirements for credit institutions and investment firms (CRR). These proposals lay down the Basel III measures at European level.

In 2011, the CSSF confirmed the capital surcharge[2] imposed on credit institutions that are highly exposed to the local real estate sector. These banks are required to observe a regulatory solvency ratio of 10%, i.e. 2% higher than the regulatory minimum.

### • Risks linked to intra-group exposures

The liabilities collected by Luxembourg banks in the context of portfolio management services they provide have to be reinvested. This investment is risky by nature. Consequently, the CSSF accepts, in principle, and in accordance with the intra-group exemption laid down in the European regulatory framework governing large exposures, that a portion of these deposits be invested by a Luxembourg banking subsidiary with its parent company up to an amount exceeding the 25% limit of own funds usually applicable under the regulations on large exposures. This position is justified by the inside information the CSSF has on the risks inherent in these investments, in particular through the colleges of supervisors of the banking groups concerned, as opposed to other types of investment with less visibility.

It should be specified, however, that the CSSF decides on a case-by-case basis if the intra-group exemption applies, in accordance with the financial situation, the risk profile and support factors of the parent company. Moreover, the intra-group exemption is subject to conditions: it does not allow banks to carry out a risky business of maturity transformation which occurs when short-term customer deposits are invested as long-term loans, or when used to finance peripheral group entities in which the Luxembourg banks have no particular interest.

However, the intra-group exemption on large exposures does not imply that intra-group exposures are not subject to regulatory capital requirements. The exposures must be weighted according to the provisions of Circular CSSF 06/273, which, in accordance with the European directives, does not provide for such an exemption in Luxembourg. In addition, the CSSF has decided in 2011 to systematically reflect, henceforth, any capital surcharge imposed on the parent company of the Luxembourg bank at the level of the solvency ratio of the Luxembourg subsidiaries, where the Luxembourg bank holds significant exposures to the parent company.

Besides the aforementioned risks, which require specific management and monitoring, the following risks are also worth mentioning.

### • Risks related to the activity of a depositary bank

The activity of depositary bank carried out by Luxembourg banks in the framework of their services related to wealth management concerns global assets amounting to around EUR 2,400 billion. By adding the assets deposited during payment and securities settlement transactions to the previous figure, the total amounts to EUR 12,500 billion.

Given the high amount of values deposited with Luxembourg banks, an interruption of the service provision by the depositary bank could jeopardise the orderly functioning of the global financial markets. Unlike the aforementioned risks, the risk linked to business continuity of a depositary bank is therefore mainly a risk that the financial centre implies for the global financial system.

The CSSF expects Luxembourg banks to take appropriate measures to limit the adverse effects of business discontinuity in accordance with Article 5(3) of Grand-ducal regulation of 13 July 2007 on organisational requirements and rules of conduct in the financial sector.

### • Economic risks

When the economic situation deteriorates, the proportion of borrowers that have difficulties to fulfil their commitments tends to rise. Banks can be accommodating and allow such debtors to adjust their repayment plans. This practice may be beneficial both for the borrower and the bank if it allows continuing the underlying transaction and realising mutual inherent benefits. However, this practice is unacceptable if it leads to bad debts being considered as performing, to making asset quality assessment opaque and to not recording the necessary depreciations.

[2] The concept of “capital surcharge” means additional own funds that a credit institution must have in addition to its overall (capital) requirement as defined in Part V of Circular CSSF 06/273.

Banks that make these types of arrangements find it somewhat difficult to accurately assess the quality of their exposures. This is because the exposure is not subject to a contractual restructuring, fully reflected in the bank's IT system, but only to an amendment to the agreement which is often not entirely reflected in all the management data of the bank. In this context, the CSSF requires banks that are accommodating to have an IT management system that allows them to monitor the impact of this practice on the quality of their assets, to regularly assess the quality of their assets based on the arrangements made and to assess the need or opportunity to make provisions or depreciations.

**• Other risks**

During 2011, the General Board of the European Systemic Risk Board (ESRB) has approved two public recommendations that require supervisory authorities of the Member States to take a set of prudential measures in order to limit or prevent certain risks considered as systemic. The risks concerned are risks linked to lending in foreign currencies and US dollar denominated funding[3]. In Luxembourg, these risks are of lesser significance. Nevertheless, even though the principle of proportionality applies to both ESRB recommendations, the CSSF needs to regulate this specific area, to produce very detailed analyses on the risks concerned and to give an account to the ESRB in 2012.

Recently, the ESRB has also expressed concern about credit tightening in the EU. It has called on the prudential supervisory authorities to avoid a "disorderly or excessive deleveraging process" in the banking sector. In Luxembourg, the balance sheet total of banks fell by almost a quarter between October 2008 and February 2011. Although this drop mainly concerned transactions between financial sector entities, it is nevertheless a fact that the volume of loans granted to companies by those banks that had to substantially reduce their intermediation activities due to the financial crisis, decreased between 2008 and 2010. In 2011, owing to the European sovereign debt crisis, a smaller-scale deleveraging took place within certain credit institutions whose sovereign exposures were significant. Since February 2011, the balance sheet total of Luxembourg banks has been growing again.

In accordance with Article 3-2 of the law of 23 December 1998 establishing a financial sector supervisory commission (*Commission de surveillance du secteur financier*), the CSSF "takes duly into account the potential impact of its decisions on the stability of the financial system at a national, EU and international level", including with respect to deleveraging. Even though the CSSF shares the concerns regarding deleveraging, it is legally required to ensure a sound and prudent management of the Luxembourg credit institutions' business and must, in this respect, insist on a risk reduction should these become excessive.

### 1.1.2. New policy with respect to capital surcharge

Directive 2009/111/EC of 16 September 2009 (CRD II) amended Directive 2006/48/EC (CRD) by adding a third paragraph to Article 129 providing for a joint decision by the home and host supervisory authorities as regards capital adequacy of banking groups operating in the EU. The authorities, acting as a college, shall decide jointly on the capital surcharge imposed on a banking group and on the entities composing it, having regard to the financial situation and the risk profile. The CSSF is thus required to provide the colleges with its assessment of the situation of the Luxembourg credit institutions belonging to the group and to propose the capital surcharge required for these entities. At the end of the process, the CSSF must also validate the joint risk analysis and decision on capital surcharge.

Where the financial situation or the risk profile of the group require a capital surcharge, interbank amounts due that the subsidiary holds on its group cannot receive the minimum risk weights laid down in Circular CSSF 06/273 any more. In order to reflect this increased risk, the CSSF requires henceforth from subsidiaries that have a significant intra-group exposure to have a solvency ratio that observes the same limit than that imposed on the group under the joint decision.

On 8 December 2011, the EBA decided to require 71 European banking groups to comply with a 9% Core Tier 1 ratio as from July 2012 (cf. below). According to the above, this decision means that 4/5 of the banking sector in terms of assets should comply with a 9% Core Tier 1 capital ratio. In order to ensure a level playing field within the Luxembourg banking sector and after having analysed the situation of the banks that are not subject to the EBA's decision, the CSSF decided to assess henceforth the capital adequacy of all Luxembourg banks according to a 9% Core Tier 1 ratio on a regular basis.

[3] Both recommendations are available on the ESRB's website www.esrb.europa.eu, section "Recommendations".

It must be specified that this 9% requirement is not a maximum requirement. Where the supervisory review process reveals that the risk profile of a bank justifies that a capital ratio above 9% be imposed, the CSSF shall require this capital surcharge in accordance with Article 53(2) of the law of 5 April 1993 on the financial sector.

According to the CSSF's calculations, the vast majority of Luxembourg banks have already a Core Tier 1 ratio exceeding 9% as at 31 December 2011. Thus, the average Core Tier 1 ratio is 15.1%. Credit institutions that do not meet the 9% Core Tier 1 ratio yet have proposed to the CSSF the measures they intend to implement to reach this level on a medium-term basis.

The CSSF will of course continue to monitor the solvency ratios laid down in the European regulations transposed into Circular CSSF 06/273 as amended.

The financial crisis has shaken the confidence in the banking sector in many countries. This crisis has once again demonstrated that the extent and the quality of own funds are a considerable bulwark against economic and financial uncertainties. This observation is all the more true for a banking centre such as Luxembourg which is greatly centred on wealth management and thereby dependent on the confidence of depositors and investors. The new Core Tier 1 ratio of 9% helps to strengthen public confidence and allows the Luxembourg banking sector to remain competitive *vis-à-vis* other international financial centres that are also subject to strengthened solvency ratios.

### 1.1.3. Stress tests and recapitalisation measures coordinated by the EBA

Stress tests are an efficient tool to assess the financial sector stability. Indeed, they allow identifying the vulnerabilities and assessing the impact of exogenous shocks on the financial sector. Associated with adequate disclosure, they contribute to enhanced transparency of the risks held by financial players. Within the EU, the stress tests are part of the mandate of the EBA, successor of the Committee of European Banking Supervisors (CEBS).

Thus, the EBA performed a stress test in 2011 assessing the solvency of 90 European banks under a macroeconomic shock defined by the European Central Bank (ECB) and the ESRB. The EBA also implemented a recapitalisation exercise aiming to impose, as of July 2012, a Core Tier 1 capital ratio of 9% on a vast sample of banks after taking into account the unrealised losses linked to exposures to the European public sector. In this context, the CSSF monitored the sound application of both exercises for Banque et Caisse d'Épargne de l'État, Luxembourg, which, according to the EBA's guidelines, is the sole Luxembourg bank that is part of the sample of institutions subject to the stress test. However, it should be noted that the measures indirectly cover 4/5 of the Luxembourg banking sector exposures as Luxembourg bank subsidiaries and branches whose parent undertaking is included in the sample on a consolidated basis are taken into account.

#### • Macroeconomic stress test of the EBA

The results of this exercise were published on 15 July 2011 on an individual basis by 90 European banks representing 65% of consolidated assets of the European banking sector and about 80% of the assets of the Luxembourg banking centre. The stress test consisted in the simulation of the development over two years of high-quality capital as defined by the EBA (Core Tier 1 capital) under an adverse macroeconomic scenario. The test was developed by the ECB and approved by the national authorities. The adversity of this scenario consists in the application of a series of hypothetical shocks to the economic outlook established by the European Commission in November 2010. In addition, there is the adverse development of other economic parameters, such as a rise in interest rates and unemployment, a decline in stock prices and real estate prices, or an increase in risk premiums on the government bond market. In comparison to the stress test performed by the CEBS in 2010, the adverse scenario used in this exercise is significantly severer in that it is farther away from the European Commission's economic outlook.

The banks' calculations were controlled by the national authorities before being subjected to a quality assurance process by EBA agents, assisted by a group of experts from several national authorities, the ECB and the ESRB. These controls allowed guaranteeing a consistent application of the methodology and a greater comparability of results.

Under the adverse scenario, the aggregated Core Tier 1 ratio of the 90 European banks fell from 8.9% in 2010 to 7.7% in 2012. The ratio of eight banks fell below the 5% critical threshold defined by the EBA. The ratio of 24 banks is below 6% in 2012. The EBA has required that an action plan be set up in order to enhance the resilience of banks considered fragile. Such is not the case for Banque et Caisse d'Épargne de l'État, Luxembourg, whose Core Tier 1 ratio rises from 12% to 13.3% under the adverse scenario. The improvement in the estimated solvency of Banque et Caisse d'Épargne de l'État, Luxembourg, is due, on the one hand, to a mild development of Luxembourg-specific economic factors under the adverse scenario and, on the other hand, to the fact that the profit-generating capacity of the bank for the years 2011 and 2012 is more than sufficient to make up for the presumed increased impairments and foregone revenues under the adverse scenario.

The detailed results of the 90 European banks that participated in the stress test, as well as an aggregated analysis, are available on the EBA's website www.eba.europa.eu, section "EU-wide stress testing", sub-section "2011".

The EBA's methodology does not provide for the impairment of non-trading book sovereign exposures of banks. This measured decision was taken given the tensions that rose on the European sovereign debt and the publicity surrounding the EBA's exercise, in order to avoid that such a scenario be considered as inside information of the EBA with respect to the possible failure of a sovereign. Moreover, the granular information published by the EBA following the exercise allowed an easy assessment of the impact of such impairment on sovereign exposures.

### • EBA recommendation of 8 December 2011 to recapitalise banks

Among the measures aiming to control the sovereign debt crisis adopted at the EU summit of 26 October 2011 is the decision to raise the Core Tier 1 ratio of a sample of 71 European banks to 9% until July 2012. Even if in Luxembourg, the Banque et Caisse d'Épargne de l'État, Luxembourg, is the only bank that is part of the sample of 71 banks, 4/5 of the Luxembourg banking sector are indirectly covered as the parent undertakings of Luxembourg subsidiaries and branches take part in the exercise on the basis of their consolidated accounts.

The 9% Core Tier 1 ratio must be reached after deduction of unrealised losses on all European sovereign debt securities reflecting market prices as of 30 September 2011. Portfolio sales or other deleveraging strategies are in principle not allowed to fulfil the 9% ratio.

The EBA's exercise revealed that there was an overall capital shortfall of EUR 115 billion. The EBA's formal recommendation to the supervisory authorities of the Member States requires that recapitalisation measures be taken for banks whose Core Tier 1 ratio was below 9%. Such a measure was not required for the Banque et Caisse d'Épargne de l'État, Luxembourg, whose Core Tier 1 ratio exceeded 9%.

In February 2012, the EBA evaluated the recapitalisation measures proposed by the banks whose Core Tier 1 ratio was assessed as being below 9%. According to this assessment, the measures concerned mainly provided for a strengthening of Core Tier 1 own funds allowing these banks to uphold their capacity to lend into the real economy. Consequently there would be no risk of credit crunch.

Details regarding the EBA's methodology, the individual results of the 71 banks, as well as the EBA's assessment of the proposed measures are available on the EBA's website (www.eba.europa.eu), section "EU Capital Exercise".

### 1.1.4. Follow-up of the FSAP mission of the International Monetary Fund (IMF)

On 28 June 2011, the IMF published a financial sector stability report on the Luxembourg financial sector[4]. This Financial Sector Stability Assessment (FSSA) is based on the findings of the on-site mission that IMF representatives conducted in Luxembourg from 8 to 23 November 2010 and 14 to 25 February 2011 in the context of the IMF's Financial Sector Assessment Program (FSAP).

The mission examined two areas in particular, i.e. the financial stability of the Luxembourg financial centre and compliance of the regulatory framework and of prudential supervision of the Luxembourg financial sector with international standards.

As regards financial stability, the report confirms the CSSF's recurrent analyses. It concludes that the Luxembourg banking sector is resilient when faced with adverse developments with respect to solvency and liquidity and that contagion effects inside the Luxembourg financial sector are limited. The most substantial (systemic) risks for the Luxembourg banking sector result from a default of a foreign sovereign State or when the financial soundness of the foreign parent of a Luxembourg bank is impaired.

These results stem in particular from stress tests regarding solvency, liquidity and contagion performed for the account of the IMF by the CSSF based on its internal methodologies and parameters determined by the IMF.

As regards the supervision over the financial sector, the IMF considers that the CSSF's approach is of high quality and largely in line with the "Core Principles for Effective Banking Supervision" established by the Basel Committee on banking supervision. Thus, the ratings granted by the IMF with respect to the Luxembourg banking regulation and the CSSF's prudential supervision of banks are consistently of the two best grades on a rating scale of four grades.

Notwithstanding these encouraging results, which comfort the CSSF in its approach, the IMF's analyses include various recommendations and specific areas for improvement that the IMF released to the public in May 2011 on the occasion of its visit to Luxembourg within the context of its annual engagements pursuant to Article IV[5]. The progress made in this field will be presented to the IMF during the next mission pursuant to Article IV which will be held in Luxembourg in May 2012.

## 1.2. Characteristics of the Luxembourg banking sector

Since the entry into force of the law of 20 May 2011 on payment services and the activity of electronic money institutions, the latter are no longer considered as credit institutions but as a separate category of financial sector players (cf. Chapter IV "Supervision of payment institutions and electronic money institutions"). This is why the Luxembourg banking law henceforth only recognises two types of banking authorisations, i.e. universal banks (137 institutions as at 31 December 2011) and banks issuing covered bonds (six institutions as at 31 December 2011).

Depending on their legal status and geographical origin, banks belong to one of the following three categories:

- banks incorporated under Luxembourg law (107 on 31 December 2011),
- branches of banks incorporated in an EU Member State or assimilated (30 on 31 December 2011),
- branches of banks incorporated in a non-EU Member State (6 on 31 December 2011).

Furthermore, there is one special case: the *caisses rurales* (13 on 31 December 2011) and their central establishment, Banque Raiffeisen, are to be considered as a single entity, according to the law on the financial sector.

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[4] The report "Financial System Stability Assessment" may be downloaded from the IMF's website (www.imf.org), section "FSSA Country Reports".

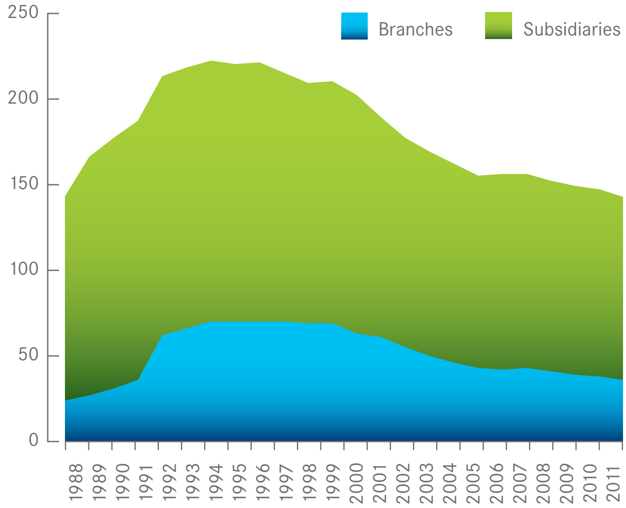
[5] Cf. box 3 in the IMF's public report on the Article IV mission of 2011.

## 1.3. Development in the number of credit institutions

With 143 entities authorised at the end of the financial year 2011, the number of banks decreased by four entities as compared to 31 December 2010 (147). Among those 143 entities, 107 were banks incorporated under Luxembourg law (109 in 2010) and 36 were branches (38 in 2010).

**Development in the 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 |
| 2007 | 43 | 113 | 156 |
| 2008 | 41 | 111 | 152 |
| 2009 | 39 | 110 | 149 |
| 2010 | 38 | 109 | 147 |
| 2011 | 36 | 107 | 143 |



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

| | |
|---|---|
| • Sal. Oppenheim jr. & Cie S.C.A. | Merger with the new bank Sal. Oppenheim jr. & Cie Luxembourg S.A. on 1 January 2011 |
| • Union Bancaire Privée, succursale de Luxembourg | Merger with Union Bancaire Privée (Luxembourg) S.A. on 10 January 2011 |
| • IKB International | Voluntary liquidation on 1 April 2011 |
| • ABN AMRO Bank (Ireland) Ltd, Luxembourg branch | Withdrawal on 30 April 2011 |
| • Amazon Payments Europe S.C.A. | Change of status on 20 May 2011: following the entry into force of the law of 20 May 2011, the entity became an electronic money institution |
| • WGZ BANK Luxembourg S.A. | Merger with DZ PRIVATBANK S.A. on 9 June 2011 |
| • BNY Mellon International Bank Limited, Luxembourg branch | Withdrawal on 30 September 2011 |

It should be noted that on 1 January 2012, Landesbank Saar Girozentrale, Niederlassung Luxemburg ceased its activities in Luxembourg.

Three banks started their activities in 2011:

| | |
|---|---|
| • Sal. Oppenheim jr. & Cie Luxembourg S.A. | 1 January 2011 |
| • Lombard Odier Darier Hentsch & Cie (Belgique) S.A., succursale de Luxembourg | 4 April 2011 |
| • Société Générale LDG | 29 December 2011 |

Sal. Oppenheim jr. & Cie Luxembourg S.A. took over the activities of former Sal. Oppenheim jr. & Cie S.C.A., Lombard Odier Darier Hentsch & Cie (Belgique) S.A., succursale de Luxembourg, operates as depositary bank for UCIs and Société Générale LDG operates as bank issuing covered bonds.

The following six credit institutions changed their name in 2011.

| Former denomination | New denomination (date of change) |
|---|---|
| West LB International S.A. | VM Bank International S.A. (1 January 2011) |
| Industrial and Commercial Bank of China Luxembourg S.A. | Industrial and Commercial Bank of China (Europe) S.A., in abbreviated form ICBC (Europe) S.A. (1 January 2011) |
| Nikko Bank (Luxembourg) S.A. | SMBC Nikko Bank (Luxembourg) S.A. (1 April 2011) |
| Compagnie de Banque Privée, in abbreviated form CBP | Compagnie de Banque Privée Quilvest S.A., in abbreviated form CBP Quilvest (3 May 2011) |
| UFG-LFP Private Bank | La Française AM Private Bank (28 October 2011) |
| DnB NOR Luxembourg S.A. | DNB Luxembourg S.A. (11 November 2011) |

**Geographical origin of banks**

| Country | Number |
|---|---|
| Germany | 42 |
| France | 14 |
| Belgium | 11 |
| Switzerland | 10 |
| Italy | 8 |
| United Kingdom | 8 |
| Sweden | 7 |
| United States | 6 |
| Japan | 5 |
| Luxembourg | 5 |
| China | 4 |
| Netherlands | 4 |
| Israel | 3 |
| Andorra | 2 |
| Brazil | 2 |
| Denmark | 2 |
| Norway | 2 |
| Portugal | 2 |
| Belgium / Canada | 1 |
| Canada | 1 |
| Greece | 1 |
| Liechtenstein | 1 |
| Russia | 1 |
| Turkey | 1 |
| **Total** | **143** |

## 1.4. Development in banking employment

As at 31 December 2011, the Luxembourg credit institutions employed 26,695 people. Following two consecutive years of decline, employment in the Luxembourg banking sector thus grew by 441 units in 2011.

However, this 1.7% rise did not mean a net creation of jobs in the financial sector as a whole. Indeed, banking employment fell throughout the year 2011 except for the third quarter. The growth in the third quarter however (+657 units) was mainly due to a bank taking over a PFS. This takeover did not have an impact on the number of jobs in the financial sector, but modified only the distribution by decreasing PFS employment for the benefit of banking employment. Without this effect, employment in the banking sector would have remained almost unchanged over a year.

Taken individually, development of employment within the banks varied. Thus, 39% of credit institutions increased their staff year-on-year. Variations in employment of a certain importance (+/- 15 units) were mostly to be found in a context of personnel reallocation among entities of the financial sector following mergers or acquisitions.

The breakdown of total employment shows that the female employment rate remained quite stable, decreasing from 46.4% to 45.9%. The share of executives in total employment remained also almost unchanged at 26.5% (26.4% in 2010).

## Situation of employment in credit institutions

| | Total | | Management | | | Office staff | | | Technical staff | | | Total staff | | | Variation | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Luxemb. | Foreigners | Men | Women | Total | Men | Women | Total | Men | Women | Total | Men | Women | Total | in number | in % |
| **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 | 299 | 1.6% |
| **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 | 507 | 2.7% |
| **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 | 745 | 3.9% |
| **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 | 1.363 | 6.9% |
| **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 | 1.871 | 8.8% |
| **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 | 793 | 3.4% |
| **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 | -561 | -2.4% |
| **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 | -771 | -3.3% |
| **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 | 25 | 0.1% |
| **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 | 673 | 3.0% |
| **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 | 1.525 | 6.6% |
| **2007** | 6,962 | 19,177 | 4,669 | 1,475 | 6,144 | 9,525 | 10,407 | 19,932 | 32 | 31 | 63 | 14,226 | 11,913 | 26,139 | 1.387 | 5.6% |
| **2008** | 6,898 | 20,307 | 5,101 | 1,672 | 6,773 | 9,658 | 10,729 | 20,387 | 15 | 30 | 45 | 14,774 | 12,431 | 27,205 | 1.066 | 4.1% |
| **2009** | 6,599 | 19,821 | 5,221 | 1,781 | 7,002 | 9,184 | 10,199 | 19,383 | 15 | 20 | 35 | 14,420 | 12,000 | 26,420 | -785 | -2.9% |
| **2010** | 6,623 | 19,631 | 5,048 | 1,875 | 6,923 | 9,019 | 10,282 | 19,301 | 14 | 16 | 30 | 14,081 | 12,173 | 26,254 | -166 | -0.6% |
| **2011** | 6,270 | 20,425 | 5,175 | 1,905 | 7,080 | 9,251 | 10,338 | 19,589 | 14 | 12 | 26 | 14,440 | 12,255 | 26,695 | 441 | 1.7% |

**Breakdown of the number of employees per bank**

| | Number of banks | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Number of employees | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| > 1,000 | 4 | 4 | 5 | 5 | 5 | 5 | 6 | 6 |
| 500 to 1,000 | 2 | 6 | 7 | 9 | 8 | 9 | 8 | 9 |
| 400 to 500 | 6 | 4 | 3 | 2 | 4 | 3 | 1 | 3 |
| 300 to 400 | 8 | 7 | 8 | 10 | 11 | 9 | 9 | 7 |
| 200 to 300 | 8 | 7 | 10 | 9 | 8 | 8 | 7 | 5 |
| 100 to 200 | 19 | 20 | 18 | 18 | 16 | 18 | 16 | 15 |
| 50 to 100 | 21 | 18 | 18 | 21 | 20 | 20 | 21 | 21 |
| < 50 | 94 | 89 | 87 | 82 | 80 | 77 | 79 | 77 |
| **Total** | **162** | **155** | **156** | **156** | **152** | **149** | **147** | **143** |

## 1.5. Development of balance sheets and off-balance sheet accounts

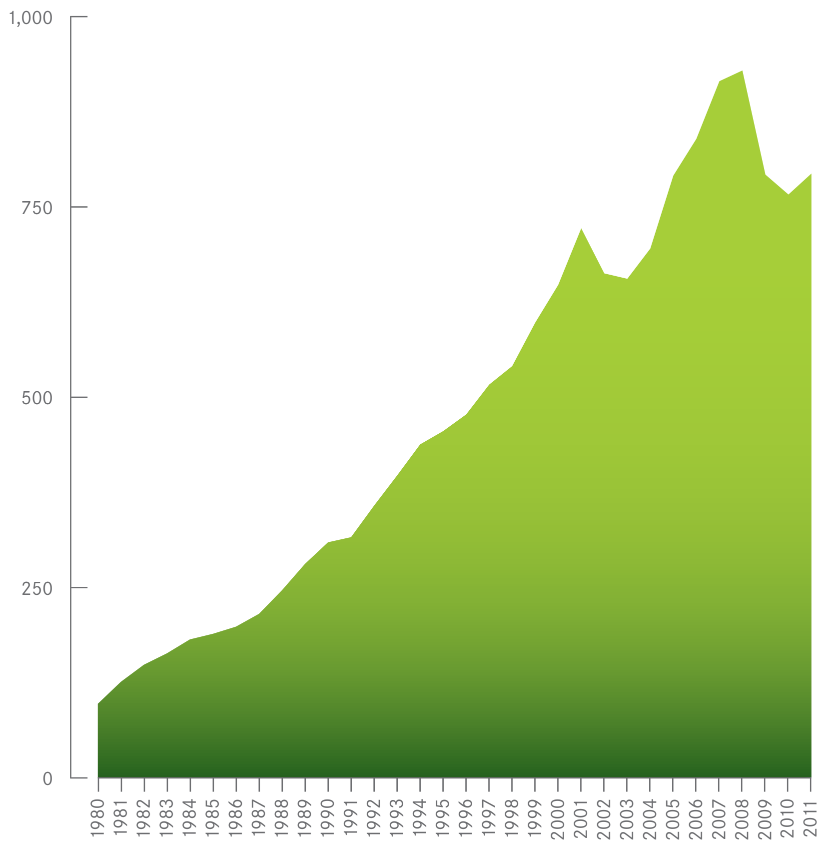
### 1.5.1. Balance sheet total of credit institutions

As at 31 December 2011, the balance sheet total of credit institutions amounted to EUR 794.0 billion against EUR 762.3 billion as at 31 December 2010. This annual increase by 4.2% came after two years of decline in the total balance sheet of banks (-3.8% in 2010 and -14.7% in 2009). At the end of 2011, the balance sheet total was about 20% below the historic high reached in October 2008 when the aggregated balance sheet exceeded EUR 1,000 billion.

60% of the banks in the financial sector shared this upward trend in the balance sheet total. Most of this growth was due to the establishment or development of specific competence centres that these banks operated in Luxembourg for the account of their groups. A significant proportion of this rise was owed to banks whose parent company's head office was outside the EU, in particular in Switzerland and China. The majority of the banks whose balance sheet total decreased year-on-year are part of banking groups established in the euro area. These balance sheet decreases largely affected Luxembourg banks belonging to banking groups that are forced to reduce their business due to the financial crisis.

**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 |
| 2007 | 915.34 |
| 2008 | 929.45 |
| 2009 | 792.54 |
| 2010 | 762.32 |
| 2011 | 794.05[6] |




[6] Preliminary figure.

### 1.5.2. Development of the structure of the aggregated balance sheet

On the **asset** side, the growth in the balance sheet total is reflected in the loans and advances to customers. However, variable-yield transferable securities as well as fixed-income transferable securities fell substantially (-10.3% and -13.1% year-on-year). In terms of counterparties, all assets included, only exposures to central banks (+218%) and to retail customers (+3.4%) grew over a year.

**Loans and advances to credit institutions** rose by 1.4% over a year to EUR 351.5 billion at the end of December 2011. Dominated by intra-group commitments, interbank loans and advances remained predominant on the asset side with 44.3%.

**Loans and advances to customers**, which include companies and retail customers, grew by 3.8% to EUR 177.9 billion at the end of 2011 (against 171.5 billion in 2010). Among those loans and advances, the exposures to retail customers, which were mainly from Luxembourg, rose by 3.4% over a year. These exposures, which had grown by almost 9% in 2010, were worth EUR 39.1 billion. On the other hand, loans and advances to companies decreased by 6.1% over a year. This decrease was mainly present in Luxembourg banks belonging to banking groups forced to reduce their business following the financial crisis.

As regards the balance sheet structure, the proportion of loans and advances to customers remained stable with 22.4% of the balance sheet total as at 31 December 2011.

At the end of 2011, **loans and advances to central banks and central governments** reached EUR 64.4 billion against EUR 26.7 billion at the end of 2010. Among these loans and advances, deposits with central banks rose by 218% and reached EUR 54.6 billion. Two thirds of this growth stemmed from Swiss banking groups that used Luxembourg as entry point into the European System of Central Banks. It should also be noted that exposures in the form of loans and advances to central governments grew by 2% to EUR 9.8 billion at the end of 2011.

**Fixed-income securities** which represented over 90% of the total of transferable securities, dropped by 13.1% during 2011. The depreciation of the Greek debt and the active reduction of certain positions in sovereign debt securities considered incompatible with the risk profile of Luxembourg banks induced a 19.2% decrease of positions in sovereign bonds. Banks' holdings in securities issued by financial and non-financial counterparties were affected by adverse developments in the financial markets as well as by changes in risk policies. Indeed, holdings of securities issued by financial counterparties dropped by 6.4% while holdings of securities issued by companies fell by 30.6%.

Consequently, the importance of the portfolio of fixed-income securities fell from 22.6% in 2010 to 18.9% at the end 2011. The sectoral composition of this portfolio continued to show mainly bank (50.2%) and government (26.7%) securities.

The rise in assets went hand in hand with a growth in the three **refinancing sources**: amounts owed to central banks, amounts owed to credit institutions and amounts owed to customers.

**Amounts owed to credit institutions**, mainly in the form of intra-group operations, grew by 5.9% to EUR 357.2 billion at the end of December 2011. These amounts represented 45% of the Luxembourg banks' balance sheet total.

**Amounts owed to customers**, mainly consisting of corporate deposits, wealth management structures and retail customers, rose by 4.5% to EUR 263.7 billion. As in the past, the volume of the amounts owed to customers, with 33.2%, played a prominent role among the refinancing means of the banking activities of the financial centre and allowed the Luxembourg banking sector to easily refinance its credits to clients.

**Amounts owed to central banks** reached EUR 14.0 billion as at 31 December 2011. Despite a 58.7% increase over a year, these amounts represented only 1.8% of the aggregated liabilities. The refinancing possibilities offered by central banks, mainly by the European System of Central Banks, were used only by a dozen banks of the financial sector in a substantial manner.

As opposed to other third-party liabilities, **amounts owed represented by securities** fell in 2011 (-8.4%). This decrease was part of a market context characterised by weak demand for banking debt securities. As a consequence, the importance in the balance sheet total of amounts owed represented by securities fell. With EUR 66.3 billion, they represented 8.3% of aggregated liabilities as at 31 December 2011 (9.5% in 2010).

At the end of 2011, own funds accounted for EUR 46.2 billion of the aggregated liabilities of the financial centre's banks. Equities increased by 1.8% under the effect of hoarding transactions.

### Aggregated balance sheet total – in million EUR

| ASSETS | 2010 | 2011 (*) | Variation | LIABILITIES | 2010 | 2011 (*) | Variation |
|---|---|---|---|---|---|---|---|
| Loans and advances to central banks and central governments | 26,750 | 64,424 | 140.84% | Amounts owed to central banks | 8,852 | 14,049 | 58.71% |
| Loans and advances to credit institutions | 346,586 | 351,498 | 1.42% | Amounts owed to credit institutions | 337,159 | 357,205 | 5.95% |
| Loans and advances to customers | 171,496 | 177,925 | 3.75% | Amounts owed to customers | 252,397 | 263,678 | 4.47% |
| Financial assets held for trading | 15,417 | 17,263 | 11.98% | Amounts owed represented by securities | 72,410 | 66,333 | -8.39% |
| Fixed-income transferable securities | 172,362 | 149,860 | -13.06% | Liabilities (other than deposits) held for trading | 15,753 | 18,717 | 18.82% |
| Variable-yield transferable securities | 15,194 | 13,627 | -10.31% | Provisions | 6,006 | 5,046 | -15.99% |
| Fixed assets and other assets | 14,510 | 19,452 | 34.06% | Subordinated debts | 9,719 | 7,822 | -19.52% |
| | | | | Other liabilities | 14,686 | 15,047 | 2.45% |
| | | | | Capital and reserves | 45,333 | 46,151 | 1.80% |
| **Total** | **762,315** | **794,048** | **4.16%** | **Total** | **762,315** | **794,048** | **4.16%** |

(*) Preliminary figures

### Structure of the aggregate balance sheet

| ASSETS | 2010 | 2011 (*) | LIABILITIES | 2010 | 2011 (*) |
|---|---|---|---|---|---|
| Loans and advances to central banks and central governments | 3.51% | 8.11% | Amounts owed to central banks | 1.16% | 1.77% |
| Loans and advances to credit institutions | 45.46% | 44.27% | Amounts owed to credit institutions | 44.23% | 44.99% |
| Loans and advances to customers | 22.50% | 22.41% | Amounts owed to customers | 33.11% | 33.21% |
| Financial assets held for trading | 2.02% | 2.17% | Amounts owed represented by securities | 9.50% | 8.35% |
| Fixed-income transferable securities | 22.61% | 18.87% | Liabilities (other than deposits) held for trading | 2.07% | 2.36% |
| Variable-yield transferable securities | 1.99% | 1.72% | Provisions | 0.79% | 0.64% |
| Fixed assets and other assets | 1.90% | 2.45% | Subordinated debts | 1.27% | 0.99% |
| | | | Other liabilities | 1.93% | 1.89% |
| | | | Capital and reserves | 5.95% | 5.81% |
| **Total** | **100.00%** | **100.00%** | **Total** | **100.00%** | **100.00%** |

(*) Preliminary figures

## 1.5.3. Use of derivative financial instruments by credit institutions

Banks in the financial centre used derivative financial instruments for a total nominal amount of EUR 723.8 billion in 2011, which is comparable to the level reached at the end of 2010 (EUR 722.6 billion).

The net market value of the derivative financial instruments, included in the balance sheet items according to the IFRS standards, represented liabilities of EUR 6.9 billion as at 31 December 2011. This growth in liabilities of EUR 2.2 billion compared to the end of 2010 was mainly due to the variation in interest rates and their negative impact on the valuation of interest rate swaps held by the Luxembourg banks with a view to covering the interest rate risk.

**Use of derivative financial instruments by credit institutions**

| Notional amounts *(in billion EUR)* | 2010 | 2011 (*) | Variation | | Structure | |
|---|---|---|---|---|---|---|
| | | | in volume | in % | 2010 | 2011 |
| **Transactions related to interest rate** | **245.7** | **238.8** | **-6.9** | **-2.8%** | **34%** | **33%** |
| *of which: options* | *5.5* | *10.4* | *4.9* | *90.0%* | *2%* | *4%* |
| *of which: interest rate swaps* | *230.6* | *217.9* | *-12.7* | *-5.5%* | *94%* | *91%* |
| *of which: future or forward rate agreements (FRA)* | *0.7* | *1.5* | *0.8* | *106.0%* | *0%* | *1%* |
| *of which: interest rate futures* | *8.9* | *9.0* | *0.1* | *1.5%* | *4%* | *4%* |
| **Transactions related to title deeds** | **21.0** | **20.9** | **-0.1** | **-0.2%** | **3%** | **3%** |
| *of which: futures* | *11.0* | *8.5* | *-2.6* | *-23.3%* | *53%* | *40%* |
| *of which: options* | *10.0* | *12.5* | *2.5* | *25.2%* | *47%* | *60%* |
| **Transactions related to exchange rates** | **455.9** | **464.0** | **8.1** | **1.8%** | **63%** | **64%** |
| *of which: forward foreign exchange transactions* | *381.7* | *389.1* | *7.4* | *1.9%* | *84%* | *84%* |
| *of which: cross-currency IRS* | *63.2* | *60.8* | *-2.3* | *-3.7%* | *14%* | *13%* |
| *of which: options* | *11.0* | *14.1* | *3.0* | *27.2%* | *2%* | *3%* |
| **Total** | **722.6** | **723.8** | **1.2** | **0.2%** | **100%** | **100%** |

(*) Preliminary figures

### 1.5.4. Off-balance sheet

As at 31 December 2011, the incidental exposure of the Luxembourg banking sector through loan commitments and financial guarantees given amounted to EUR 142.2 billion, against EUR 152.2 billion at the end of 2010, which represented a 6.6% fall over a year.

Following the 20.2% and 15.2% rises in 2010, the assets deposited by UCIs and the assets deposited by other professionals acting on financial markets fell by 7.4% and 7.7% in the course of 2011. These drops reflected the development of stock prices of assets under custody.

**Assets deposited by customers as in the off-balance sheet - in billion EUR**

| | 2010 | 2011 (*) | Variation | |
|---|---|---|---|---|
| | | | in volume | in % |
| Assets deposited by UCIs | 2,249.1 | 2,083.8 | -165.3 | -7.4% |
| Assets deposited by clearing or settlement institutions | 1,150.8 | 1,225.4 | 74.5 | 6.5% |
| Assets deposited by other professionals acting in the financial markets | 6,952.9 | 6,420.4 | -532.6 | -7.7% |
| Other deposited assets | 330.2 | 318.3 | -11.9 | -3.6% |

(*) Preliminary figures

## 1.6. Development in the profit and loss account

The profit and loss account of the Luxembourg banking sector showed a net result of EUR 2,828 million as at 31 December 2011, i.e. a fall of EUR 988 million (-25.9%) compared to 2010.

In a difficult economic and financial context, Luxembourg banks succeeded in increasing their recurrent operational income. Nevertheless, despite the rise in interest-rate margin and net commissions received, the net result fell significantly due to an extraordinary effect, namely, value adjustments concomitant with the participation of the banking sector in the restructuring of the Greek debt.

### Development in the profit and loss account – in million EUR

| | 2010 | Relative share | 2011 (*) | Relative share | Variation 2010/2011 | |
|---|---|---|---|---|---|---|
| | | | | | in volume | in % |
| Interest-rate margin | 5,479 | 57% | 5,844 | 62% | 366 | 6.7% |
| Net commissions received | 3,587 | 38% | 3,830 | 41% | 243 | 6.8% |
| Other net income | 483 | 5% | -311 | -3% | -794 | -164.3% |
| **Banking income** | **9,549** | **100%** | **9,363** | **100%** | **-185** | **-1.9%** |
| General expenses | -4,609 | -48% | -4,817 | -51% | -207 | 4.5% |
| *of which: staff costs* | *-2,497* | *-26%* | *-2,553* | *-27%* | *-56* | *2.2%* |
| *of which: general administrative expenses* | *-2,112* | *-22%* | *-2,264* | *-24%* | *-151* | *7.2%* |
| **Result before provisions** | **4,939** | **52%** | **4,547** | **49%** | **-393** | **-7.9%** |
| Net depreciation | -498 | -5% | -1,520 | -16% | -1,022 | 205.4% |
| Taxes | -625 | -7% | -198[7] | -2% | | |
| **Net result for the financial year** | **3,817** | **40%** | **2,828** | **30%** | **-988** | **-25.9%** |

(*) Preliminary figures

The **interest-rate margin**, which amounted to EUR 5,844 million, rose by 6.7% over a year. This development was due to growing margins and volumes of intermediation. The intermediation activity of Luxembourg banks had greatly dropped owing to the financial crisis, as is reflected by the almost 25% fall in the aggregate balance sheet between October 2008 and February 2011. Since March 2011, the trend has been reversing with growing balance sheet totals among 60% of the credit institutions of the financial centre.

**Net commissions received** are mainly resulting from asset management activities on behalf of private and institutional clients, including the services provided to investment funds. They grew by EUR 243 million (+6.8%) over a year despite a strong deterioration of the stock market climate in the second half of 2011. However, this growth only concerned 56% of the banks.

**Other net income** fell by EUR 794 million and suffered losses of EUR 311 million at the end of 2011. This development was partly due to the fall in value of hedging instruments that Luxembourg banks use to hedge against changes, in particular against rises, in interest rates. In the context of falling key interest rates of the ECB in the second half of 2011, the market value of these transactions decreased.

Total operating income, as measured by the banking income, amounted to EUR 9,363 million as at 31 December 2011. The downward trend of the aggregated banking income (-1.9% over a year) hid differences between banks of the financial centre. Indeed, the banking income of the majority of banks (58%) developed favourably during 2011.

Gross profit before provisions and taxes decreased by 7.9% over a year, given the 4.5% increase in general expenses.

[7] In 2011, due to substantial income from deferred taxes, the taxes recorded in the profit and loss accounts were not representative of the real tax burden relating to the financial year 2011, which can be estimated at EUR 531 million.

**Net depreciation** reached EUR 1,520 million as at 31 December 2011. This figure includes gross depreciation of EUR 1,355 million that Luxembourg banks made in relation to their exposures to the Greek State. The exposure net of provisions to the Greek debt thus fell to EUR 750 million as at 31 December 2011.

Tax charges recorded in the 2011 profit and loss accounts amounted to EUR 198 million. The application of IFRS accounting standards, which allow activating future tax charges by crediting the tax charges account, led for the financial year 2011, and as opposed to the situation as at 31 December 2010, to a greatly reduced hypothetical tax charge. Current tax, which does not take into account these "deferred" taxes and on which the calculation of the taxes due for the financial year 2011 was based, reached EUR 531 million. This figure represented a 19.3% fall year-on-year.

Overall, the above indicated factors taken as a whole resulted in a net income decrease by EUR 988 million in 2011 (-25.9%). As in the previous years, the development of the aggregated net result hid significant disparities in the performance of banks of the financial centre. Thus, 46% of Luxembourg banks recorded net results which, as at 31 December 2011, rose compared to the end of 2010.

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

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 (*) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Interest-rate margin | 4,383 | 4,141 | 4,080 | 3,913 | 3,905 | 4,830 | 6,002 | 7,298 | 6,571 | 5,479 | 5,844 |
| Net commissions received | 2,793 | 2,615 | 2,533 | 2,771 | 3,209 | 3,674 | 4,010 | 3,644 | 3,132 | 3,587 | 3,830 |
| Other net income | 672 | 1,258 | 942 | 734 | 1,140 | 2,296 | 964 | -505 | 850 | 483 | -311 |
| **Banking income** | **7,848** | **8,014** | **7,554** | **7,418** | **8,255** | **10,800** | **10,976** | **10,437** | **10,553** | **9,549** | **9,363** |
| General expenses | -3,624 | -3,490 | -3,385 | -3,461 | -3,693 | -3,981 | -4,420 | -4,560 | -4,451 | -4,609 | -4,817 |
| *of which: staff costs* | *-1,759* | *-1,809* | *-1,752* | *-1,798* | *-1,945* | *-2,160* | *-2,372* | *-2,461* | *-2,449* | *-2,497* | *-2,553* |
| *of which: general administrative expenses* | *-1,866* | *-1,681* | *-1,632* | *-1,663* | *-1,748* | *-1,821* | *-2,048* | *-2,099* | *-2,002* | *-2,112* | *-2,264* |
| **Result before depreciation** | **4,224** | **4,524** | **4,170** | **3,957** | **4,562** | **6,819** | **6,556** | **5,877** | **6,102** | **4,939** | **4,547** |
| Net depreciation | -536 | -1,166 | -637 | -344 | -296 | -305 | -1,038 | -5,399 | -3,242 | -498 | -1,520 |
| Taxes | -826 | -638 | -658 | -746 | -768 | -843 | -780 | -259[8] | -804 | -625 | -198[8] |
| **Net result for the financial year** | **2,862** | **2,720** | **2,874** | **2,866** | **3,498** | **5,671** | **4,739** | **218** | **2,056** | **3,817** | **2,828** |

(*) Preliminary figures

## 1.7. Development in own funds and in the solvency ratio

### 1.7.1. Number of banks required to meet a solvency ratio

As at 31 December 2011, the number of banks required to meet a non-consolidated solvency ratio stood at 107, i.e. two entities less than at the same date in 2010. Among those banks, 101 carry out limited trading activities and are therefore authorised to calculate a simplified ratio. Actual trading activities remained confined to a limited number of banks (6 entities), representing a substantial fall compared to 2010 (14 entities). This drop followed the generally observed trend within the large cross-border banking groups according to which trading on own account activities are run down in order to reduce their capital requirements and internal liquidity reserves. Among the 26 banks that also calculate a consolidated solvency ratio, 11 were required to calculate an integrated ratio.

[8] Due to substantial income from deferred tax, the taxes recorded for the financial years 2008 and 2011 were not representative of the real tax burden relating to these financial years. The real tax burden can be estimated at EUR 531 million for 2011 and at EUR 654 million for 2008.

**Number of banks required to meet a non-consolidated and/or consolidated solvency ratio**

| | Integrated ratio | | Simplified ratio | | Total | |
|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 |
| Non-consolidated | 14 | 6 | 95 | 101 | 109 | 107 |
| Consolidated | 11 | 11 | 18 | 15 | 29 | 26 |

### 1.7.2. Development of the solvency ratio

The figures below are based on consolidated figures for those banks required to calculate their solvency ratio on a consolidated basis. The periodic information is to be provided to the CSSF within time limits that should allow banks to gather and validate the requested information. As these deadlines are longer for consolidated figures, the consolidated figures as at 31 December 2011 were available only after the cut-off date for the CSSF's annual report. As a consequence, the figures below reflect the situation as at 31 December 2011 except for banks required to calculate their solvency ratio on a consolidated basis. The data of the latter relate to 30 June 2011, which is the last available reporting.

#### • Aggregated solvency ratio

The aggregated solvency ratio, which measures the volume of own funds compared to the total minimum own funds requirements according to Circular CSSF 06/273, reached 17.4% as at 31 December 2011 and thus largely exceeded the minimum set at 8% as required under the existing prudential regulations. This ratio remained overall stable over a year after a sharp increase between 2008 and 2009.

With 15.3% as at 31 December 2011, the Tier 1 ratio, the numerator of which includes only own funds which absorb losses in going-concern situations, also remained stable compared to 31 December 2010 (15.3%). As the original own funds (Tier 1) are only marginally constituted of hybrid instruments, which are no longer eligible as original own funds under the future Basel III framework, the average Core Tier 1 ratio was 15.1% as at 31 December 2011.

#### • Own funds

Aggregated own funds, eligible for the purpose of complying with prudential standards in terms of solvency, amounted to EUR 42,807 million as at 31 December 2011, i.e. a 1.6% decrease compared to 31 December 2010. This drop was mainly due to the rise in deduction items from own funds (EUR 1,022 million).

As regards the quality of aggregated own funds, it should be noted that the total amount of own funds slightly decreased compared to the end of the financial year 2010. In terms of distribution of own funds, the portion of original own funds has however slightly increased to 88% of total own funds eligible for the denominator of the solvency ratio at the end of 2011 (87% at the end of 2010). Additional own funds (Tier 2) and sub-additional own funds (Tier 3) only represented 14.41% and 0.01% of eligible own funds.

### Own funds - in million EUR

| Numerator | 2010 | 2011 |
|---|---|---|
| *Original own funds* | *42,884.5* | *43,029.2* |
| Paid-up capital | 17,689.2 | 14,744.6 |
| Silent participation (*Stille Beteiligungen*) | 1,185.5 | 547.6 |
| Share premium account | 8,592.4 | 8,090.8 |
| Reserves (including funds for general banking risks) | 16,166.3 | 20,498.6 |
| Prudential filters | -575.7 | -773.5 |
| Gains and losses brought forward for the financial year | -302.5 | -210.1 |
| Minority interests | 129.3 | 131.2 |
| *Items to be deducted from original own funds* | *-5,115.3* | *-5,413.8* |
| Own shares | -93.5 | -1.6 |
| Intangible assets | -3,545.8 | -3,487.4 |
| Other deductions from original own funds | -1,476.0 | -1,924.8 |
| **ORIGINAL OWN FUNDS (Tier 1)** | **37,769.2** | **37,615.4** |
| *Additional own funds before capping* | *6,941.0* | *7,050.8* |
| Upper Tier 2 | 3,885.9 | 5,021.0 |
| Lower Tier 2: Lower Tier 2 subordinated debt instruments and cumulative preference shares with fixed maturity | 3,055.1 | 2,029.7 |
| *Additional own funds after capping* | *6,729.4* | *6,920.8* |
| Deductions from additional own funds | -674.7 | -750.4 |
| **ADDITIONAL OWN FUNDS after capping and after deductions (Tier 2)** | **6,054.7** | **6,170.4** |
| Sub-additional own funds before capping | 328.6 | 129.9 |
| **SUB-ADDITIONAL OWN FUNDS after capping (Tier 3)** | **3.8** | **3.0** |
| *Own funds before deductions (T1 + T2 + T3)* | *43,827.8* | *43,788.8* |
| Deductions from the total of own funds | -332.9 | -981.6 |
| **ELIGIBLE OWN FUNDS** (numerator of integrated ratio/simplified ratio) | **43,494.8** | **42,807.2** |

### • Capital requirements

The minimum prudential own funds requirements remained almost stable (-0.5%) between the end of 2010 and the end of 2011 and reached EUR 19,680 million. The downward trend registered in the sector since 2008 and resulting, among others, from the active policies carried out by the banks in order to reduce their balance sheet totals and their risk assets (deleveraging policies) has reversed since February 2011 so that the fall in minimum capital requirements is substantially slowing down.

As regards the components of capital requirements, the credit risk exposures still need the most important capital requirements. Their proportion in total requirement amounted to 83% as at 31 December 2011. Owing to the activities carried on in the financial centre, the other minimum capital requirements remained marginal, except for the requirements to cover operational risk that represented 8.4% of total minimum capital requirements. The minimum own funds requirements for market risk remained well below 1%.

Basel II standards were accompanied by transitional measures that provided in particular for the application of floor levels. These levels limit the prudential recognition of the reducing effects of minimum capital requirements that could result from the implementation of advanced measurement methods such as the internal ratings-based (IRB) approach for credit risk or advanced measurement (AMA) approaches for operational risk. Thus, the overall minimum capital requirement according to Basel II could not fall below 90% of the global capital requirement calculated according to Basel I during the first year of application in 2008. This threshold was lowered to 80% in 2009, a level which applied until 31 December 2011. The additional capital requirements under the threshold increased by more than 50% in 2011 and represent now almost 8% of the total capital requirements. Since the calculation of the threshold depends on the difference between the minimum capital requirements under Basel I and the advanced methods which are more risk-sensitive, for a given portfolio, an increase of the floor level reflects an effective decrease of the levels of portfolio risk measurements. This increase is partly due to the fact that two newly registered banks have used in 2011 the internal ratings-based approach to calculate the minimum capital requirements for credit risk.

### Capital requirements - in million EUR

| Denominator | 2010 | 2011 |
|---|---|---|
| **TOTAL CAPITAL ADEQUACY REQUIREMENT** | **19,773.8** | **19,680.1** |
| Requirement to cover credit risk | 16,819.7 | 16,354.4 |
| Requirement to cover foreign exchange risk | 91.6 | 61.0 |
| Requirement to cover interest rate risk | 67.5 | 35.4 |
| Requirement to cover the risk in relation to equities | 2.5 | 1.7 |
| Requirement to cover the risk in relation to commodities | 4.1 | 0.0 |
| Requirement according to internal models | 27.9 | 32.7 |
| Requirement to cover settlement/delivery risk | 0.1 | 0.5 |
| Requirement to cover operational risk | 1,740.1 | 1,648.7 |
| Other capital adequacy requirements (among others exceeding large exposures, floor level, etc.) | 1,020.3 | 1,545.7 |

| **RATIO** | | |
|---|---|---|
| Solvency ratio (base 8%) | 17.6% | 17.4% |
| Solvency ratio (base 100%) | 220.0% | 217.5% |
| Tier 1 Ratio (base 8%) | 15.3% | 15.3% |
| Tier 1 Ratio (base 100%) | 191.0% | 191.1% |

As at 31 December 2011, 19 banks had obtained the authorisation to use an internal ratings-based approach regarding credit risk according to Basel II, 11 of which have used advanced methods allowing not only own estimates of probabilities of default but also of the loss given default and/or of the conversion factors. These 19 banks represented almost 40% of the balance sheet total of the financial centre as at 31 December 2011.

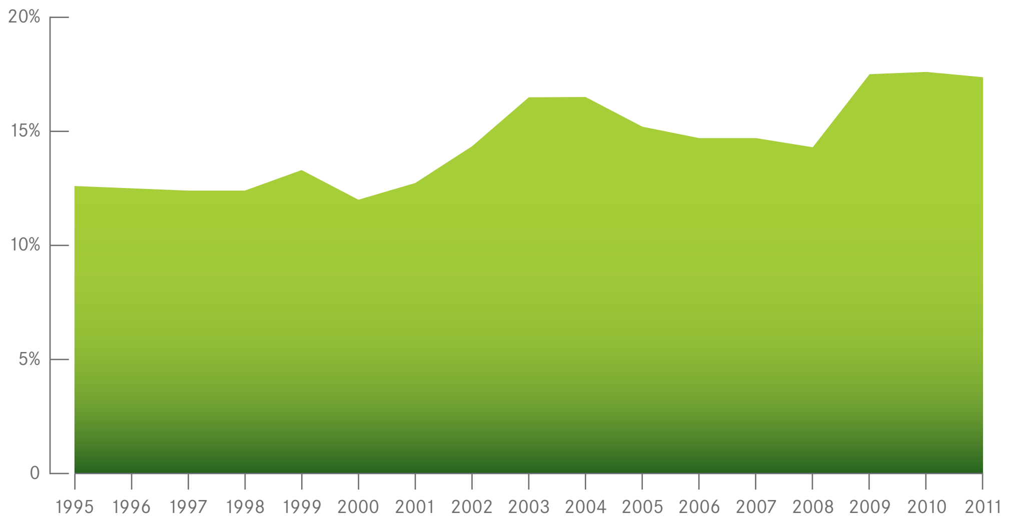
As regards operational risk, 10 banks were authorised to use advanced measurement approaches (AMA). The other banks used the basic indicator approach (59 banks) and the standardised approach (38 banks) to determine the capital requirements.

**Basel II calculation methods implemented by the banks of the financial centre**

| | Number of banks |
|---|---|
| **Credit risk** | |
| Standardised approach | 88 |
| Internal ratings-based approach | 19 |
| *of which: foundation approach (F-IRB)* | *8* |
| *of which: advanced approach (ADV-IRB)* | *11* |
| **Operational risk** | |
| Basic indicator approach | 59 |
| Standardised approach | 38 |
| Advanced measurement approaches | 10 |

The following graph illustrates the development in the solvency ratio (base 8%) since 1995. The weighted average is the ratio of total eligible own funds in the financial centre over total risk weighted exposure amounts. This average takes into account credit institutions according to the volume and risk level of their business.

**Development in the solvency ratio (base 8%)**




| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Weighted average | 12.6% | 12.5% | 12.4% | 12.4% | 13.3% | 12.0% | 12.7% | 14.3% | 16.5% | 16.5% | 15.2% | 14.7% | 14.7% | 14.3% | 17.5% | 17.6% | 17.4% |

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

The high level of capitalisation, reflected by the aggregated solvency ratio, also appears at disaggregated level. Thus, only 10 banks had a solvency ratio within the weak capitalisation bands, i.e. below 10%. However, this number has slightly increased since the financial year 2011 (+3 entities). For one credit institution, the solvency ratio fell below 8% in 2011. Nevertheless, this institution submitted a recapitalisation programme to the CSSF. At the other extreme, i.e. in the high capitalisation end, 64% of the banks had a ratio above 15%.

### Distribution of the solvency ratio (base 8%)

| | 2010 | | 2011 | |
|---|---|---|---|---|
| Ratio | Number of banks | as % of total | Number of banks | as % of total |
| <8% | 0 | 0% | 1 | 1% |
| 8%-9% | 2 | 2% | 1 | 1% |
| 9%-10% | 5 | 4% | 8 | 7% |
| 10%-11% | 3 | 3% | 0 | 0% |
| 11%-12% | 6 | 6% | 4 | 4% |
| 12%-13% | 13 | 11% | 9 | 8% |
| 13%-14% | 4 | 4% | 11 | 10% |
| 14%-15% | 2 | 2% | 5 | 5% |
| 15%-20% | 24 | 22% | 16 | 15% |
| >20% | 50 | 46% | 52 | 49% |
| **Total** | **109** | **100%** | **107** | **100%** |

## 1.8. International presence of Luxembourg banks

### Freedom to provide services within the EU/EEA as at 31 December 2011

| Country | Luxembourg banks providing services in the EU/EEA | EU/EEA banks providing services in Luxembourg |
|---|---|---|
| Austria | 37 | 28 |
| Belgium | 56 | 25 |
| Bulgaria | 19 | - |
| Cyprus | 22 | 3 |
| Czech Republic | 22 | - |
| Denmark | 40 | 6 |
| Estonia | 21 | 1 |
| Finland | 39 | 8 |
| France | 59 | 80 |
| Germany | 61 | 52 |
| Gibraltar | 1 | 6 |
| Greece | 36 | 2 |
| Hungary | 21 | 7 |
| Iceland | 6 | 2 |
| Ireland | 32 | 30 |
| Italy | 44 | 11 |
| Latvia | 21 | - |
| Liechtenstein | 8 | 6 |
| Lithuania | 21 | 1 |
| Malta | 20 | 7 |
| Netherlands | 48 | 30 |
| Norway | 18 | 1 |
| Poland | 24 | 1 |
| Portugal | 35 | 7 |
| Romania | 23 | - |
| Slovakia | 21 | 1 |
| Slovenia | 21 | - |
| Spain | 46 | 8 |
| Sweden | 35 | 6 |
| United Kingdom | 44 | 79 |
| **Total number of notifications** | **901** | **408** |
| **Total number of banks concerned** | **75** | **408** |

**Branches established in the EU/EEA as at 31 December 2011**

| Country | Branches of Luxembourg banks established in the EU/EEA | Branches of EU/EEA banks established in Luxembourg |
|---|---|---|
| Austria | 2 | - |
| Belgium | 7 | 3 |
| France | 2 | 4 |
| Germany | 4 | 16 |
| Ireland | 3 | - |
| Italy | 5 | - |
| Netherlands | 2 | 1 |
| Poland | 1 | - |
| Portugal | 1 | 1 |
| Spain | 7 | - |
| Sweden | 1 | 1 |
| United Kingdom | 1 | 4 |
| **Total** | **36** | **30**[9] |

Some non-European banking groups develop their European activities from a Luxembourg head office which sets up branches in other EU Member States. The CSSF accompanies such developments under the condition that the risks for the Luxembourg deposit-guarantee scheme remain bearable.

## 1.9. Banks issuing covered bonds (*Banques d'émission de lettres de gage, Pfandbriefbanken*)

The year 2010 marked the beginning of an unprecedented event for the public sector financing activity, namely the default of a sovereign EU Member State and of the euro area. This default has badly hit certain banks issuing covered bonds.

In this difficult context, banks issuing covered bonds have not launched substantial new issues, but have mostly only managed their existing cover assets, or even reduced their portfolios.

As at 31 December 2011, the balance sheet total of banks issuing covered bonds reached EUR 50.3 billion and the volume of public sector covered bonds issued by the six banks has slightly fallen to EUR 26.7 billion at the end of 2011, against EUR 28.7 billion at the end of 2010.

Issues of covered bonds are guaranteed by ordinary cover assets and by substitute cover assets. As at 31 December 2011, public sector mortgage bonds in circulation benefited from an over-collateralisation (nominal value) of EUR 5.4 billion. Over-collateralisation calculated according to the net present value amounted to EUR 5.3 billion as at 31 December 2011.

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

- claims on or guaranteed by public organisations: EUR 13.3 billion;
- bonds issued by public organisations: EUR 8.8 billion;
- public sector mortgage bonds of other issuers: EUR 4.9 billion;
- derivative transactions: EUR 1.3 billion.

Besides these ordinary cover assets, the banks used substitute cover assets to cover their public sector covered bonds amounting to EUR 3.8 billion as at 31 December 2011.

[9] Including an EU financial institution according to Article 31 of the law of 5 April 1993 on the financial sector.

Notwithstanding the effects of the crisis, a new player, namely a subsidiary of the banking group Société Générale, the Société Générale LDG, was authorised on 29 December 2011 as bank issuing covered bonds. The bank plans to launch its first issues in the course of the financial year 2012. It is noteworthy that, as opposed to existing banks issuing covered bonds that issue exclusively public sector covered bonds, Société Générale LDG plans to issue public sector covered bonds, mortgage covered bonds and certain types of moveable covered bonds.

In order to take into account the international development and to maintain the competitiveness of the product "covered bond", the legal framework must be continuously updated. The CSSF has therefore prepared, in cooperation with industry representatives, a draft bill aimed at strengthening the law on banks issuing covered bonds.

This reform notably covers the liquidation regime for banks issuing covered bonds and aims to align it on the recently reformed German framework which consists in maintaining the banking status for the part constituted by the collateral and covered bonds issued in case of liquidation of the bank issuing mortgage bonds. The purpose is to create the possibility for this "patrimonial compartment" to have access to the liquidities of the central bank.

## 2. PRUDENTIAL SUPERVISORY PRACTICE

### 2.1. Purpose of prudential supervision

It is commonly admitted that the purpose of the prudential supervision of banks is to maintain financial stability and protect the public's savings, i.e. to preserve the non-professional customers' deposits. This objective is an obligation of means, not of results. Prudential supervision is not an absolute guarantee against bank bankruptcies involving losses for depositors.

### 2.2. Monitoring of quantitative standards

In order to ensure financial stability and risk spreading, credit institutions must observe the following quantitative standards:

- minimum equity capital;
- a minimum ratio between own funds and capital requirements;
- limitation of risk concentration to a single debtor or a group of associated debtors;
- a liquidity ratio;
- limitation of qualifying holdings;
- a reference limit set at 20% of own funds for non-trading book interest rate risk (see item 2.5. below).

The CSSF monitors compliance with these standards and follows the banks' activities by means of a reporting harmonised at European level. This reporting includes the Financial Reporting (balance sheet, profit and loss account and related detailed tables) and the Common Reporting (detailed calculation of the solvency ratio). In addition, the CSSF requires periodic tables on, among other things, currency positions, large exposures and liquidity.

In 2011, the CSSF intervened once regarding non-compliance with the capital ratio. The CSSF intervened once in writing regarding failure to meet the liquidity ratio.

Within the scope of monitoring compliance with large exposure limits, the CSSF intervened 12 times in writing in 2011 (*idem* in 2010), notably to inform that the maximum level of large exposures had been exceeded and to request the bank concerned to provide information on the measures it intended to take to bring back the commitments within the regulatory limits.

The sanctions imposed by the CSSF on Luxembourg banks for non-compliance with the regulatory provisions are described in Chapter XII "Means of administrative police".

## 2.3. Supervisory review process

The term “Supervisory Review Process” (SRP) refers to the assessments, controls and measures as a whole, implemented by the CSSF in order to assess and preserve the capacity of a credit institution to manage and support the risks it incurs.

In 2011, the CSSF finalised the review of its SRP processes and tools in order to fully align them with Directive 2009/11/EC, which implements the joint decision on capital adequacy within the colleges of supervisors, and the EBA’s guidelines GL39 which harmonise the exchange of information between supervisory authorities of the home countries and host countries as regards SRP.

In November 2011, the CSSF provided detailed responses to the EBA regarding the implementation of the GL39 in Luxembourg. These responses were part of an assessment exercise on the implementation of the GL39 across Member States. Moreover, in the context of the proposed review of CRR/CRD IV, the EBA started preparatory works to further structure the joint decisions on capital through the publication of binding technical standards.

In 2011, the supervisory review process led the CSSF to confirm the capital surcharge imposed on banks with concentrated exposures on residential mortgage credit in Luxembourg. Moreover, the joint decisions regarding the capital surcharge taken in the colleges of supervisors in accordance with Article 129(3) of the CRD entailed capital surcharges for 10 other institutions in the financial centre. These surcharges take the form of a Tier 1 ratio requirement between 8.5% and 10%. Given the sound capitalisation of Luxembourg banks, compliance with these strengthened standards does not require additional own funds, in general. In Luxembourg, this measure is essentially aimed at maintaining the level of existing own funds necessary to sustain the risks incurred.

With the CSSF’s new policy regarding capital surcharges (cf. item 1.1.2. above) and the finalisation of all the joint decisions initiated in 2011 in the colleges of supervisors, the number of Luxembourg credit institutions that are subject to strengthened capital requirements should rise substantially.

## 2.4. Developments regarding liquidity supervision

As they focus on the businesses of wealth management and depositary bank, most local banks structurally have excess liquidities. The re-use of these liquidities varies strongly according to the business model (placed within the group, active cash management, credit financing, etc.). A minority of banks carry out liquidity-consuming businesses and refinance themselves either autonomously or by using group resources.

The CSSF monitors the liquidity situation of banks mainly through existing prudential reporting and self-assessments to be provided in the context of ICAAP (Internal Capital Adequacy Assessment Process). In addition to this permanent supervision, the CSSF performs, in cooperation with the BCL, on-site inspections in order to assess in a detailed manner the situation and management of liquidity risk within credit institutions. On-site inspections have been initiated within banks that are likely to incur substantial liquidity risk or that are among the most important banks of the financial centre. These inspections revealed that there are substantial variations in the quality of liquidity risk management among the controlled banks. In this context, the CSSF continues to focus on strengthening liquidity stress tests and improving the steering of liquidity buffers.

The regulatory framework which is the basis for the liquidity supervision carried out by the CSSF did not undergo major changes in 2011. It is mainly defined in three circulars: Circular CSSF 07/301 which lays down the main guiding principles regarding the sound risk management, Circular CSSF 09/403 which provides the qualitative requirements as regards the sound liquidity risk management and Circular IML 93/104 which limits the structural liquidity risk by imposing a liquidity ratio (table B1.5).

The proposed fourth review of Directive 2006/48/EC, i.e. the proposed CRR/CRD IV, introduces two prudential liquidity ratios called Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). These ratios are based on proposals of the Basel Committee on banking supervision as published in December 2010 (“International framework for liquidity risk measurement, standards and monitoring”). The final implementation of the LCR is scheduled for 1 January 2015 and that of the NSFR for 1 January 2018. The quantitative regime regarding liquidity as laid down in Circular IML 93/104 (table B1.5 “Liquidity ratio”) will be repealed with the entry into force of the LCR.

According to the provisions of the proposed CRR/CRD IV, banks must report to the CSSF all the elements serving to calculate the LCR as from 1 January 2013. To this end, the EBA is currently drawing up a harmonised presentation layout. In 2012, the CSSF will continue to monitor the development and impact of both liquidity ratios based on local impact assessments (cf. www.cssf.lu, section "Banks", sub-section "Impact assessment").

## 2.5. Supervision of interest rate risk according to Circular CSSF 08/338

Financial intermediation, at the heart of the traditional banking activity, includes the collection of refundable deposits on the liabilities side and the granting of credits on the assets side. In general, the duration of assets exceeds that of liabilities. In this case, a rise in interest rates increases the cost of short maturity deposits while fixed-rate assets continue to generate the same level of interest income until their maturity. This results in a decreasing profitability.

In Luxembourg, the diversification of the traditional banking activity, by means of private banking and investment fund services, entails that the interest rate risk is overall less marked. Moreover, the wide range of available interest rate risk cover instruments allows reducing this risk efficiently. On the other hand, the instruments concerned could be used to take on higher interest rate risk positions.

In order to allow a uniform supervision of interest rate risk (non-trading book), Circular CSSF 08/338 requires banks to submit on a half-yearly basis the results of an interest rate stress test to the CSSF. This requirement is in line with an EU requirement laid down in Article 124(5) of Directive 2006/48/EC.

The CSSF analyses the results of these stress tests based on a ratio whose numerator is the result of the simulation of interest rate changes according to Circular CSSF 08/338 and whose denominator is given by regulatory capital. This ratio measures the percentage of own funds mobilised through the (unrealised) value losses resulting from an adverse change in interest rates. According to Article 124(5) of Directive 2006/48/EC, the CSSF shall require measures when this ratio falls below -20%. Such measures aim to ensure that own funds of an institution remain adequate with respect to its overall risk situation, which includes in particular non-trading book interest rate risk. It should be borne in mind that the non-trading book interest rate risk is not subject to a capital requirement according to Circular CSSF 06/273, as opposed to interest rate risk inherent in the trading book portfolio.

The analysis of the stress test results according to Circular CSSF 08/338 as at 31 December 2010 and 30 June 2011 showed that the Luxembourg banking sector is only moderately exposed to structural interest rate risk. Indeed, average assessment ratios amounted to -3.50% on a stand-alone basis and -2.84% on a consolidated basis as at 30 June 2011. The impact of an immediate 2% rise in overall interest rates would cut the intrinsic value of the financial centre's banks only by about 3.50% of own funds.

On a stand-alone basis, the results showed a slight decrease of structural interest rate risk compared to the results of 31 December 2010 where the average ratio was -3.9%. As far as the dispersion of the results is concerned, 79.5% of the banks of the financial centre had a ratio higher than or equal to -5% and only 4.5% of the banks had a ratio of less than -15% as at 30 June 2011. As regards the consolidated level, the average assessment ratios remained stable compared to the results of 31 December 2010. Moreover, the dispersion showed that 78% of the banks had a ratio above -5% whereas no bank has a ratio below -15%.

In 2011, the CSSF carried out two on-site inspections as regards structural interest rate risk. The controls were aimed at banks whose exception ratio was below the -20% threshold. Moreover, the CSSF required two credit institutions to evidence their sound and prudent interest rate risk management.

## 2.6. Developments regarding operational risk supervision

During the year 2011, the CSSF strengthened its field presence by carrying out on-site inspections that covered specific aspects of operational risk management. These on-site inspections concerned four credit institutions that applied the advanced measurement approach (AMA). The AMA approach allows banks to use their internal models to determine the minimum capital requirements for operational risk. In accordance with point 26 of Part XV of Circular CSSF 06/273, these approaches must be authorised by the CSSF according to the provisions laid down in Circular CSSF 06/260.

The CSSF's on-site inspections aimed to verify compliance with the minimum requirements that govern the use of an AMA approach, to assess adequacy between the AMA approach and the bank's operational risk profile and to assess the level of autonomy or dependence, or even influence of the Luxembourg entity in the determination of the parent company models. Indeed, most of the AMA approaches used in Luxembourg are group approaches. The Luxembourg bank uses the AMA model developed by its group. It provides its parent undertaking with local statistics on operational risk and is allocated an amount of capital reflecting its operational risk profile.

For banks having opted for the AMA approaches, the CSSF insists on the active and reactive manner of the management of operational risk in Luxembourg. Beyond the application of a management model set up by the parent undertaking, the CSSF ensures that within the Luxembourg entity the capital allocated to operational risk is well analysed, argued and justified as regards its adequacy with the operation of the entity in Luxembourg.

Stemming from internal management processes, the capital allocated to operational risk under an AMA approach should perfectly reflect the actual risk profile. This is true in particular for the mandatory recognition of worst-case scenarios within AMA approaches. It is essential that these scenarios correspond to the intrinsic risk of the Luxembourg entity. More generally, the comparison of the scenarios with the historic losses, the extent of the expected losses, as well as the analysis of the adequacy of the scenarios with the local characteristics must allow Luxembourg banks to make a judgement on the adequacy of the AMA approach implemented at local level and to make, should weaknesses have been identified, the required improvements.

Moreover, it is important that the Luxembourg subsidiary avoids being exclusively reduced to providing data to be integrated in the group's model. Furthermore, it should promote a better understanding, quantification and management of operational risk, allowing it to take the necessary measures, at local level, to mitigate or to reduce these risks.

Finally, although the AMA method generally reduces regulatory capital, it should above all promote a better recognition and a granular identification of operational risks incurred in order to achieve a sounder risk management policy according to the group models and in compliance with the local specificities.

For the Luxembourg financial centre, strongly implicated in wealth management activities, the management of operational risks and of compliance risks is imperative. To this end, the CSSF plans to extend its on-site inspections on operational risk in 2012 to banks having adopted The Standardised Approach (TSA) or an Alternative Standardised Approach (ASA) to determine the minimum capital requirements for operational risk.

## 2.7. Monitoring of qualitative standards

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

- analytical reports prepared by the *réviseurs d'entreprises* (statutory auditors);
- management letters and similar reports prepared by the *réviseurs d'entreprises*;
- on-site inspections by CSSF agents;
- reports prepared by the banks' internal auditors;
- compliance reports;
- ICAAP reports.

All these reports are analysed according to a methodology laid down in the CSSF's internal procedures. The CSSF's response depends on the seriousness of the problem raised and whether it is repetitive in nature. It varies from simple monitoring of the problem based on reports, through the preparation of deficiency letters, to convening the bank's management or on-site inspections undertaken by CSSF agents. Where necessary, the CSSF may use its formal powers of injunction, suspension and sanction.

During 2011, the CSSF sent 220 deficiency letters to banks based on shortcomings in terms of organisation.

The CSSF intervened 16 times with respect to quality deficiencies of internal reports, including mainly the ICAAP report (6 times in 2010).

The sanctions imposed by the CSSF on Luxembourg banks for non-compliance with the regulatory provisions are described in Chapter XII "Means of administrative police".

## 2.8. Cooperation with authorities

Besides the cooperation that has been institutionalised in the colleges (cf. item 2.20. below), the CSSF works closely with the foreign supervisory authorities for consultations provided for by the European directives and in all circumstances in which cooperation is needed. Cooperation generally takes place in the form of requests for advice, information or assistance initiated by the CSSF or received by the CSSF. In this context, the CSSF has sent 50 letters to supervisory authorities in 2011.

The CSSF also cooperates with the national judicial and law enforcement authorities in accordance with Article 2 of the law of 23 December 1998 establishing a financial sector supervisory commission (*Commission de surveillance du secteur financier*) and Article 9-1 of the law of 12 November 2004 on the fight against money laundering and terrorist financing. In this context, the CSSF has sent 13 letters to the State Prosecutor's office of the Luxembourg District Court and four to the Grand-ducal police. They are mainly requests for information relating to the candidates for a stakeholding within a bank.

## 2.9. Intervention in commercial policies

One of the important lessons to be learned from the financial crisis of 2008 is that prudential supervision must not be limited to verifying compliance with regulations. Some banks had to be supported by their respective States or have their payments suspended despite their strict compliance with prudential regulations. Within the process of prudential supervision laid down in Circular CSSF 07/301, the CSSF requires banks to maintain a sound relation between their risk exposures and their capacity to bear these risks.

During 2011, the CSSF intervened eight times with banks in order to request either a reduction in risks or the cessation of risky practices (six times in 2010).

## 2.10. Analytical reports

The analytical report prepared by the *réviseur d'entreprise*s is an important instrument to assess the Luxembourg credit institutions' quality of organisation and exposure to different risks. The CSSF requires an analytical report on a yearly basis for every 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, on a yearly basis, a consolidated analytical report and individual analytical reports of each subsidiary included in the consolidation and carrying out an activity of the financial sector.

The CSSF examines the individual and consolidated analytical reports drawn up by the *réviseurs d'entreprises agréés* as well as those of the subsidiaries of Luxembourg banks. It includes its conclusions in the overall assessment of the supervised institution's situation. Where appropriate, the CSSF intervenes within the institution.

## 2.11. Cooperation with the *réviseurs d'entreprises*

Article 54 of the law of 5 April 1993 on the financial sector governs the relationship between the CSSF and the *réviseurs d'entreprises*. The supervised professionals are requested to communicate all the reports in relation to the audit of the accounting documents issued by the *réviseur d'entreprises* to the CSSF.

Furthermore, the *réviseurs d'entreprises* are required by law to swiftly inform the CSSF of any relevant findings, defined more specifically under Article 54(3) of the aforementioned law, which have come to their attention in the course of their duties.

Since 2002, the CSSF has held annual meetings with the main *cabinets d'audit* (audit firms) in order to exchange opinions on specific issues encountered within the supervised institutions. The discussions may also address the quality of the reports made.

## 2.12. On-site inspections

At the beginning of the year, the programme of inspections to be carried out by CSSF agents in the course of that year is drawn up. This programme is based on the assessment of the risk areas of the various credit institutions. On-site inspections generally follow standard inspection procedures, in the form of discussions with the people responsible, the assessment of procedures and the verification of files and systems.

In 2011, 58 on-site inspections were performed (35 in 2010), eight of which took place together with the Luxembourg Central Bank, seven with the department "Supervision of undertakings for collective investment" and 32 with the department "General supervision". The CSSF continued to strengthen its field presence by carrying out 20 on-site management interviews in 2011, including one in cooperation with the Luxembourg Central Bank (21 management interviews in 2010).

### Breakdown of on-site inspections according to the controlled area

| Subject | Number of on-site inspections |
|---|---|
| Money laundering | 19 |
| Credits | 8 |
| Liquidity | 8 |
| Internal models – IRB (4) and AMA (2) | 6 |
| Corporate governance | 4 |
| Depositary bank / Central administration | 4 |
| Internal audit function | 2 |
| MiFID | 2 |
| Interest rate risk | 2 |
| Risk management | 1 |
| Others | 2 |
| **Total** | **58** |

| Subject | Number of management interviews |
|---|---|
| Internal audit | 3 |
| Liquidity | 2 |
| Internal model AMA | 2 |
| Credits | 1 |
| ICAAP | 1 |
| Risk management | 1 |
| Corporate governance | 1 |
| Others | 9 |
| **Total** | **20** |

During the year under review, 78 missions (on-site inspections and management interviews) were carried out, against 56 in 2010. This rise reflects the policy pursued by the CSSF for several years to strengthen its field presence.

As in previous years, the CSSF has in particular focused on control of compliance with professional requirements as regards the fight against money laundering and terrorist financing during the on-site inspections.

## 2.13. Combating money laundering

Article 15 of the law of 12 November 2004 concerning the fight against money laundering and financing of terrorism provides that the CSSF is the relevant authority to ensure that every person subject to its supervision complies with the professional obligations as regards the fight against money laundering and financing of terrorism (AML/CFT). However, non-compliance with the professional obligations in full knowledge falls under the penal law and the relevant proceedings, thus, fall within the competence of the State Prosecutor's office.

The CSSF uses the following instruments to monitor compliance with AML/CFT rules: reports of the *réviseurs d'entreprises*, reports prepared by internal auditors and inspections made by CSSF agents.

In 2011, the CSSF made 19 on-site inspections within banks with respect to compliance with professional obligations concerning AML/CFT (15 in 2010). The CSSF sent 27 letters to banks in relation with shortcomings concerning AML/CFT. These letters, based on on-site inspections carried out by the CSSF or on external or internal audit reports, listed the shortcomings identified and enquired about the corrective measures envisaged.

In addition, the yearly analytical report prepared by the *réviseurs d'entreprises* must specifically cover compliance with legal requirements and the adequate implementation of internal procedures for the prevention of money laundering.

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

## 2.14. Management letters

Management letters drawn up by the *réviseurs d'entreprises* for the attention of the banks' management are an important source of information as regards the quality of the credit institutions' organisation. The CSSF analysed these management letters in which the *réviseurs d'entreprises* notably state the weaknesses of the internal control system that they identify during their engagement.

## 2.15. Meetings

The CSSF attaches particular importance to meetings with bank managers in order to discuss the course of business as well as any issues. It also requires prompt notification by the banks if a serious problem arises. These meetings include "structured dialogues" by which the CSSF presents the results and prudential measures stemming from its assessment of the financial soundness and the risks of the different banks to the authorised managers of the banks (cf. item 2.3. above).

In 2011, 217 meetings were held between CSSF representatives and bank executives (264 in 2010). Moreover, 58 meetings with, among others, *réviseurs d'entreprises*, foreign authorities or the Luxembourg Central Bank took place on the CSSF's premises in 2011.

## 2.16. Specific audits

Article 54(2) of the law of 5 April 1993 on the financial sector allows the CSSF to require a *réviseur d'entreprises* to conduct an audit on a specific subject in a given institution.

In 2011, the CSSF made use of this right five times against eleven in 2010. Most of these audits covered compliance with the disclosure of information on risk (Pillar 3) and on payment services.

## 2.17. Internal audit and compliance 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, as well as the report of the Compliance officer. In 2011, the CSSF analysed the internal audit summary reports and compliance reports and requested, where applicable, specific reports from internal audit in order to have more detailed information on specific subjects.

## 2.18. Supervision on a consolidated basis

As at 31 December 2011, 26 banks under Luxembourg law (*idem* in 2010), two financial holding companies under Luxembourg law (one in 2010), as well as one financial holding company incorporated under foreign law (*idem* in 2010) 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. The practical application of the rules governing supervision on a consolidated basis is explained in Circular IML 96/125.

The CSSF pays particular attention to the "group head" function set up at the Luxembourg establishment falling under its consolidated supervision and takes a particular interest in 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, and 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.
- The ICAAP report shall provide an assessment of the consolidated capital adequacy in relation to the risks taken by the group or sub-group. Part of this report concentrates on the consolidated risk profile of the group or sub-group subject to the consolidated supervision.
- The reports prepared by the external auditors are another source of information. Circular CSSF 01/27 on practical rules regarding the mission of the *réviseur d'entreprises* 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 of the risk management and structures of the group.
- The CSSF requires an individual analytical report for each major 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 also extended 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 intervention 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 cover, on the one hand, the manner in which the parent company sets up its policies and implements its strategies within the subsidiaries and, on the other hand, 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 analyses, in accordance with the terms of Circular IML 96/125, application files of indirect participations to be taken by banks under its consolidated supervision.

## 2.19. Supplementary supervision of financial conglomerates

Chapter 3b of Part III of the law of 5 April 1993 on the financial sector requires the CSSF to carry out a supplementary supervision of financial conglomerates. A financial conglomerate is defined as a group that includes at least one important entity within the banking or investment services sector and one important entity within the insurance sector.

The law requires that the CSSF perform a supplementary supervision of those 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 of the financial conglomerate.

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

As the CSSF has not at this stage identified any financial conglomerate for which it has to exercise the role of coordinator of this supplementary supervision, the practical consequences of these provisions for Luxembourg credit institutions and investment firms are limited.

## 2.20. International cooperation in matters of banking supervision

### 2.20.1. Colleges of supervisors

Articles 128 to 132 of Directive 2006/48/EC govern the cooperation between European competent authorities and may also include non-European authorities. These articles require an intensive cooperation between the competent authorities of cross-border banking groups and strive towards a more centralised and harmonised supervision of these large cross-border groups at EU level *via*, among others, the implementation of a college of supervisors for these cross-border groups. Article 131a, as amended by Directive 2009/111/EC, now provides that "the consolidating supervisor shall establish colleges of supervisors to facilitate the exercise of the tasks referred to in Article 129 and Article 130(1), ...". These amendments to Directive 2006/48/EC were transposed into Luxembourg law by the law of 28 April 2011 which amended the law of 5 April 1993 on the financial sector.

In 2011, the CSSF established two colleges of supervisors for the supervision of banking groups for which it exercises an ultimate consolidated supervision at European level (RBC Dexia Investor Services Ltd and State Street Bank Luxembourg S.A.). A third college will be organised for the group Quilvest Wealth Management S.A..

As a very large number of banking groups are present in the Luxembourg financial centre *via* subsidiaries which, on the one hand, are subject to the supervision of the CSSF on an individual basis, and, on the other hand, belong to the perimeter of consolidated supervision carried out by their home authorities, the CSSF participates, as host supervisor, in many colleges of supervisory authorities set up for these banking groups. In 2011, the CSSF participated in 62 meetings of colleges of supervisors (58 in 2010) which concerned 53 banking groups.

The establishment and functioning of the colleges are based on written agreements (Memorandum of Understanding, MoU) signed between the different authorities participating in the colleges. In 2011, the CSSF was a signatory to 33 MoUs (24 in 2010).

Since 2011, the EBA has contributed to promoting the establishment of colleges of supervisors and their control of the effective, efficient and consistent functioning. To this end, it is also part of the colleges as competent authority.

Among the objectives of the colleges of supervisory authorities are mainly the Joint Risk Assessment and the Joint Capital Decision. The college must achieve a joint assessment of the financial situation, the organisation and the risks of a banking group with cross-border activities. To that end, the different authorities, members of the colleges, provide the authority in charge of the consolidated supervision (home supervisor) with their risk assessment. The latter aggregates the information received by also taking into account the entities established in its own country. Based on this Joint Risk Assessment, the college assesses the capital adequacy of the banking group with the risks it incurs. The college must reach a Joint Capital Decision on the capital adequacy of a banking group, or capital surcharges that the banking group must comply with at a consolidated and/or individual level. This Joint Capital Decision, which states the underlying motivations of the decision, shall be formally transmitted to the banking group.

Furthermore, the colleges are responsible for promoting joint missions carried out by the authorities from different countries participating in the colleges, as well as the delegation of work between authorities. In the future, this delegation will need to be extended to the responsibilities of the different authorities.

The CSSF has also participated in three colleges of supervisors organised by the supervisory authorities of non-EEA countries.

### 2.20.2. Bilateral cooperation

In 2011, the CSSF held three bilateral meetings and one trilateral meeting with banking supervisory authorities in order to exchange prudential information on supervised institutions present in these countries.

Besides the consultations required under the European directives, the CSSF also informs the relevant authorities of all significant facts relating to supervision. In particular, it consults the relevant authorities regarding acquisitions of major holdings and restructurings of share ownerships.

## 2.21. Review of risk management models

In 2011, the CSSF continued its review of the risk management models. In this context, a distinction should be made between those risk management models eligible for the calculation of regulatory capital requirements (“Pillar 1 models”) and those models which may be used for the calculation of internal capital requirements (“economic capital models” or “Pillar 2 models”).

The risk management models used for Pillar 1 purposes cover three categories of risks[10], namely:

- credit risk with models relating to internal rating systems (internal ratings-based approach - IRB);
- market risk, with “internal models” to cover general and specific market risk, as well as, since 31 December 2011, incremental default and migration risks for the trading book positions of the credit institution; and
- operational risk with the advanced measurement approach (AMA).

As banks established in Luxembourg are often subsidiaries of European banking groups, the review of risk management models takes place in close coordination between the CSSF and the home supervisory authorities of these groups in accordance with Article 129 of Directive 2006/48/EC.

As regards the division of tasks between authorities, three different cases may arise:

**a) The CSSF is the host authority of a bank that uses a risk management model developed by the group.**

In this case, the parent’s home authority reviews the model’s theoretical bases while the CSSF’s role is limited to verifying its local use. In order to be permitted to use the models for the calculation of regulatory capital requirements, credit institutions shall prove that they are indeed used for daily risk management.

The review of the local application for models relating to internal ratings-based systems mainly covers the following points: the internal governance, the representativity of the model compared to the local population, the use of the models for risk management and the experience acquired during their use before their regulatory use (use test and experience test), a sufficient overall coverage of exposures by the models, allocation of exposures to the relevant grades and pools, stress tests and the internal model governance.

As regards the operational risk management models, the CSSF’s mission mainly concerns the use of the model on a day-to-day basis, the process of stocktaking and of reporting of operational losses, and the methodology regarding the allocation of capital requirements.

The observations as regards these missions are then communicated to the home authority and to the bank.

[10] See also item 1.7. of this Chapter.

**b) The CSSF is the host authority of a bank that uses a risk management model developed locally.**

In this case, the CSSF's mission, besides the use test described in point a) above, consists in reviewing the model's theoretical foundations. Thus, this mission mainly concerns the review, by the CSSF, of the bank's internal development and validation process, of the internal governance (role of the management, risk management functions and internal audit) and of the conception and methodologies. The observations made are then communicated to the home authority and to the bank.

**c) The CSSF is the home authority of a bank that develops a risk management model.**

In this case, the review process is the same as that described in points a) and b), except, of course, for the communication process with the home authority.

In 2011, the CSSF conducted three more extended missions relating to the review of the internal rating systems, including two follow-up missions regarding already approved models or the implementation of new versions of the models within the group, and one mission regarding the first application of the IRB approach by the institution in Luxembourg.

As regards the review of AMA for the calculation of regulatory capital requirements in relation to operational risk, three follow-up missions and one mission regarding the first application by the institution in Luxembourg took place in 2011.

As regards the review of the internal models for market risk, credit institutions must calculate, as of 31 December 2011 and in accordance with Part XIV of Circular CSSF 06/273, capital requirements for a stress value-at-risk in addition to the "current" value-at-risk, and, as far as specific interest rate risk is concerned, an incremental risk charge (IRC) for default and migration risk inherent in the trading book positions. To date, the CSSF granted only one authorisation for the use of an internal model for the calculation of those additional requirements for default and migration risk.

The follow-up of the compliance with the qualitative and organisational requirements of credit institutions which already received authorisation to use the models for the calculation of the regulatory capital requirements represents an integral part of the supervisory review and evaluation process (SRP) carried out by the CSSF. In this context, the CSSF is currently fine-tuning its analysing tools based on the existing periodic reporting (notably COREP and FINREP) in order to identify important developments of the risk parameters, in particular between credit institutions with similar activities (comparative analysis), as well as between the different reporting dates. Outliers and anomalies which are identified may lead the CSSF to request further information or to conduct specific and targeted on-site missions. On-site missions in such a transversal approach are planned for 2012.

In addition to risk management models used within the context of Pillar 1, the CSSF regularly monitors the results of the models for the calculation of internal capital. These figures represent an integral part of the reporting on risk management and capital (ICAAP report) such as described under points 17 and 26 of Circular CSSF 07/301.

It is important to note that, unlike the risk management models used in the framework of Pillar 1, the models used in the framework of Pillar 2 are not subject to an explicit authorisation procedure of the authorities. The purpose of the review of these models lies with the more general and less prescriptive assessment of the sound risk management. Thus, the review of the methodology is performed by the home authority in most cases. In the particular case of joint missions between authorities, the participation by the CSSF is usually limited to local aspects and to risk models which have a particular importance for the activities of the Luxembourg subsidiaries[11].

[11] In most cases, those aspects deal with the definition of internal capital and with the operational, reputational and liquidity risks.

# SUPERVISION OF PFS



# 1. DEVELOPMENTS OF PFS IN 2011

## 1.1. Major events in 2011

### 1.1.1. Annual long form reports

Pursuant to Article 54(1) of the law of 5 April 1993 on the financial sector and Circular CSSF 03/113, as amended by Circular CSSF 10/486, relating to the practical rules concerning the mission of *réviseurs d'entreprises agréés* (approved statutory auditors) of investment firms, the latter shall spontaneously and without being specifically requested communicate to the CSSF the long form reports issued by the *réviseur d'entreprises agréé* in the framework of his control of annual accounting documents.

In the past, the CSSF took the decision to exempt investment advisers and brokers in financial instruments from the obligation to provide the CSSF with a long form report in the framework of prudential supervision.

For a better follow-up of the prudential requirements and a better response to its international cooperation obligations as regards prudential supervision, the CSSF decided not to grant this exemption in the future. Hence, the investment firms concerned shall provide an annual long form report to the CSSF as from the financial year ending on 31 December 2011.

### 1.1.2. "Specialised PFS" and "Support PFS"

The term "support PFS" originates from non-financial market players who wanted to be distinguished from so-called "traditional" financial PFS which are now referred to as "specialised PFS". The characteristic of support PFS is that they do not exercise a financial activity but act as subcontractors of operational functions on behalf of other financial professionals. The law of 28 April 2011 amending the law of 5 April 1993 on the financial sector adopted the term "support PFS" which had only been recognised by the market until then. In the law on the financial sector, the acronym "PFS" means investment firms, specialised PFS and support PFS whereas the term "professionals of the financial sector" stands for the banks and the PFS.

### 1.1.3. Statistics

As at 31 December 2011, 322 PFS were subject to the prudential supervision of the CSSF. They employ a total of 14,217 persons, which is slightly more than the previous year but this increase does not correspond to a net creation of new employments as explained under item 1.4. below. The balance sheet total of all PFS amounted to EUR 12,958 million as at 31 December 2011 against EUR 11,421 million at the end of December 2010. The PFS recorded a significant decrease of their net results which fell from EUR 1,518.9 million as at 31 December 2010 to EUR 693.6 million as at 31 December 2011; the value of this indicator is however relative (cf. item 1.6. below).

## 1.2. Scope of the prudential supervision carried out by the CSSF

The following PFS fall under the scope of the prudential supervision of the CSSF:

- PFS incorporated under Luxembourg law (the activities performed by these entities in another EU/EEA Member State, by means of a branch or under the freedom to provide services, are also subject to the prudential supervision of the CSSF; certain aspects of the prudential supervision, in particular compliance with the rules of conduct for the provision of investment services to clients, fall however under the competence of the supervisory authority of the host Member State[1]);
- branches of investment firms from non-EU/EEA countries;
- branches of other categories of PFS originating from EU/EEA or from non-EU/EEA countries.

[1] In accordance with the law of 13 July 2007 on markets in financial instruments transposing the MiFID Directive into Luxembourg law.

The supervision of branches set up in Luxembourg by investment firms originating from another EU/EEA Member State is based on the principle of the supervision by the home Member State authority. Nevertheless, certain specific aspects of the supervision fall under the competence of the CSSF, the supervisory authority of the host Member State[2].



## 1.3. Development in the number of PFS

In 2011, the ongoing increase of the number of PFS subject to the supervision of the CSSF, noted since 2004, was confirmed. The number of PFS rose from 301 as at the end of 2010 to 322 entities as at 31 December 2011. The number of entities which received authorisation in 2011 slightly increased compared to the previous year (38 new entities in 2011 against 33 in 2010). 17 entities abandoned their PFS status during the year under review against 18 status withdrawals in 2010.

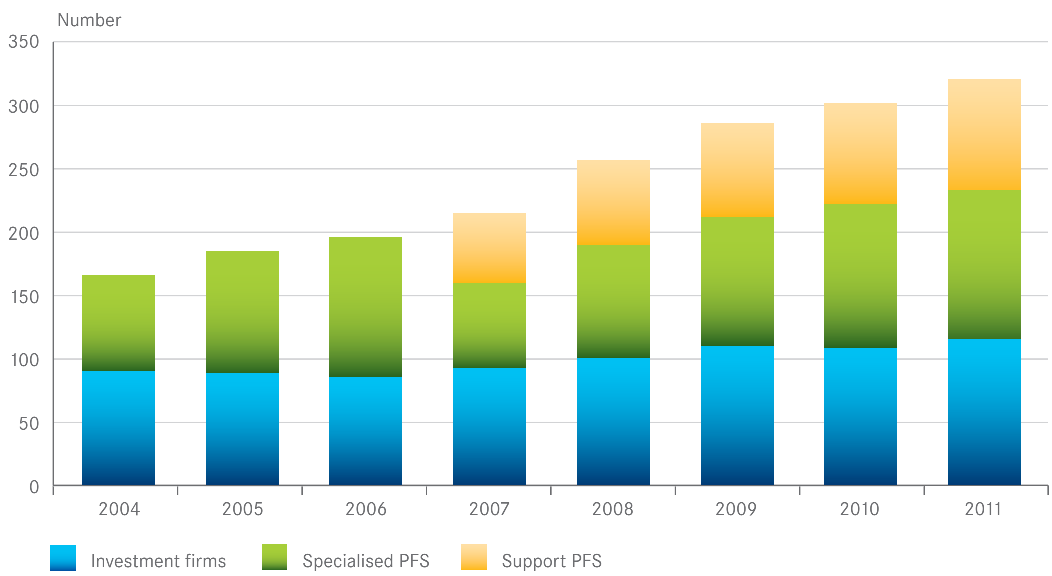
### Development in the number of PFS

| Year | Investment firms | Specialised PFS | Support PFS | Total |
|---|---|---|---|---|
| 2004 | 90 | 76 | / | **166** |
| 2005 | 88 | 97 | / | **185** |
| 2006 | 85 | 111 | / | **196** |
| 2007 | 92 | 68 | 55 | **215** |
| 2008 | 100 | 90 | 67 | **257** |
| 2009 | 110 | 102 | 74 | **286** |
| 2010 | 109 | 113 | 79 | **301** |
| 2011 | 116 | 118 | 88 | **322** |

The breakdown of PFS into investment firms, specialised PFS and support PFS shows a positive development for the three categories with the support PFS recording the highest growth. After a stabilisation phase, the number of investment firms experienced a net increase by seven units in 2011.

Among the investment firms, the activity of private portfolio manager was most widely found with 79 entities carrying out this activity as at 31 December 2011.

### Breakdown of PFS into investment firms, specialised PFS and support PFS




[2] Cf. footnote No. 1.

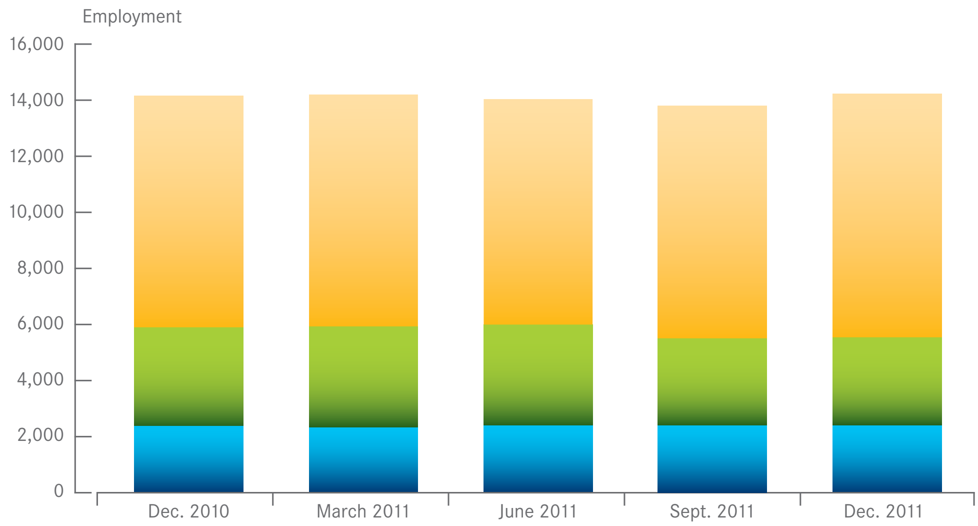
## 1.4. Development in employment

Total PFS employment registered a slight increase during 2011, the development being proportionally less than the increase in the number of PFS. Indeed, employment of all the PFS rose from 14,159 persons as at the end of December 2010 to 14,217 persons as at 31 December 2011, which corresponds to an increase of 0.4% over a year.

### 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 |
| 2007 | 215 | 12,174 |
| 2008 | 257 | 13,605 |
| 2009 | 286 | 13,485 |
| 2010 | 301 | 14,159 |
| 2011 | 322 | 14,217[3] |

### Quarterly development of employment per PFS sub-groups




| | Dec. 2010 | March 2011 | June 2011 | Sept. 2011 | Dec. 2011 |
|---|---|---|---|---|---|
| Support PFS | 8,249 | 8,274 | 8,045 | 8,279 | 8,679 |
| Specialised PFS | 3,552 | 3,599 | 3,595 | 3,112 | 3,127 |
| Investment firms | 2,358 | 2,326 | 2,395 | 2,399 | 2,411 |

[3] Preliminary figures.

### 1.4.1. Employment in investment firms

Employment in investment firms shows a constant upward but weak development as from the second quarter of the year under review. The net increase in employment over the whole year, rising from 2,358 persons as at 31 December 2010 to 2,411 persons as at 31 December 2011, may be partially explained by an increase in employment in a restricted number of investment firms already active before 2011. Variations of employment related to new authorisations as investment firm and status withdrawals during 2011 shall be added to the previous figure.



### 1.4.2. Employment in specialised PFS

Specialised PFS recorded a significant decrease of staff during the third quarter mainly attributable to Fund Administration Services & Technology Network Luxembourg S.A., in abbreviated form “Fastnet”. Indeed, in the framework of the merger by takeover of Fastnet by CACEIS Bank Luxembourg, the personnel of Fastnet (approximately 550 persons) was taken over by the bank and is henceforth included in the banking employment statistics. Thus, this transfer did not have an impact on the employment in the financial sector as a whole. The increase in the number of specialised PFS during the period under review as well as the staff growth in some entities already active only slightly counterbalanced this important decrease of employment in specialised PFS.

### 1.4.3. Employment in support PFS

The staff of support PFS rose from 8,249 persons as at 31 December 2010 (79 active entities) to 8,679 persons as at 31 December 2011 (88 active entities), representing an annual rise of 430 persons. This rise is attributable to support PFS which started their activity during the year and in particular one support PFS which represents almost three-quarters of this increase.

**Situation of employment in support PFS**

| | 2010 | | | 2011 | | | Variation |
|---|---|---|---|---|---|---|---|
| | Luxembourg | Foreigners | **Total** | Luxembourg | Foreigners | **Total** | |
| Executives | 132 | 407 | **539** | 132 | 483 | **615** | 14.1% |
| Office staff | 958 | 5,760 | **6,719** | 987 | 6,055 | **7,042** | 4.8% |
| Technical staff | 126 | 865 | **991** | 129 | 893 | **1,022** | 3.3% |
| | | | | | | | |
| *of which part-time* | *68* | *728* | ***796*** | *77* | *802* | ***879*** | *10.4%* |
| | | | | | | | |
| **TOTAL** | **1,217** | **7,032** | **8,249** | **1,248** | **7,431** | **8,679** | **5.2%** |
| | | | | | | | |
| *of which men* | *1,000* | *5,397* | ***6,397*** | *1,011* | *5,729* | ***6,740*** | *77.7%* |
| *of which women* | *217* | *1,635* | ***1,852*** | *237* | *1,702* | ***1,939*** | *22.3%* |

An important increase may be noted for foreign executives and part-time jobs.

As regards the quarterly development in 2011, support PFS recorded an important increase in employment during the last quarter after a decrease in employment in a restricted number of support PFS during the second quarter. However, this increase shall not be assimilated to a net creation of employment in support PFS or to a net creation of employment for the Luxembourg economy as a whole. Indeed, the greatest part of the increase in employment between September and December 2011 was due to newly authorised support PFS which include companies already active without being PFS, among which an entity with high employment. By extending their business to areas that need an authorisation as support PFS, the existing staff of these companies is included in the statistics relating to support PFS after they obtained the authorisation.

## 1.5. Changes in the official list of PFS in 2011

### 1.5.1. PFS having started their activities in 2011

#### • Investment firms

Pursuant to Part I, Chapter 2, Section 2, Sub-section 1 of the law of 5 April 1993 on the financial sector, the following categories are defined as investment firms:

- investment advisers (Article 24);
- brokers in financial instruments (Article 24-1);
- commission agents (Article 24-2);
- private portfolio managers (Article 24-3);
- professionals acting for their own account (Article 24-4);
- market makers (Article 24-5);
- underwriters of financial instruments (Article 24-6);
- distributors of units/shares of UCIs (Article 24-7);
- financial intermediation firms (Article 24-8);
- investment firms operating an MTF in Luxembourg (Article 24-9).

The following investment firms were registered on the official list of PFS in 2011:

- Almagest Wealth Management S.A.
- Alpha Patrimoine S.A.
- Andreas Capital S.à r.l.
- Amrego Kapitalförvaltning AB, Luxembourg branch
- Anoa Capital S.A.
- Clearbridge Settlement Services S.A.
- Greenleaf Financial Luxembourg S.A.
- Heyder Krüger & Kollegen GmbH, Niederlassung Luxemburg
- JRS Asset Management S.A.
- Lehner Investments Advice S.A.
- Midas Gestion S.A.
- Turner International Limited, Luxembourg branch
- Ycap Asset Management (Europe)

### • Specialised PFS

The following categories are considered as specialised PFS:

- registrar agents (Article 25);
- professional custodians of financial instruments (Article 26);
- operators of a regulated market authorised in Luxembourg (Article 27);
- currency exchange dealers (Article 28-2);
- debt recovery (Article 28-3);
- professionals performing credit offering (Article 28-4);
- professionals performing securities lending (Article 28-5);
- administrators of collective savings funds (Article 28-7);
- management companies of non-coordinated UCIs (Article 28-8);
- domiciliation agents of companies (Article 28-9);
- professionals performing services of setting-up and of management of companies (Article 28-10);
- professionals of the financial sector authorised to exercise any activity referred to in Part I, Chapter 2, Section 1 of the law of 5 April 1993 on the financial sector, with the exception of the categories of PFS also referred to in Section 2 of the same chapter;
- 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.

The following specialised PFS were added to the official list of PFS during the year 2011:

- Ameo Luxembourg S.A.
- Atlantic Fund Services S.A.
- Circle Investment Support Services (Luxembourg) S.A.
- Citadel Services PSF S.à r.l.
- Citigroup Global Markets Luxembourg S.à r.l.
- EF Trust S.A.
- Laven Financial Services (Luxembourg) S.A.
- LuxCSD S.A.
- Luxembourg Fund Services S.A.
- navAXX S.A.
- Real I.S. Management S.A.
- Regis-TR S.A.
- Stonehage Corporate Services Luxembourg S.A.
- T&F Luxembourg S.A.

### • Support PFS

Pursuant to Part I, Chapter 2, Section 2, Sub-section 3 of the law of 5 April 1993 on the financial sector, the following categories are defined as support PFS:

- client communication agents (Article 29-1);
- administrative agents of the financial sector (Article 29-2);
- primary IT systems operators of the financial sector (Article 29-3);
- secondary IT systems and communication networks operators of the financial sector (Article 29-4).

The following support PFS were registered on the official list of PFS in 2011:

- Comarch Luxembourg S.à r.l.
- C-Services S.A.
- Dussmann Security S.à r.l.
- Global IT Services PSF S.à r.l.
- Johnson Controls Luxembourg BE S.A.
- NextiraOne Luxembourg PSF S.A.
- Oddo Services Luxembourg S.A.
- Oktopus Consulting PSF S.A.
- Opexia PSF S.A.
- Solfia S.A.
- Trasys Luxembourg PSF S.A.

### 1.5.2. PFS having abandoned their status in 2011

Seventeen entities, including six investment firms, abandoned their PFS status in 2011 for the following reasons:

a) change or cessation of activities, so that the former entity no longer requires an authorisation as PFS, because it does not fall under the scope of the law of 5 April 1993 on the financial sector any more (10 entities)

   - Belvall Capital S.A.
   - Domiciliation + Services S.à r.l.
   - ICBS S.A.
   - KMC Finance S.A.
   - Laven Financial Services (Luxembourg) S.A.
   - Midas Asset Management S.A.
   - Oracle Luxembourg S.à r.l.
   - Tandem Partners S.à r.l.
   - TASL PSF S.A.
   - Van Lanschot Trust Company (Luxembourg) S.A.

b) voluntary winding-up (2 entities)

   - ABN AMRO Fund Services (Luxembourg) S.à r.l.
   - Nordnet Securities Luxembourg S.A.

c) merger (3 entities)

   - Fund Administration Services & Technology Network Luxembourg S.A., in abbreviated form “Fastnet” (merger by takeover by the credit institution CACEIS Bank Luxembourg)
   - Fideos Financial Services S.A. (merger by takeover by the specialised PFS Alter Domus Alternative Asset Fund Administration S.à r.l.)
   - SGG-FFW S.A. (merger by takeover by the specialised PFS SGG S.A.)

d) closing of the branch BNY Mellon Investment Servicing (International) Limited, originating from Ireland, and of the branch Heyder Krüger & Kollegen GmbH, established in Luxembourg in 2011 by an investment firm originating from Germany.

## 1.6. Development of balance sheets and profit and loss accounts

The provisional balance sheet total of all PFS established in Luxembourg reached EUR 12,958 million[4] as at 31 December 2011, against EUR 11,421 million as at 31 December 2010, i.e. an annual increase of 13.46%. The categories of investment firms and specialised PFS show a significant rise in the balance sheet total of the year under review. The positive development of specialised PFS may be mainly explained by the volume of activities developed by a professional performing securities lending newly authorised in 2011 and by a particularly positive development noted in a restricted number of financial players. The growth observed in investment firms is mainly the result of the significant increase of the balance sheet total of one player authorised in 2010. Support PFS reported however a slight decrease of their balance sheet total year-on-year.

The PFS show a significant fall in their net results over a year. Indeed, provisional net results amounted to EUR 693.6 million[5] as at 31 December 2011, against EUR 1,518.9 million as at 31 December 2010, representing a drop of 54.34% over a year. This negative development is mainly due to the significant drop in the net result of one important player among specialised PFS but does not reflect the general trend noted in most specialised PFS.

When taking into account the sub-groups “investment firms”, “specialised PFS” and “support PFS”, only support PFS registered a slight increase in their net results compared to the figures of the previous year. A decrease in the net results was recorded however for investment firms and, to a greater extent, for specialised PFS. For this last category, as indicated above, the negative development is mainly attributable to an important player whose net results considerably decreased year-on-year. Most specialised PFS registered however net results which were either constant or slightly higher during the financial year 2011. Net results of most investment firms showed a certain stability even though one important player registered a significant drop in its net results compared to those of 2010. It should be pointed out that, in a difficult economic and financial context, approximately one-third of investment firms recorded a negative result as at 31 December 2011, a slightly higher percentage compared to the previous year.

### Development of the balance sheet total and of the net results of PFS - in million EUR

| | Balance sheet total | | | | Net results | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | 2011 | | 2010 | | 2011 | |
| | Volume | Relative share | Volume | Relative share | Volume | Relative share | Volume | Relative share |
| Investment firms | 1,655 | 14.5% | 2,629 | 20.3% | 360.9 | 23.8% | 296.3 | 42.7% |
| Specialised PFS | 8,746 | 76.6% | 9,419 | 72.7% | 1,116.0 | 73.5% | 353.1 | 50.9% |
| Support PFS | 1,020 | 8.9% | 910 | 7.0% | 42.0 | 2.7% | 44.2 | 6.4% |
| **Total** | **11,421** | **100.0%** | **12,958** | **100.0%** | **1,518.9** | **100.0%** | **693.6** | **100.0%** |

[4] The figures of the branches established in Luxembourg by investment firms originating from another EU/EEA Member State and included since 2009 in the total number of PFS are not included in these figures.

[5] Cf. footnote No. 4 above.

## 1.7. International expansion of PFS

### 1.7.1. Subsidiaries created and acquired abroad during 2011

In 2011, the investment firm Assya Asset Management Luxembourg S.A. opened a subsidiary in France.

### 1.7.2. Freedom of establishment

Five investment firms incorporated under Luxembourg law established a branch in one or several other EU/EEA countries during 2011:

- Advantage Financial S.A. in Italy;
- CBRE Global Investors Luxembourg S.à r.l. in Belgium and the Netherlands;
- Compagnie Financière Indépendante S.A. in Belgium;
- JRS Asset Management S.A. in Sweden; and
- Marguerite Adviser S.A. in France.

As at 31 December 2011, the following Luxembourg investment firms were represented in one or several EU/EEA countries by means of a branch.

| Name of the PFS | Country of establishment of the branch |
|---|---|
| Advantage Financial S.A. | Italy |
| Assya Asset Management Luxembourg S.A. | Belgium |
| CBRE Global Investors Luxembourg S.à r.l. | Belgium<br>Netherlands |
| Compagnie Financière et Boursière Luxembourgeoise S.A., in abbreviated form "Cofibol" | Belgium |
| Compagnie Financière Indépendante S.A. | Belgium |
| Createrra S.A. | Belgium |
| European Fund Services S.A. | Germany<br>Irland |
| Fuchs & Associés Finance S.A. | Belgium |
| Hottinger & Cie | Belgium |
| II PM Luxembourg S.A. | Belgium |
| JRS Asset Management S.A. | Sweden |
| Luxembourg Financial Group A.G. | United Kingdom |
| Marguerite Adviser S.A. | France |
| Moventum S.C.A. | Austria<br>Germany |
| Opportunité Luxembourg S.A. | Belgium |
| Orbit Private Asset Management S.A. | Belgium |
| Rhein Asset Management (Lux) S.A. | Germany |
| Skandia Invest S.A. | France |
| Valbay International S.A. | Sweden |
| Vontobel Europe S.A. | Austria<br>Italy<br>Spain<br>United Kingdom |
| WH Selfinvest S.A. | Belgium<br>France<br>Germany |

In 2011, Belvall Capital S.A. gave up the PFS status and is no longer included in the list of Luxembourg investment firms having established a branch in one or more EU/EEA countries at the end of 2011. The branches established by Farad Investment Advisor S.A. in Italy and by UBS Fund Services (Luxembourg) S.A. in Poland were closed in 2011.

Three support PFS and one specialised PFS had a branch in an EU/EEA country as at 31 December 2011.

As regards non-EU/EEA countries, one investment firm and one specialised PFS incorporated under Luxembourg law are each represented through a branch in Switzerland.

The number of branches established in Luxembourg by investment firms originating from another EU/EEA Member State increased by one entity year-on-year, amounting to 11 entities as at 31 December 2011.

The following branches started their activities in Luxembourg in 2011:

- Amrego Kapitalförvaltning AB (country of origin: Sweden);

- Heyder Krüger & Kollegen GmbH (country of origin: Germany);

- Turner International Limited (country of origin: United Kingdom).

The branches BNY Mellon Investment Servicing (International) Limited of Irish origin and Heyder Krüger & Kollegen GmbH of German origin closed during 2011.

It should be pointed out that the UK branch T. Rowe Price Global Investment Services Limited, in abbreviated form "TRPGIS", became T. Rowe Price International Ltd in 2011.

**EU/EEA branches established in Luxembourg as at 31 December 2011**

| Name of the branch | Country of origin |
|---|---|
| Amrego Kapitalförvaltning AB | Sweden |
| Eiger Securities LLP | United Kingdom |
| IG Markets Limited | United Kingdom |
| Morgan Stanley Investment Management Limited | United Kingdom |
| Nevsky Capital LLP | United Kingdom |
| PineBridge Investments Europe Ltd | United Kingdom |
| Superfund Asset Management GmbH | Austria |
| T. Rowe Price International Ltd | United Kingdom |
| Thames River Capital LLP | United Kingdom |
| Tullett Prebon (Europe) Ltd | United Kingdom |
| Turner International Limited | United Kingdom |

### 1.7.3. Free provision of services

In 2011, 17 investment firms incorporated under Luxembourg law applied to pursue business in one or several EU/EEA Member States by way of free provision of services. The total number of investment firms which are active in one or more EU/EEA countries following a notification amounted to 67 entities as at 31 December 2011 (against 62 as at 31 December 2010). The majority of the investment firms concerned carried out their activities in several EU/EEA countries by way of free provision of services.

The total number of investment firms established in the EU/EEA and authorised to perform activities under the freedom to provide services within the Luxembourg territory amounted to 2,251 entities at the end of 2011 (against 2,042 entities as at 31 December 2010).

As at 31 December 2011, the global situation relating to free provision of services in or from the EU/EEA was as follows.

| Country | Luxembourg investment firms providing services in the EU/EEA | EU/EEA investment firms providing services in Luxembourg |
|---|---|---|
| Austria | 17 | 22 |
| Belgium | 47 | 15 |
| Bulgaria | 4 | 5 |
| Cyprus | 7 | 51 |
| Czech Republic | 6 | 1 |
| Denmark | 16 | 21 |
| Estonia | 5 | 1 |
| Finland | 12 | 6 |
| France | 38 | 80 |
| Germany | 34 | 103 |
| Gibraltar | - | 6 |
| Greece | 7 | 8 |
| Hungary | 8 | 2 |
| Iceland | 3 | - |
| Ireland | 8 | 52 |
| Italy | 22 | 7 |
| Latvia | 5 | 1 |
| Liechtenstein | 2 | 9 |
| Lithuania | 6 | - |
| Malta | 6 | 4 |
| Netherlands | 25 | 103 |
| Norway | 11 | 26 |
| Poland | 9 | - |
| Portugal | 8 | 4 |
| Romania | 5 | - |
| Slovakia | 5 | 1 |
| Slovenia | 5 | 2 |
| Spain | 19 | 19 |
| Sweden | 17 | 7 |
| United Kingdom | 20 | 1,695 |
| **Total number of notifications** | **377** | **2,251** |
| **Total number of investment firms concerned** | **67** | **2,251** |

The geographical breakdown of EU/EEA investment firms active by way of free provision of services in Luxembourg reveals that UK investment firms are by far the most important in number.

Similarly, among the 294 new notifications for free provision of services on the Luxembourg territory received in 2011 (slightly decreasing number as compared to the 312 new notifications in 2010), those originating from the United Kingdom represented a large majority. Apart from the United Kingdom, the entities that show considerable and ongoing interest in exercising their activities in Luxembourg by way of free provision of services are mainly from countries close to Luxembourg, like the Netherlands, France and Germany. In 2011, Cyprus confirmed the important upward trend already initiated in 2010.

The target countries of investment firms incorporated under Luxembourg law, whose total number of notifications amounted to 377 units as at 31 December 2011, are above all Luxembourg's neighbouring countries (Belgium, France and Germany). Luxembourg investment firms also show major interest in the Netherlands, Italy and the United Kingdom.

## 2. PRUDENTIAL SUPERVISORY PRACTICE



As regards support PFS, the specific aspects of the prudential supervisory practice are described under item 3. below.

### 2.1. Instruments of prudential supervision

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

- financial information periodically submitted to the CSSF enabling it to continuously monitor the activities of PFS and the inherent risks, and, as regards investment firms, to perform a periodic supervision of the capital adequacy ratio and large exposures limits as laid down in Article 56 of the law of 5 April 1993 on the financial sector;
- the documents established yearly by the *réviseur d'entreprises agréé*: for investment firms, the audit report and audited annual accounts, long form report and, where applicable, the management letter; for specialised PFS, the audit report and audited annual accounts, control report relating to the fight against money laundering and terrorist financing and, where applicable, the management letter;
- 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;
- the introductory visits and on-site inspections carried out by the CSSF.

### 2.2. Compliance with the quantitative standards by the investment firms

#### 2.2.1. Capital base

In accordance with Articles 24 to 24-9 of the law of 5 April 1993 on the financial sector, the authorisation of investment firms is subject to the production of evidence showing the existence of minimal capital base. This capital base consisting of a subscribed and paid-up capital, share premiums, legally formed reserves and profits brought forward, after deduction of possible losses for the current financial year, shall be permanently available to the investment firm and invested in its own interest.

Based on the financial data that the investment firms shall provide to the CSSF on a monthly basis in accordance with Circular CSSF 05/187, the CSSF verifies particularly compliance with the minimal capital base conditions by investment firms. In 2011, the CSSF intervened at 12 investment firms for non-compliance with the legal provisions relating to capital base.

In this context, the CSSF reminds that subordinated loans shall not be taken into account for the determination of minimal capital base of a professional of the financial sector.

#### 2.2.2. Capital adequacy ratio

Investment firms falling under the scope of Circular CSSF 07/290 (as amended by Circulars CSSF 10/451, 10/483 and 10/497) defining the capital ratios pursuant to Article 56 of the law of 5 April 1993 on the financial sector shall permanently have eligible own funds at least equal to the global capital requirement.

During 2011, the CSSF recorded 11 cases of non-compliance with the capital adequacy ratio. Besides isolated cases where temporary derogations were granted by the CSSF in accordance with the provisions of Circular CSSF 07/290, most investment firms already regularised the situation of non-compliance or are in the process of being regularised shortly.

### 2.2.3. Large exposures limits

Concerning the supervision of compliance with the large exposures limits, the CSSF intervened once in 2011 as regards an excess in the maximum ratio of 25% between all the risks incurred for one client or the same group of related clients and the amount of own funds of the investment firm.

## 2.3. On-site inspections

The CSSF attaches particular importance to this instrument of prudential supervision, as it allows a global and direct view of the situation and functioning of the PFS in practice. On-site inspections also allow a better control and monitoring of one or more specific aspects of prudential supervision. On-site inspections are usually carried out jointly with the department "General supervision".

In 2011, the CSSF carried out, in addition to on-site inspections, introductory visits at newly authorised PFS. These visits generally take place on the premises of PFS within the first months following the ministerial authorisation and allow an immediate verification of the data and information supplied in the application files. Compliance with regulatory requirements and the implementation of adequate procedures are other issues broached during these visits.

### 2.3.1. Investment firms

During the year under review, the CSSF carried out on-site inspections in 13 investment firms.

This figure includes five on-site inspections focusing on compliance with professional obligations regarding the fight against money laundering and terrorist financing (AML/CFT) and six introductory visits with newly authorised investment firms.

The control missions in two investment firms took place in the framework of the MiFID provisions (law of 13 July 2007 on markets in financial instruments and Grand-ducal regulation of 13 July 2007 relating to organisational requirements and rules of conduct in the financial sector).

One visit in an investment firm in order to verify compliance with the professional requirements as regards AML/CFT resulted in an injunction by the CSSF, pursuant to Article 59 of the law of 5 April 1993 on the financial sector, for non-compliance with the above-mentioned professional obligations.

### 2.3.2. Specialised PFS

In 2011, the CSSF carried out 30 on-site inspections in specialised PFS, namely:

- 12 missions concerning more particularly compliance with the professional obligations as regards AML/CFT, among which one follow-up mission to monitor the state of regularisation of the breaches noted during a previous mission carried out in 2010;
- 15 introductory visits at newly authorised entities; and
- three inspections in order to verify specific aspects of the prudential supervision, such as the organisational structure and the activities exercised.

Following these on-site inspections, the CSSF intervened by way of injunction against four entities pursuant to Article 59 of the law of 5 April 1993 on the financial sector. These injunctions related to breaches noted as regards procedures and/or compliance with professional obligations relating to AML/CFT, absence of domiciliation agreements as well as important delays in the approval, deposit and publication of the domiciled companies' annual accounts.

Moreover, one on-site inspection relating to the verification of professional obligations regarding AML/CFT resulted in an administrative fine imposed on the relevant entity.

## 2.4. Meetings

During the year under review, a total of 107 meetings in relation to PFS activities took place on the CSSF's premises. 73 of these meetings concerned the department "Supervision of investment firms" and 34 meetings the department "Supervision of specialised PFS". In the context of closer control aimed at by the CSSF, the latter attaches specific importance to these meetings, preferably on an annual basis, with the financial players subject to its supervision.

During 2011, meetings with PFS representatives covered the following areas:

- information requests on the qualification of the activities performed (scope of the law of 5 April 1993 on the financial sector);
- new requests for authorisation as PFS;
- initial meetings with the persons in charge of the newly authorised PFS in order to deal with the practical aspect of on-going supervision;
- changes in the authorisation of active PFS (activity, acquisition of subsidiaries, legal form, etc.);
- planned changes notably relating to the shareholding structure, day-to-day management and internal control;
- discussions concerning problems or specific points noticed in the framework of the prudential supervision exercised by the CSSF;
- information requests in the context of prudential supervision;
- presentation of the general context and activities of the companies concerned;
- courtesy visits.

## 2.5. Specific controls

Article 54(2) of the law of 5 April 1993 on the financial sector entitles the CSSF to require a *réviseur d'entreprises agréé* to carry out a specific audit at 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 formally made use of this right twice in 2011.

## 2.6. 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 and in particular 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.

The CSSF carries out supervision on a consolidated basis for investment firms falling under the scope of application of the above-mentioned law. An in-depth study of the financial groups to which most investment firms belong is 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.

As at 31 December 2011, the following 10 investment firms were submitted to the supervision on a consolidated basis by the CSSF:

- Assya Asset Management Luxembourg S.A.
- Brianfid-Lux S.A.
- CapitalatWork Foyer Group S.A.
- Crédit Agricole Luxembourg Conseil S.A., in abbreviated form “CAL Conseil”
- European Value Partners Advisors S.à r.l.
- FIL (Luxembourg) S.A.
- Fuchs & Associés Finance S.A.
- Fund Channel S.A.
- Hottinger & Cie
- Petercam (Luxembourg) S.A.

## 3. SUPPORT PFS

Support PFS include financial professionals which have been authorised only under Articles 29-1, 29-2, 29-3 and/or 29-4 of the law of 5 April 1993 on the financial sector. Their characteristic is that they do not exercise as such a financial activity themselves but act as subcontractors of operational functions on behalf of other financial professionals.

The CSSF notes that the reasons given by the companies contemplating a support PFS status are that some financial professionals, among which particularly banks, prompt their providers to obtain a support PFS status even though it is not necessary. This phenomenon which two or three years ago mainly concerned IT activities extends hence to companies providing facility management services like cleaning premises, usher works with the transport and internal distribution of mail and the on-site destruction of documents. The trend has stabilised or even reversed for IT service provisions, some service providers having willingly renounced to the authorisation in agreement with their clients and by proceeding at the same time to contractual adjustments of the service level agreements in order to remove any ambiguity as regards the responsibilities of each party.

The CSSF would like to specify once again that the service provisions which are sensitive to professional secrecy do not intrinsically justify the use of a support PFS. A financial professional which relies upon a support PFS for an activity that does not require authorisation, as for example the distribution of incoming mail without opening the envelopes, is not entirely covered considering Article 41(5) of the law of 5 April 1993 on the financial sector which provides that “[...] insofar as the information communicated to those professionals is provided under an agreement for the provision of services”. Thus, the information communicated to a service provider shall *a priori* be necessary for the execution of the service. Any communication of confidential information not needed for the service provision may be considered as negligence by the financial professional.

It is essential for a balance of the outsourcing market in the Luxembourg financial sector that each party - client and service provider - complies with its professional obligations and does not use the particular status of support PFS and the specificities of Article 41(5) to ignore the latter. Thus, the CSSF considers as inappropriate for a financial professional to rely upon a support PFS (client communication agent) for cleaning services just because the persons in charge of these tasks may tidy up confidential documents left on desks. The financial professional shows negligence if it does not set up a clean desk policy in accordance with its professional secrecy. Conversely, the companies which received the status of support PFS only in order to be able to respond to a demand from the financial professionals should remain prudent because:

- they might lose their authorisation one year after receiving it if the CSSF considers the requested copy of the agreement justifying the authorisation as inappropriate for the given authorisation; and
- they undertake responsibility initially incumbent upon their clients and which goes beyond the responsibilities related to the service provision.

Moreover, the status should not be obtained based on an inappropriate business case and the charges ensued due to the authorisation should not exceed the expected income of the service provision. The following example illustrates this imbalance. A facility management company requests an authorisation as client communication agent as requested by its financial professional client only because the employee of the subcontractor destroys confidential documents on-site without the presence of an employee of the financial professional. Even if the service provision does fall under this status, the service provider shall consider the consequences of its approach and the realism of its business plan. If the financial professional adapts its way of proceeding, the service provision may be performed without the use of a support PFS authorisation. Moreover, in the long run, the service provision of a support PFS may become more expensive than that of a service provider not having this authorisation which will in turn be unfavourable to those financial professionals opting for an "only PFS" approach.



## 3.1. Development in the number of support PFS

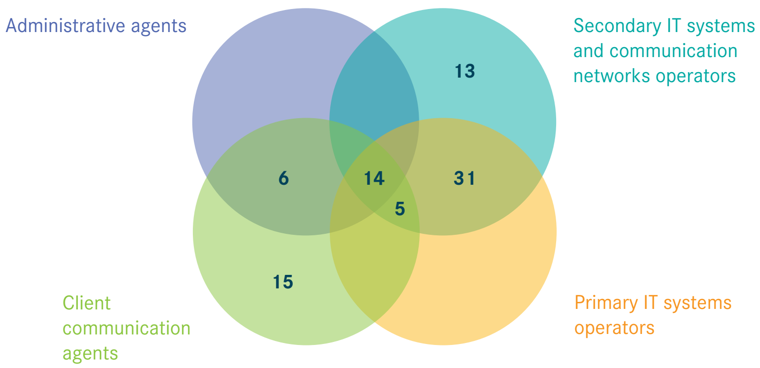
In 2011, the total number of support PFS increased from 79 entities as at 31 December 2010 to 88 as at 31 December 2011.

The following 11 new support PFS received authorisation in 2011[6]:

- two client communication agents (ACC);
- three primary IT systems operators of the financial sector and secondary IT systems and communication networks operators of the financial sector (OSIP - OSIS);
- three secondary IT systems and communication networks operators of the financial sector (OSIS);
- three entities cumulating the statuses of client communication agent, administrative agent of the financial sector, primary IT systems operator of the financial sector and secondary IT systems and communication networks operator (ACC - AA - OSIP - OSIS).

Two support PFS were withdrawn from the official list after ceasing their activity in 2011.

As at 31 December 2011, the 88 support PFS break down as follows.




Client communication agents + secondary IT systems and communication networks operators: 4 entities

It should be noted that administrative agents are *ipso jure* authorised to exercise the activities of client communication agents. As a result, no entity has only the status of administrative agent. The same applies to primary IT systems operators which are authorised *ipso jure* to carry out the activities of secondary IT systems and communication networks operators of the financial sector.

[6] Cf. item 1.5.1. above.

## 3.2. Prudential supervisory practice for support PFS

The prudential supervision of support PFS is carried out by the department "Information systems and supervision of support PFS" which covers all technological aspects, i.e. the CSSF's own information systems including the coordination of the users' needs and the supervision of information systems supporting other supervisory departments, security of information systems and supervision of support PFS.

### 3.2.1. Introductory visits

The purpose of the introductory visits, which usually take place within the first six months as of the authorisation, is twofold. On the one hand, a meeting is organised between the persons in charge of the day-to-day management of the support PFS and the persons in charge of its supervision in order to encourage a constructive and efficient dialogue. On the other hand, these visits ensure that the information supplied in the application file is in accordance with the practical implementation within the PFS. The CSSF checks, among others, the set-up and functioning of the central administration and internal control, two key elements for an efficient corporate governance.

Introductory visits also allow correcting, at an early stage, possible weaknesses revealed at the start of the PFS's activities.

As in the previous years, the CSSF systematically organised introductory visits at support PFS newly authorised to exercise their activities in 2011. Thus, the division in charge of the prudential supervision of support PFS carried out six introductory visits over the past year.

It should be pointed out that two of the six visited entities have in the meantime voluntarily renounced their authorisation.

### 3.2.2. On-site inspections

On-site inspections were carried out in three entities showing serious breaches of the applicable law or circulars. The CSSF aims at continuing continue its efforts in this matter in the following years by systematically performing on-site inspections in order to verify that the situation as presented in the documents of the internal auditor or *réviseur d'entreprises* (statutory auditor) corresponds to the physical and operational reality.

### 3.2.3. Outsourcing of the information systems used by domiciliation agents of companies

During the review of new application files submitted by companies wishing to provide, among others, domiciliation services, the CSSF noticed that there was some confusion of the required authorisation needed for service providers in charge of certain outsourced information systems; thus some clarifications are necessary as regards the CSSF's requirements relating to outsourcing information systems used by domiciliation agents depending on the nature of the systems concerned.

When contemplating the services provided on behalf of a domiciled company, it is essential to distinguish the services that allow the establishment of accounts and financial statements from other services such as holding general meetings or services which concern decision-making bodies which can be qualified as "company's life".

The processing and conservation of all the data is mostly carried out through high-performance information systems that are directly operated by the domiciliation agent himself. However, in the event that a domiciliation agent chooses to make use of an external service provider to be in charge of the IT systems, two situations shall be considered:

- as regards taking charge of the IT systems' operations allowing the establishment of accounts and financial statements of the domiciled companies, the outsourcing may only be entrusted to primary IT systems operators of the financial sector in accordance with Article 29-3 of the law of 5 April 1993 on the financial sector as the continuity of the services provided by the operator is essential to the domiciliation agent in order to be able to determine its clients financial situation;

- as regards taking charge of the IT systems' operations other than those which are used for the establishment of accounts and financial statements and which concern, for example, the domiciled companies' company life, this outsourcing may be entrusted to secondary IT systems and communication networks operators of the financial sector in accordance with Article 29-4 of the law of 5 April 1993 on the financial sector;
- in the event that these functions are provided by a single common system, the outsourcing of the latter may only be entrusted to a service provider authorised as primary IT systems operator of the financial sector.

Thus, the CSSF recommends that the domiciliation companies ensure, when the outsourcing their IT systems specifically dedicated to provide services on behalf of domiciled companies, that the service providers have the required authorisation. The above applies to domiciliation agents submitting a new application file as well as to those already authorised.

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### 3.2.4. Capital base

In accordance with Articles 29-1 to 29-4 of the law of 5 April 1993 on the financial sector, the authorisation of support PFS is subject to the evidence showing the existence of a minimal capital base. This capital base is composed of the subscribed and paid-in share capital and legally formed reserves, after deduction of possible losses brought forward or losses for the current financial year and shall be permanently available to the support PFS and invested in its own interest.

Depending on the status of support PFS, the minimal capital base is as follows:

- EUR 50,000 for client communication agents (Article 29-1) and secondary IT systems and communication networks operators of the financial sector (Article 29-4);
- EUR 125,000 for administrative agents of the financial sector (Article 29-2);
- EUR 370,000 for primary IT systems operators of the financial sector (Article 29-3).

#### • Statistics

In accordance with Circular CSSF 05/187 relating to the financial information to be submitted to the CSSF on a periodic basis, the support PFS shall send their financial statements to the CSSF on a monthly basis *via* a secured channel. Moreover, based on this reporting, the CSSF verifies compliance with the minimal capital base according to the PFS status.

In 2011, these verifications had the following results:

| **2011** | Jan. | Feb. | March | Apr. | May | June | July | Aug. | Sept. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total number of support PFS | 79 | 79 | 79 | 79 | 81 | 81 | 83 | 84 | 86 | 87 | 87 | 88 |
| Number of support PFS with insufficient capital base | 6 | 5 | 2 | 2 | 2 | 5 | 5 | 4 | 4 | 5 | 5 | 3 |

On average, the CSSF noted four cases of non-compliance with the legal provisions per month, i.e. 4.8% of the total number of support PFS.

In 2011, 12 support PFS did not observe the legal provisions regarding minimal capital base, namely two administrative agents of the financial sector (AA), seven primary IT systems operators of the financial sector (OSIP) and three secondary IT systems and communication networks operators of the financial sector (OSIS).

No PFS having the status of client communication agent (ACC) failed to comply with the legal provisions relating to capital base during 2011.

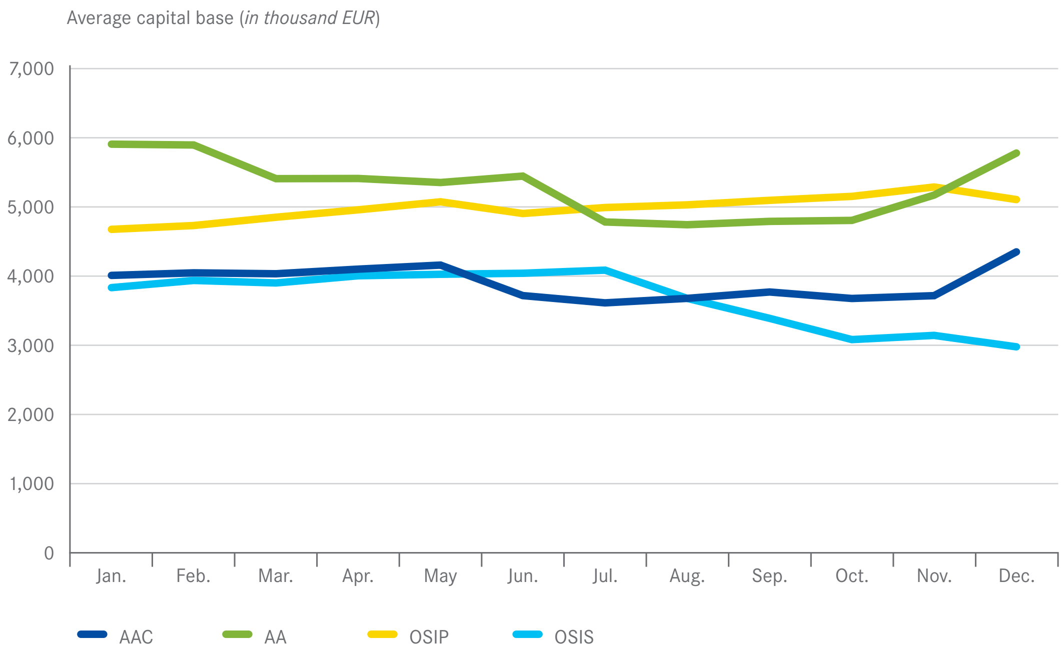
Primary IT systems operators of the financial sector which have the highest capital base requirements, i.e. EUR 370,000, represented over half of the cases of non-compliance with legal provisions.

Nevertheless, the average capital base of support PFS, calculated per status, largely complies with the legal minimum as illustrated in the following table.

| *in EUR* | ACC | AA | OSIP | OSIS |
|---|---|---|---|---|
| Minimum legal capital base | 50,000 | 125,000 | 370,000 | 50,000 |
| Average capital base | 3,904,804 | 5,288,377 | 4,985,759 | 3,673,676 |

The administrative agents have on average the highest capital base whereas the secondary IT systems and communication networks operators of the financial sector have on average the lowest capital base but greatly observe the legal minimum.

**Development of average capital base per status of support PFS in 2011**




The level of capital base was relatively constant during 2011.

• **Identification of non-compliance with the legal provisions**

Where the CSSF notices a deficiency in capital base, it immediately informs per mail the PFS and requests to submit within eight working days a proposal on the measures that the PFS intends to take to conform again to the applicable legal provisions.



The following two situations may arise:

a) a slight and temporary deficiency in capital base

A slight and temporary deficiency in capital base may for example result from a cash-flow mismatch in accounting between the expenses of the PFS which are mostly on a monthly basis and the income of the PFS which is often quarterly. The late accounting for the income compared to expenses may trigger a temporary cash-flow imbalance and generate a deficit, which affects the capital base of the PFS. In this case, the subsequent income booking brings back the balance and, consequently, a sufficient level of the capital base of the PFS.

b) an important and lasting deficiency in capital base

When the level of deficiency in capital base is persistent compared to the legal minimum, for example in case of important losses brought forward, the PFS has to take more drastic measures by carrying out, for instance, an increase in capital share, accompanied, where applicable, by a prior write-off of the losses brought forward.

It can be observed that the newly created support PFS tend to be insufficiently capitalised since the cash-flows defined in their business plan often do not materialise. The PFS which encounter losses at the beginning of the activity must therefore proceed to an increase in capital share during the first year of their activity.

• **Conclusion**

Among the 12 support PFS having had an insufficient capital base in 2011, the following cases occurred.

- Eight support PFS experienced large insufficiency in capital base, notably due to losses brought forward or important losses during the year under review. They had to increase their capital share.
- Two PFS had an capital base slightly lower than the legal minimum. These PFS could account, during the subsequent months, for additional income allowing getting back to the legal minimum level.
- Two PFS which received authorisation in 2011 had temporary insufficient capital base before increasing their capital share which was already planned at the time of the authorisation.

Finally, it should be noted that PFS took on average four months as from the moment the non-compliance was observed to re-establish the legal minimum requirement. This time span of four months may be explained as follows:

- for PFS which have slightly insufficient capital base, the situation tends to get back to normal by itself one or even two months later when the additional income is accounted for;
- for PFS which have largely insufficient capital base and which have to increase their capital share, the delays are longer. Since a capital increase may only take place in the framework of a general shareholder meeting, legal deadlines are to be respected, in particular as regards the convening of the shareholders to the meeting. These legal constraints thus delay the re-establishment of sufficient capital base.

***Agents hired in 2011 and 2012: Legal Department, Departments "General supervision", "Supervision of banks", "Supervision of specialised PFS" and "Supervision of investment firms"***

Left to right: Isabelle JASPART, Laurent PETRY, Livia MORETTI, Christoph WINNEFELD, Isabelle SCHMIT, Annick HEINTZ, Carola NILSSON, Carole WINANDY, Timo LITZENBERGER, Maryse DUARTE

# SUPERVISION OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS



# 1. PAYMENT INSTITUTIONS

## 1.1. Regulatory framework

The law of 10 November 2009 on payment services, on the activity of electronic money institutions and settlement finality in payment and securities settlement systems transposes Directive 2007/64/EC of 13 November 2007 on payment services in the internal market into national law. This directive aims to set up a coherent legal framework in order to establish a single European market for payment services and to ensure its proper functioning.

The law of 10 November 2009 introduces a new status of financial institutions, i.e. the payment institutions which may exercise the activity of payment services and imposes authorisation, exercise and supervisory conditions on them. The payment services concerned are specifically listed in the annexe to the law.

Article 31(1) of the law designates the CSSF as the competent authority for the supervision of payment institutions.

The main prudential provisions applicable to payment institutions may be summarised as follows:

- quantitative prudential standards, i.e. a minimum capital and capital requirements calculated according to one of the three methods provided by the law; the CSSF monitors the proper application and compliance with these quantitative standards based on a specific reporting pursuant to Circular CSSF 11/511;
- rules for the protection of funds received for the execution of payment transactions;
- guarantee of a sound and prudent management and the existence of a strong internal governance system;
- rules related to the fight against money laundering and terrorist financing.

As regards the two last indents, the rules are in principle those applicable to credit institutions and to investment firms but they will be applied to payment institutions according to a proportionality principle based, among others, on the type of payment services activities and the risks incurred.

The activities exercised by the Luxembourg payment institutions in another EU/EEA Member State through the establishment of a branch, through the intermediary of an agent or by way of the free provision of services, are also subject to the prudential supervision of the CSSF.

By way of compensation for the simplified rules to access the profession and for the lighter prudential supervision compared to those applicable to credit institutions, the payment institutions are subject to activity restrictions and prohibitions:

- strict control of credit granting according to the provisions of Article 10(3) of the law of 10 November 2009;
- prohibition to conduct the business of taking deposits or other repayable funds within the meaning of Article 2(3) of the law of 5 April 1993 on the financial sector;
- exclusive use of payment accounts opened by payment institutions for payment transactions.

## 1.2. Payment institutions authorised in Luxembourg

As at 31 December 2011, three payment institutions incorporated under Luxembourg law, i.e. SIX Pay S.A., FIA-NET Europe S.A. and Diners Club Beneflux S.A., as well as a branch of a payment institution incorporated under German law, Deutsche Post Zahlungsdienste GmbH, Niederlassung Luxemburg, were listed in the public register of the payment institutions established in Luxembourg.

## 2. ELECTRONIC MONEY INSTITUTIONS

### 2.1. Regulatory framework

Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (hereafter first Electronic Money Directive) created a first European legal framework for the activity of issuing electronic money and was transposed into Luxembourg law by the law of 14 May 2002. The overriding purpose of the directive, which considers electronic money as an electronic alternative to coins and banknotes, stored on an electronic media and generally aimed to make electronic payments of low amounts, was to make it easier for institutions other than credit institutions to take up and pursue the activity of issuing electronic money.



Yet, the electronic money regime established by the first Electronic Money Directive did not meet with the expected success, in particular owing to prudential and statutory constraints which are unsuited to the economic model. Indeed, the legal requirements applicable to electronic money institutions (hereafter EMIs) were modelled on those of credit institutions and turned out to be too stringent to develop the activity of issuing electronic money in the EU. Consequently, the rules governing EMIs needed to be reviewed.

Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions (hereafter second Electronic Money Directive) aims to reform the rules governing the issuance of electronic money in the EU as defined in the first Electronic Money Directive.

The major purpose of the second Electronic Money Directive is to provide electronic money with a sustainable and attractive regime and, in particular, to make the prudential supervisory regime of EMIs consistent with that applicable to the payment institutions governed by Directive 2007/64/EC (i.e. simplified rules to access the profession and lighter prudential supervision compared to those applicable to credit institutions).

The second Electronic Money Directive was transposed into national law by the law of 20 May 2011 which amends the law of 10 November 2009 on payment services accordingly. The new provisions create an autonomous regime for EMIs which are no longer considered as subcategory of credit institutions. The CSSF has been designated as the competent authority to supervise EMIs.

Following the entry into force of the second Electronic Money Directive, the electronic money is viewed from a wider perspective insofar as the definition given by the directive covers in principle all the situations where an issuer of electronic money issues a pre-paid stored value in exchange for funds. Electronic money is defined as a monetary value represented by a claim on the issuer, which is:

- stored electronically, including magnetically;
- issued upon receipt of funds for the purpose of making payment transactions; and
- accepted by a natural or legal person other than an electronic money institution.

Pursuant to Article 24-6 of the law of 10 November 2009, as amended, EMIs are entitled to carry out, in addition to the issuance of electronic money, each of the following activities:

- the provision of payment services listed in the annexe to the law;
- the credit granting subject to compliance with the provisions of Article 24-6(1)(b) of the law;
- the provision of operational services and ancillary services closely related to the issuance of electronic money or the provision of payment services;
- the management of payment systems;
- other commercial activities.

The above-mentioned law imposes authorisation, exercise and supervisory conditions on EMIs. The main prudential provisions applicable to EMIs may be summarised as follows:

- quantitative prudential standards, i.e. a minimum capital and capital requirements pursuant to Articles 24-11 and 24-12. The CSSF monitors the proper application and compliance with these quantitative standards on the basis of a specific reporting pursuant to Circular CSSF 11/522;
- rules for the protection of funds received in exchange for electronic money in accordance with the provisions of Article 24-10;
- guarantee of a sound and prudent management and the existence of a strong internal governance system;
- rules related to the fight against money laundering and terrorist financing.

As regards the two last indents, the rules are in principle those applicable to credit institutions and to investment firms but they will be applied to EMIs according to a proportionality principle which is based, among others, on the type of risks incurred.

The activities exercised by Luxembourg EMIs in another EU/EEA Member State through the establishment of a branch, through intermediaries or agents or by way of the free provision of services, are also subject to the prudential supervision of the CSSF.

Similarly to the payment institutions, EMIs are not entitled to carry out an activity of taking deposits or other repayable funds within the meaning of Article 2(3) of the law of 5 April 1993 on the financial sector.

## 2.2. Electronic money institutions authorised in Luxembourg

As at 31 December 2011, one electronic money institution, i.e. Amazon Payments Europe S.C.A. was listed in the public register of EMIs authorised in Luxembourg. It should nevertheless be noted that the main activity of the company PayPal (Europe) S.à r.l. et Cie, S.C.A. authorised as a credit institution in Luxembourg is the issuance of electronic money.

# SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT



# 1. EVOLUTION OF THE UCI SECTOR IN 2011

## 1.1. Major events in 2011

In Luxembourg, the undertakings for collective investment (UCIs) sector recorded a decrease of 4.7% in the net assets and a growth of 4.9% in the number of UCIs in 2011.

In 2011, problems linked to the Euro area and US sovereign debt as well as uncertainties relating to the world economic growth raised concerns among investors, which resulted in an increase of price volatility in financial assets markets. In view of these difficulties, central banks continued expansionary monetary policies throughout the year to stabilise the monetary and financial markets and to ensure adequate liquidity in these markets. The fiscal policy measures announced during the European summit of December 2011 in respect of the sovereign debt crisis in the Euro area also led to the stabilisation of short-term markets.

Faced with these uncertainties and more volatile markets, the investors' demand for UCI products shifted mainly towards diversified asset UCIs in 2011.

Thus, diversified UCIs experienced a positive capital inflow of EUR 21.7 billion. However, equity UCIs recorded net redemptions for EUR 28.4 billion and bond UCIs recorded net redemptions for EUR 11.8 billion.

As regards the development of financial markets at global level, the global equity index "MSCI WORLD Standard (Large + Mid Cap)" depreciated by 2.38% and the global bond index "JPMorgan GBI Global Traded Index Hedged Index Level Euro" increased by 6.90% in 2011.

A slightly positive net capital investment of EUR 5.3 billion (+0.2%) and a negative impact of the financial markets of EUR 107.8 billion (-4.9%) resulted in a general decrease in the net assets of Luxembourg UCIs of EUR 102.5 billion (-4.7%) in 2011.

At the end of 2011, the number of UCIs and specialised investment funds (SIFs) totalled to 3,845 compared to 3,667 at the end of the preceding year. In 2011, the number of SIFs grew by 182 entities.

Out of the 3,845 UCIs registered on the official list as at 31 December 2011, 48.63% were UCITS governed by Part I of the law of 17 December 2010 on undertakings for collective investment.

Eleven new management companies subject to Chapter 15 of the aforementioned law were established in Luxembourg in 2011, whereas eleven management companies ceased their activities in Luxembourg during the year, mainly due to restructuring.

As far as regulations are concerned, Directive 2009/65/EC of 13 July 2009 (UCITS IV Directive) entered into force on 1 July 2011. This Directive was transposed into Luxembourg law by the law of 17 December 2010 relating to undertakings for collective investment. In 2011, the CSSF published a certain number of circulars which clarify the provisions of the law concerning, *inter alia*, the rules applicable to management companies and investment companies which have not designated a management company, the new notification procedures to be observed by UCITS and the risk management procedures.

In May 2011, the Council of the EU approved the new European Directive 2011/61/EU on alternative investment fund managers (AIFM Directive). The Directive published on 1 July 2011 in the Official Journal of the EU aims to harmonise the regulatory framework with which the alternative investment fund managers must comply and introduces the European passport which will enable these managers to provide their management services and market their funds in all EU Member States. The Directive must be transposed into national law by 22 July 2013.

## 1.2. Evolution of the UCI sector

### 1.2.1. Evolution of the number of UCIs

As at 31 December 2011, 3,845 UCIs were registered on the official list against 3,667 UCIs at the end of the previous year, representing an increase of 178 entities (+4.9%). During the year, 469 new UCIs were registered and 291 entities were withdrawn from the official list.

**Evolution of the number of UCIs**

| | Number of UCIs | Registrations on the official list | Withdrawals from the list | Net variation | in % |
|---|---|---|---|---|---|
| 2001 | 1,908 | 299 | 176 | 123 | 6.9% |
| 2002 | 1,941 | 222 | 189 | 33 | 1.7% |
| 2003 | 1,870 | 175 | 246 | -71 | -3.7% |
| 2004 | 1,968 | 202 | 104 | 98 | 5.2% |
| 2005 | 2,060 | 266 | 174 | 92 | 4.7% |
| 2006 | 2,238 | 345 | 167 | 178 | 8.6% |
| 2007 | 2,868 | 824 | 194 | 630 | 28.2% |
| 2008 | 3,371 | 712 | 209 | 503 | 17.5% |
| 2009 | 3,463 | 408 | 316 | 92 | 2.7% |
| 2010 | 3,667 | 471 | 267 | 204 | 5.9% |
| 2011 | 3,845 | 469 | 291 | 178 | 4.9% |

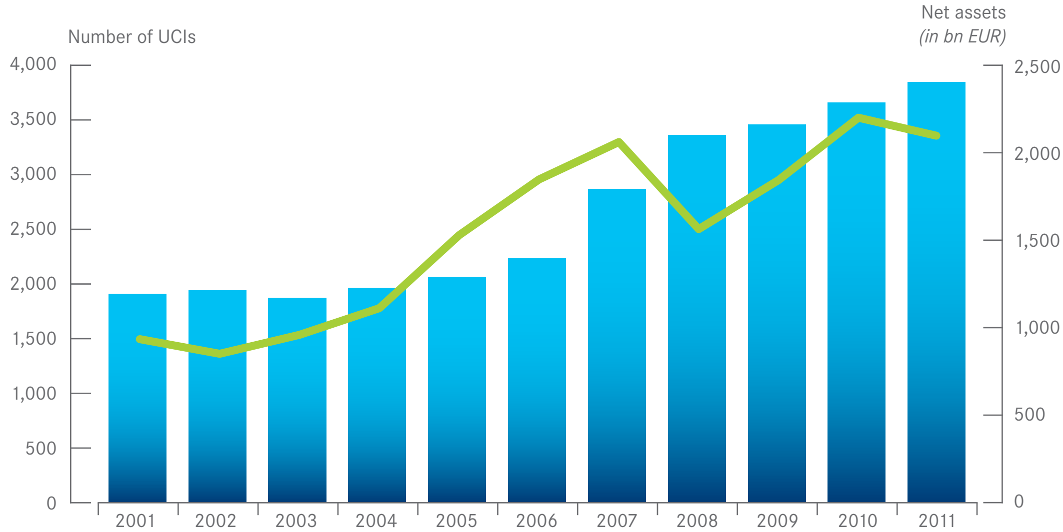
### 1.2.2. Evolution of the net assets of UCIs

The influx of new capital (EUR 5.3 billion) and the negative impact of the performance of the major financial stock markets (EUR -107.8 billion) resulted in an annual decrease in Luxembourg UCIs’ global assets of EUR 102.5 billion to EUR 2,096.5 billion as at 31 December 2011 (-4.7%).

**Evolution of UCI net assets - in billion EUR**

| | Net assets | Net subscriptions | Net asset variation | in % | Average net assets per UCI |
|---|---|---|---|---|---|
| 2001 | 928.4 | 121.7 | 53.8 | 6.2% | 0.487 |
| 2002 | 844.5 | 57.3 | -83.9 | -9.0% | 0.435 |
| 2003 | 953.3 | 82.6 | 108.8 | 12.9% | 0.510 |
| 2004 | 1,106,2 | 113.7 | 152.9 | 16.0% | 0.562 |
| 2005 | 1,525,2 | 236.3 | 419.0 | 37.9% | 0.740 |
| 2006 | 1,844,8 | 241.3 | 319.6 | 21.0% | 0.824 |
| 2007 | 2,059,4 | 188.5 | 214.6 | 11.6% | 0.718 |
| 2008 | 1,559,7 | -77.2 | -499.7 | -24.3% | 0.463 |
| 2009 | 1,841,0 | 84.4 | 281.3 | 18.0% | 0.532 |
| 2010 | 2,199,0 | 161.6 | 358.0 | 19.4% | 0.600 |
| 2011 | 2,096,5 | 5.3 | -102.5 | -4.7% | 0.545 |

**Evolution of the number and net assets of UCIs**




| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| UCIs | 1,908 | 1,941 | 1,870 | 1,968 | 2,060 | 2,238 | 2,868 | 3,371 | 3,463 | 3,667 | 3,845 |
| Net assets | 928.4 | 844.5 | 953.3 | 1,106.2 | 1,525.2 | 1,844.8 | 2,059.4 | 1,559.7 | 1,841.0 | 2,199.0 | 2,096.5 |

### 1.2.3. Evolution of the number of UCI entities[1]

As at 31 December 2011, 2,427 out of 3,845 UCIs had adopted an umbrella structure. Given that the number of operating sub-funds rose from 11,572 to 11,876 (+2.6%) and that of traditionally structured UCIs from 1,365 to 1,418 (+3.9%), the total number of economic entities went up from 12,937, as at 31 December 2010, to a record level of 13,294, as at 31 December 2011, i.e. an increase of 2.8%.

**Evolution of the number of UCI entities**

| | **Total number of UCIs** | of which traditionally structured UCIs | *as % of total* | of which umbrella funds | *as % of total* | Number of sub-funds | *Average number of sub-funds per umbrella fund* | **Total number of entities** | Variation in % |
|---|---|---|---|---|---|---|---|---|---|
| 2001 | 1,908 | 779 | *40.8%* | 1,129 | *59.2%* | 6,740 | *5.97* | 7,519 | 7.5% |
| 2002 | 1,941 | 751 | *38.7%* | 1,190 | *61.3%* | 7,055 | *5.93* | 7,806 | 3.8% |
| 2003 | 1,870 | 690 | *36.9%* | 1,180 | *63.1%* | 6,819 | *5.78* | 7,509 | -3.8% |
| 2004 | 1,968 | 742 | *37.7%* | 1,226 | *62.3%* | 7,134 | *5.82* | 7,876 | 4.9% |
| 2005 | 2,060 | 762 | *37.0%* | 1,298 | *63.0%* | 7,735 | *5.96* | 8,497 | 7.9% |
| 2006 | 2,238 | 851 | *38.0%* | 1,387 | *62.0%* | 8,622 | *6.22* | 9,473 | 11.5% |
| 2007 | 2,868 | 1,180 | *41.1%* | 1,688 | *58.9%* | 9,935 | *5.89* | 11,115 | 17.3% |
| 2008 | 3,371 | 1,352 | *40.1%* | 2,019 | *59.9%* | 10,973 | *5.43* | 12,325 | 10.9% |
| 2009 | 3,463 | 1,355 | *39.1%* | 2,108 | *60.9%* | 10,877 | *5.16* | 12,232 | -0.8% |
| 2010 | 3,667 | 1,365 | *37.2%* | 2,302 | *62.8%* | 11,572 | *5.03* | 12,937 | 5.8% |
| 2011 | 3,845 | 1,418 | *36.9%* | 2,427 | *63.1%* | 11,876 | *4.89* | 13,294 | 2.8% |

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

### 1.2.4. Evolution of the number of UCIs and of their net assets according to legal form and applicable law

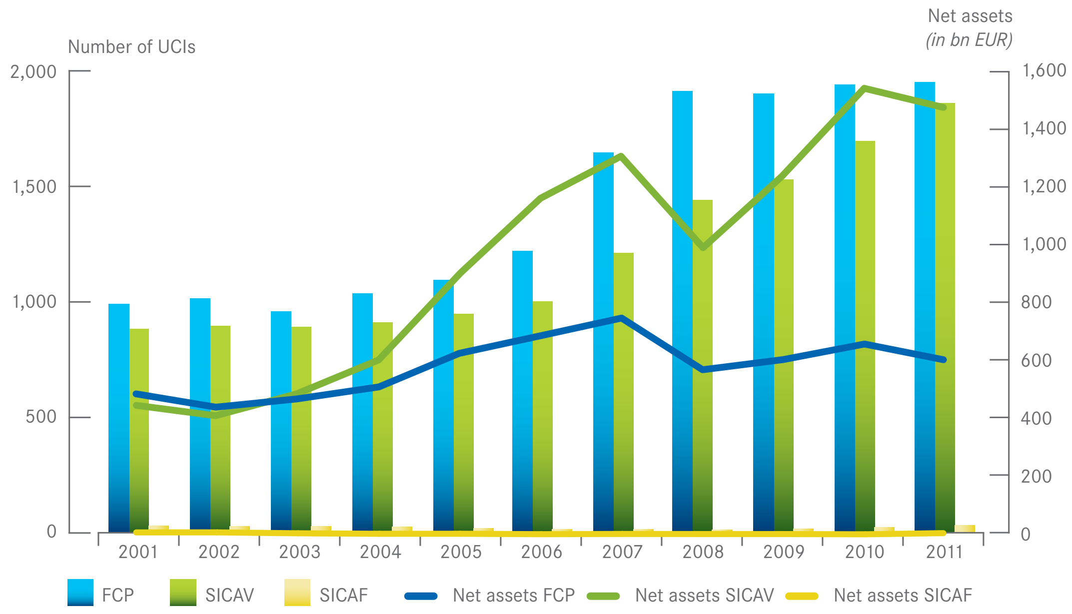
The breakdown of UCIs between *fonds communs de placement* (FCP), *sociétés d'investissement à capital variable* (SICAV) and *sociétés d'investissement à capital fixe* (SICAF) reveals that on 31 December 2011, FCPs were still the prevailing form with 1,948 entities out of a total of 3,845 active UCIs, against 1,864 entities operating as SICAVs and 33 as SICAFs. As regards the legal form of SICAFs, an upturn in terms of entities was noted for 2011.

**Breakdown of UCIs by legal form**

| | FCPs | | SICAVs | | SICAFs | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Number | Net assets *(in bn EUR)* | Number | Net assets *(in bn EUR)* | Number | Net assets *(in bn EUR)* | Number | Net assets *(in bn EUR)* |
| 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 |
| 2007 | 1,645 | 748.7 | 1,211 | 1,308.4 | 12 | 2.3 | 2,868 | 2,059.4 |
| 2008 | 1,910 | 567.2 | 1,443 | 990.9 | 18 | 1.6 | 3,371 | 1,559.7 |
| 2009 | 1,907 | 601.8 | 1,533 | 1,233.9 | 23 | 5.3 | 3,463 | 1,841.0 |
| 2010 | 1,944 | 652.2 | 1,701 | 1,540.1 | 22 | 6.7 | 3,667 | 2,199.0 |
| 2011 | 1,948 | 609.6 | 1,864 | 1,476.5 | 33 | 10.4 | 3,845 | 2,096.5 |

At the end of 2011, FCPs' net assets represented 29.1% of the total net assets of UCIs and SICAVs' net assets represented 70.4% of the total net assets of UCIs.

**Breakdown of UCIs and their net assets according to legal form**



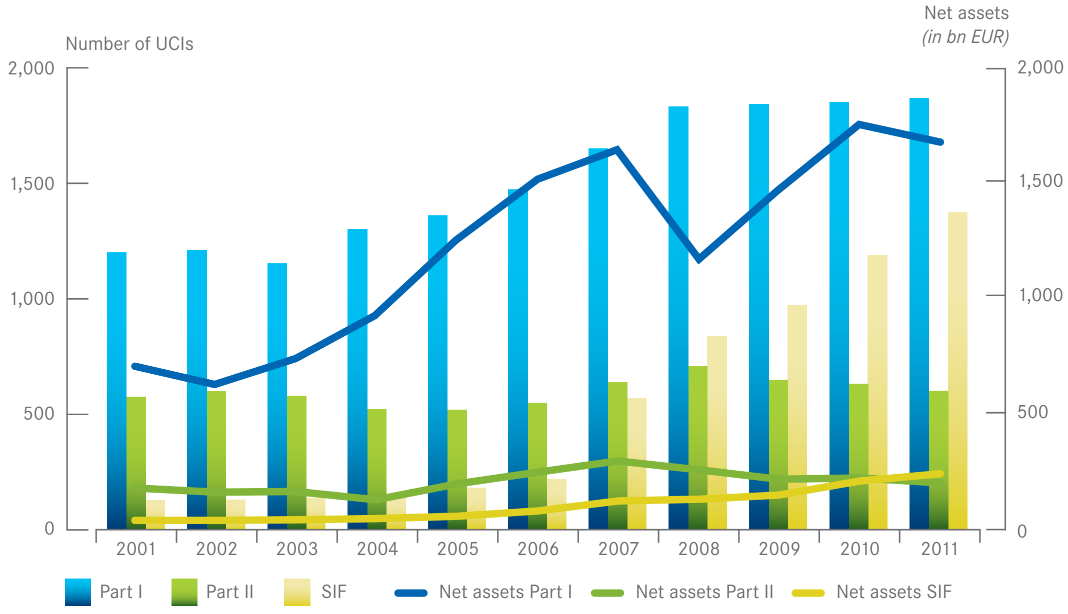
The following table illustrates the distribution of UCIs depending on whether they fall within the scope of Part I or II of the law of 17 December 2010 or the law of 13 February 2007 relating to specialised investment funds (SIFs).

**Breakdown of UCIs according to Parts I and II of the 2010 law and specialised investment funds**

| | Part I | | Part II | | SIFs | |
|---|---|---|---|---|---|---|
| | Number | Net assets *(in bn EUR)* | Number | Net assets *(in bn EUR)* | Number | Net assets *(in bn EUR)* |
| 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 |
| 2007 | 1,653 | 1,646.4 | 643 | 295.9 | 572 | 117.1 |
| 2008 | 1,826 | 1,169.4 | 708 | 259.8 | 837 | 130.5 |
| 2009 | 1,843 | 1,465.7 | 649 | 221.2 | 971 | 154.1 |
| 2010 | 1,846 | 1,762.7 | 629 | 222.2 | 1,192 | 214.1 |
| 2011 | 1,870 | 1,655.5 | 601 | 201.7 | 1,374 | 239.3 |

UCIs falling under Part I of the law of 17 December 2010 are those which comply with the provisions of the Community Directive on UCITS and which can therefore benefit from the marketing facilities provided therein. Part II encompasses all the other UCIs which solicit the public for the subscription of their units, whereas specialised investment funds are UCIs whose securities are reserved for well-informed investors according to the criteria set out in Article 2 of the law of 13 February 2007.

**Breakdown of UCIs according to Parts I and II of the 2010 law and specialised investment funds**



On 31 December 2011, 48.6% of UCIs registered on the official list were UCITS governed by Part I of the 2010 law and 15.6% were other UCIs governed by Part II (non-coordinated UCIs). Specialised investment funds represented 35.8% of the 3,845 Luxembourg UCIs. Net assets were distributed at the same date as follows: 79.0% for UCIs under Part I, 9.6% for UCIs under Part II and 11.4% for specialised investment funds.

The following table compares the evolution in 2011 of the number of UCIs and net assets according to both the legal form and applicable law.

**Evolution of the number of UCIs and their net assets according to legal form and applicable law**

| | 2010 | | | | 2011 | | | | Variation 2010/2011 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Number of UCIs** | FCPs | SICAVs | SICAFs | Total | FCPs | SICAVs | SICAFs | Total | FCPs | SICAVs | SICAFs | Total |
| Part I | 1,161 | 685 | 0 | 1,846 | 1,142 | 728 | 0 | 1,870 | 1.64% | 6.28% | 0.00% | 1.30% |
| Part II | 286 | 337 | 6 | 629 | 290 | 305 | 6 | 601 | 1.40% | -9.50% | 0.00% | -4.45% |
| SIFs | 497 | 679 | 16 | 1,192 | 516 | 831 | 27 | 1,374 | 3.82% | 22.39% | 68.75% | 15.27% |
| **Total** | **1,944** | **1,701** | **22** | **3,667** | **1,948** | **1,864** | **33** | **3,845** | **0.21%** | **9.58%** | **50.00%** | **4.85%** |
| **Net assets** *(in bn EUR)* | FCPs | SICAVs | SICAFs | Total | FCPs | SICAVs | SICAFs | Total | FCPs | SICAVs | SICAFs | Total |
| Part I | 472.60 | 1,290.06 | 0.00 | 1,762.66 | 427.52 | 1,227.99 | 0.00 | 1,655.51 | 9.54% | -4.81% | 0.00% | -6.08% |
| Part II | 83.67 | 137.53 | 0.98 | 222.18 | 79.39 | 121.37 | 0.92 | 201.67 | -5.12% | -11.75% | -6.61% | -9.23% |
| SIFs | 95.89 | 112.52 | 5.74 | 214.15 | 102.70 | 127.17 | 9.46 | 239.33 | 7.11% | 13.02% | 64.79% | 11.76% |
| **Total** | **652.16** | **1,540.11** | **6.72** | **2,198.99** | **609.61** | **1,476.52** | **10.38** | **2,096.51** | **-6.52%** | **-4.13%** | **54.36%** | **-4.66%** |

As regards Part I, an increase of 1.30% of the number of UCIs can be noted compared to 2010 and a decrease of 6.08% of the net assets, whereas the number of UCIs under Part II decreased by 4.45% and their net assets by 9.23%. However, the number of specialised investment funds increased by 15.27% and their net assets by 11.76%.

### 1.2.5. Net subscriptions

In 2011, UCIs under Part I of the 2010 law recorded significant net redemptions totalling EUR 11.693 billion. Similarly, UCIs under Part II of the 2010 law recorded net redemptions totalling EUR 12.074 billion. Net subscriptions in specialised investment funds amounted to EUR 29.051 billion.

**Breakdown of net subscriptions according to Parts I and II of the law and specialised investment funds**

| *(in million EUR)* | FCPs | SICAVs | SICAFs | Total |
|---|---|---|---|---|
| Part I | -25,909 | 14,216 | 0 | -11,693 |
| Part II | 632 | -12,694 | -12 | -12,074 |
| SIFs | 7,610 | 18,873 | 2,568 | 29,051 |
| **Total** | **-17,667** | **20,395** | **2,556** | **5,284** |

### 1.3. Valuation currencies used

As regards the valuation currencies used, most entities (8,934 out of a total of 13,294) were denominated in Euro, followed by those in US dollars (3,033) and those in Swiss francs (335). In terms of net assets, the entities denominated in Euro encompassed EUR 1,134.689 billion of a total of EUR 2,096.512 billion, ahead of entities expressed in US dollars (EUR 783.111 billion) and Swiss francs (EUR 47.696 billion).

### 1.4. UCIs' investment policy

The table below describes the evolution of the number of UCIs and net assets according to their investment policy. It should be noted that UCIs investing in other assets include UCIs investing in claims and currency transactions.

**Net assets and entities of UCIs according to their investment policy**

| | 2010 | | 2011 | | Variation in % | |
|---|---|---|---|---|---|---|
| | Number of entities | Net assets *(in bn EUR)* | Number of entities | Net assets *(in bn EUR)* | Number of entities | Net assets |
| Fixed-income transferable securities | 2,863 | 628.460 | 2,876 | 622.482 | 0.45% | -0.95% |
| Variable-yield transferable securities | 3,507 | 689.109 | 3,552 | 575.203 | 1.28% | -16.53% |
| Mixed transferable securities | 3,586 | 376.898 | 3,901 | 391.168 | 8.78% | 3.79% |
| Fund of funds | 2,010 | 160.702 | 2,034 | 145.500 | 1.19% | -9.46% |
| Money market instruments and other short-term securities | 359 | 284.851 | 326 | 296.049 | -9.19% | 3.93% |
| Cash | 140 | 7.840 | 96 | 8.236 | -31.43% | 5.05% |
| Real estate | 179 | 21.426 | 210 | 24.064 | 17.32% | 12.31% |
| Futures, options, warrants | 167 | 21.741 | 180 | 20.312 | 7.78% | -6.57% |
| Other assets | 126 | 7.967 | 119 | 13.498 | -5.56% | 69.42% |
| **Total** | **12,937** | **2,198.994** | **13,294** | **2,096.512** | **2.76%** | **-4.66%** |

Most UCI categories and in particular those investing in variable-yield transferable securities suffered from the general decline in equity markets. However, certain UCI categories, notably those investing in mixed transferable securities, in real estate and in other assets benefited from the contribution of new capital.

**Investment policy of UCIs according to Parts I and II of the 2010 law and specialised investment funds**

| Situation as at 31 December 2011 | Number of entities | Net assets *(in bn EUR)* | Net assets *(in %)* |
|---|---|---|---|
| **UCITS subject to Part I** | | | |
| Fixed-income transferable securities | 2,053 | 543.997 | 25.9% |
| Variable-yield transferable securities | 3,017 | 519.286 | 24.8% |
| Mixed transferable securities | 2,507 | 281.491 | 13.4% |
| Fund of funds | 697 | 44.955 | 2.1% |
| Money market instruments and other short-term securities | 222 | 254.787 | 12.2% |
| Cash | 35 | 2.316 | 0.1% |
| Futures and/or options | 57 | 7.537 | 0.4% |
| Other assets | 6 | 1.140 | 0.1% |
| **UCITS subject to Part II**[2] | | | |
| Fixed-income transferable securities | 286 | 30.043 | 1.4% |
| Variable-yield transferable securities | 150 | 16.806 | 0.8% |
| Mixed transferable securities | 470 | 34.012 | 1.6% |
| Fund of funds | 733 | 62.276 | 3.0% |
| Money market instruments and other short-term securities | 87 | 36.730 | 1.8% |
| Cash | 48 | 5.640 | 0.3% |
| **UCITS subject to Part II**[3] | | | |
| Non-listed transferable securities | 20 | 2.733 | 0.1% |
| Venture capital | 6 | 0.137 | 0.0% |
| **Other UCIs subject to Part II** | | | |
| Real estate | 27 | 3.139 | 0.2% |
| Futures and/or options | 65 | 9.172 | 0.4% |
| Other assets | 12 | 0.983 | 0.1% |
| **Specialised investment funds** | | | |
| Fixed-income transferable securities | 539 | 48.618 | 2.3% |
| Variable-yield transferable securities | 323 | 32.896 | 1.6% |
| Mixed transferable securities | 880 | 72.088 | 3.4% |
| Non-listed transferable securities | 70 | 6.775 | 0.3% |
| Fund of funds | 594 | 37.901 | 1.8% |
| Money market instruments and other short-term securities | 15 | 4.356 | 0.2% |
| Cash | 13 | 0.280 | 0.0% |
| Venture capital | 21 | 0.625 | 0.0% |
| Real estate | 183 | 20.925 | 1.0% |
| Futures and/or options | 58 | 3.603 | 0.2% |
| Other assets | 100 | 11.265 | 0.5% |
| **Total** | **13,294** | **2,096.512** | **100.0%** |

[2] UCITS excluded from Part I of the law of 17 December 2010, pursuant to Article 3, indents 1 to 3, i.e. UCITS closed for redemptions, not promoted in the EU or only sold to individuals in countries outside the EU.

[3] UCITS excluded from Part I of the law of 17 December 2010 pursuant to Article 3, indent 4, i.e. UCITS under one of the categories laid down by Circular CSSF 03/88 owing to their investment and loan policy.

The following table illustrates, per quarter, the flow of subscriptions and redemptions during 2011 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 - Other assets

*in million EUR*

| | 1st quarter 2011 | | | 2nd quarter 2011 | | | 3rd quarter 2011 | | | 4th quarter 2011 | | | Totals | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Pol. | subscr. | red. | n. iss. | subscr. | red. | n. iss. | subscr. | red. | n. iss. | subscr. | red. | n. iss. | subscr. | red. | n. iss. |
| 1 | 104,442 | 100,534 | 3,908 | 89,517 | 86,703 | 2,814 | 74,155 | 98,377 | -24,222 | 54,590 | 65,483 | -10,893 | 322,704 | 351,097 | -28,393 |
| 2 | 87,948 | 82,359 | 5,589 | 87,982 | 83,336 | 4,646 | 85,533 | 97,324 | -11,791 | 74,265 | 84,540 | -10,275 | 335,728 | 347,559 | -11,831 |
| 3 | 53,345 | 38,682 | 14,663 | 50,995 | 35,689 | 15,306 | 41,288 | 45,655 | -4,367 | 33,674 | 37,586 | -3,912 | 179,302 | 157,612 | 21,690 |
| 4 | 265,179 | 264,367 | 812 | 283,293 | 295,915 | -12,622 | 285,798 | 281,869 | 3,929 | 301,003 | 286,561 | 14,442 | 1,135,273 | 1,128,712 | 6,561 |
| 5 | 30,236 | 22,858 | 7,378 | 31,649 | 28,099 | 3,550 | 30,741 | 24,066 | 6,675 | 28,753 | 29,099 | -346 | 121,379 | 104,122 | 17,257 |
| **Total** | **541,150** | **508,800** | **32,350** | **543,436** | **529,742** | **13,694** | **517,515** | **547,291** | **-29,776** | **492,285** | **503,269** | **-10,984** | **2,094,386** | **2,089,102** | **5,284** |

## 1.5. Evolution of several specific categories of UCIs

### 1.5.1. Guarantee-type UCIs

Guarantee-type UCIs aim to offer investors some security given the fluctuations inherent in financial markets. According to the investment policy pursued by the funds concerned, the guarantee ensures that the investor is reimbursed a proportion of the invested capital 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 2011, the number of guarantee-type UCIs fell from 192 to 190 and the number of entities from 400 to 360. The net fall in entities is attributable to the launch of 31 new entities as well as to guarantees either expiring or not being extended for 71 entities.

As at 31 December 2011, the 360 entities were divided into 43 entities guaranteeing unitholders only a proportion of the capital commitment, 181 entities guaranteeing repayment in full of the capital commitment (money-back guarantee) and 136 entities offering their investors a return in addition to the initial subscription price.

In 2011, net assets of guarantee-type UCIs decreased by EUR 1.72 billion to EUR 40.27 billion, i.e. a decrease of 4.1%. It is also worth noting that guarantee-type UCIs set up by German promoters alone accounted for 91.2% of the total net assets of guarantee-type UCIs.

**Evolution of guarantee-type UCIs**

| | Number of UCIs | Number of economic entities | Net assets *(in bn EUR)* |
|---|---|---|---|
| 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 |
| 2007 | 154 | 360 | 43.73 |
| 2008 | 176 | 382 | 44.83 |
| 2009 | 194 | 409 | 45.83 |
| 2010 | 192 | 400 | 41.99 |
| 2011 | 190 | 360 | 40.27 |



### 1.5.2. Real estate UCIs

In 2011, net assets of UCIs principally investing in real estate increased by 12.3%. It should be noted that SIFs remain the preferred vehicles for real estate investments.

**Evolution of real estate UCIs**

| | Number of entities | of which active entities | of which Part II | of which SIFs | Net issues *(in bn EUR)* | Net assets *(in bn EUR)* |
|---|---|---|---|---|---|---|
| 2005 | 52 | 41 | 16 | 36 | 1.591 | 5.287 |
| 2006 | 76 | 64 | 22 | 54 | 2.653 | 8.057 |
| 2007 | 104 | 80 | 21 | 83 | 6.497 | 15.446 |
| 2008 | 137 | 111 | 16 | 121 | 7.126 | 20.926 |
| 2009 | 150 | 125 | 15 | 135 | 1.977 | 18.965 |
| 2010 | 179 | 149 | 13 | 166 | 0.042 | 21.426 |
| 2011 | 210 | 192 | 27 | 183 | 2.923 | 24.064 |

### 1.5.3. Sharia UCIs

The number of Sharia UCIs and entities remained stable during 2011. Their net assets nevertheless increased by 11.1%.

**Evolution of Sharia-compliant UCIs**

| | Number of Sharia entities | Net assets *(in mn EUR)* |
|---|---|---|
| 2005 | 7 | 74.5 |
| 2006 | 8 | 93.6 |
| 2007 | 9 | 202.2 |
| 2008 | 22 | 212.8 |
| 2009 | 23 | 308.3 |
| 2010 | 24 | 472.8 |
| 2011 | 24 | 525.3 |

### 1.5.4. Microfinance UCIs

The net assets of UCIs investing in microfinance increased in 2011, whereas their number has been slightly decreasing.

**Evolution of UCIs in the microfinance sector**

| | Number of microfinance entities | Net assets *(in mn EUR)* |
|---|---|---|
| 2005 | 3 | 104.8 |
| 2006 | 11 | 505.3 |
| 2007 | 15 | 771.1 |
| 2008 | 18 | 1,200.3 |
| 2009 | 29 | 1,675.7 |
| 2010 | 32 | 1,937.8 |
| 2011 | 30 | 2,429.7 |

## 1.6. Promoters of Luxembourg UCIs

The breakdown of Luxembourg UCIs according to the geographic origin of their promoters highlights the multitude of countries represented in the financial centre. Promoters of Luxembourg UCIs are spread over 60 countries.

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

**Origin of the promoters of Luxembourg UCIs**

| Situation as at 31 December 2011 | Net assets *(in bn EUR)* | in % | Number of UCIs | in % | Number of entities | in % |
|---|---|---|---|---|---|---|
| United States | 505.571 | 24.1% | 149 | 3.9% | 893 | 6.7% |
| Germany | 347.901 | 16.6% | 1,612 | 41.9% | 3,003 | 22.6% |
| Switzerland | 318.475 | 15.2% | 512 | 13.3% | 2,460 | 18.5% |
| Great Britain | 266.983 | 12.7% | 258 | 6.7% | 1,375 | 10.4% |
| Italy | 164.915 | 7.9% | 143 | 3.7% | 1,057 | 8.0% |
| France | 151.950 | 7.2% | 271 | 7.0% | 1,162 | 8.7% |
| Belgium | 111.616 | 5.3% | 172 | 4.5% | 1,353 | 10.2% |
| Netherlands | 43.113 | 2.1% | 55 | 1.4% | 198 | 1.5% |
| Luxembourg | 41.544 | 2.0% | 168 | 4.4% | 390 | 2.9% |
| Sweden | 35.037 | 1.7% | 110 | 2.9% | 284 | 2.1% |
| Others | 109.407 | 5.2% | 395 | 10.3% | 1,119 | 8.4% |
| **Total** | **2,096.512** | **100.0%** | **3,845** | **100.0%** | **13,294** | **100.0%** |

## 1.7. Notification procedure of Luxembourg UCITS

Since 1 July 2011, Luxembourg UCITS wishing to market their units in another EU Member State must comply with the notification procedure provided for in Directive 2009/65/EC of 13 July 2009. Notification is made directly between the supervisory authorities of the Member States on the basis of a file which the UCITS must submit to the supervisory authority of the home Member State.

In 2011, the CSSF received a total of 1,788 applications for notification. 825 applications have been transmitted to the authority of the host Member State, whereas the other applications had to be revised because they were incomplete and/or inaccurate as to the required format.



### Breakdown of the notifications accepted per EU/EEA Member State

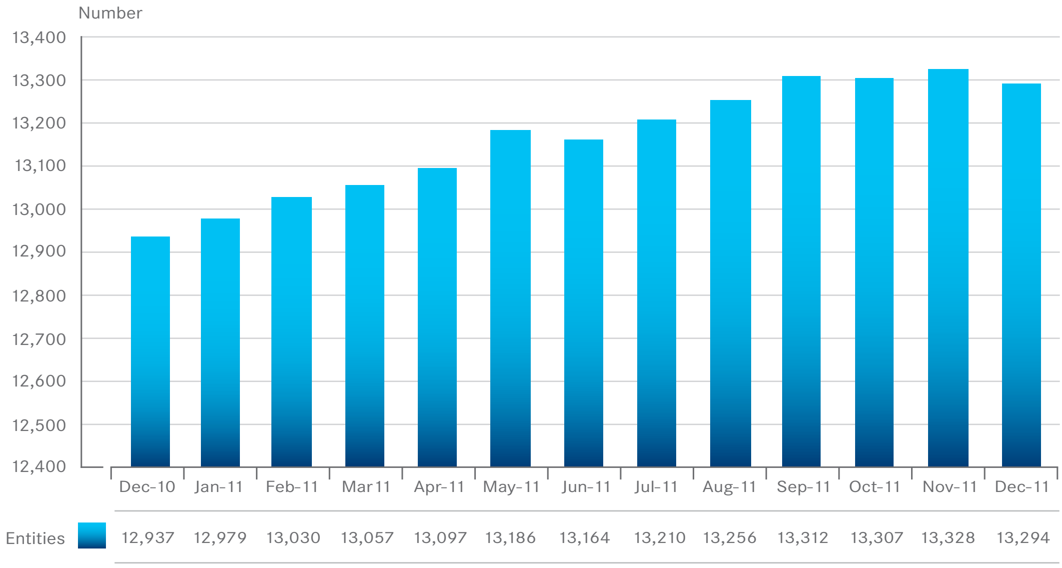
| Member State | Number |
|---|---|
| Germany | 114 |
| Italy | 90 |
| France | 74 |
| Austria | 64 |
| United Kingdom | 59 |
| Sweden | 43 |
| Finland | 38 |
| Norway | 37 |
| Belgium | 34 |
| Denmark | 28 |
| Netherlands | 27 |
| Portugal | 17 |
| Ireland | 16 |
| Spain | 12 |
| Czech Republic | 9 |
| Hungary | 8 |
| Liechtenstein | 8 |
| Estonia | 5 |
| Greece | 5 |
| Cyprus | 3 |
| Latvia | 3 |
| Poland | 3 |
| Iceland | 2 |
| Malta | 2 |
| Slovakia | 2 |
| Bulgaria | 1 |
| Lithuania | 1 |
| **Total** | **705** |

## 1.8. Evolution of UCI entities in 2011

### 1.8.1. General situation

In 2011, the number of entities grew, resulting in an increase of 357 entities by the end of the year.

**Monthly evolution of the number of entities**




### 1.8.2. Entities approved in 2011

In 2011, 2,158 new entities were authorised. In absolute terms, this figure represents a decrease of 204 entities compared to 2010, i.e. a decline of 8.6%. 1,292 out of the 2,158 entities approved in 2011, i.e. 59.9%, were launched in the same year.

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Newly approved entities | 2,119 | 2,878 | 3,361 | 1,999 | 2,362 | 2,158 |
| *of which launched in the same year* | *1,263* | *1,916* | *2,008* | *1,068* | *1,343* | *1,292* |
| In % | 59.6% | 66.6% | 59.7% | 53.4% | 56.9% | 59.9% |

The breakdown by investment policy shows that the proportion of entities investing in fixed-income transferable securities and the proportion of entities investing in variable-yield transferable securities increased slightly compared to 2010. However, the proportion of entities investing in mixed transferable securities decreased compared to 2010.

### Investment policy of entities approved in 2011

| Investment policy | 2010 | | 2011 | |
|---|---|---|---|---|
| | 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) | 455 | 19.26% | 472 | 21.87% |
| Variable-yield transferable securities | 464 | 19.65% | 483 | 22.38% |
| Mixed transferable securities | 944 | 39.97% | 686 | 31.79% |
| Fund of funds | 314 | 13.29% | 338 | 15.66% |
| Cash, money market instruments and other short-term securities | 48 | 2.03% | 35 | 1.62% |
| Futures, options, warrants (derivative instruments) | 53 | 2.24% | 46 | 2.13% |
| Real estate | 47 | 1.99% | 56 | 2.60% |
| Other assets | 37 | 1.57% | 42 | 1.95% |
| **Total** | **2,362** | **100.00%** | **2,158** | **100.00%** |

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### 1.8.3. Entities closed in 2011

In 2011, 1,401 entities were closed, which was more than in the previous year (+277 entities or +24.64%).

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|
| Liquidated entities | 426 | 412 | 424 | 752 | 968 | 633 | 747 |
| Matured entities | 70 | 45 | 83 | 84 | 92 | 111 | 143 |
| Merged entities | 202 | 223 | 282 | 485 | 482 | 380 | 511 |
| **Total** | **698** | **680** | **789** | **1,321** | **1,542** | **1,124** | **1,401** |

The breakdown by investment policy shows that the entities which had invested in fixed-income transferable securities account for the largest proportion of entities closed in 2011.

### Investment policy of entities closed in 2011

| Investment policy | 2010 | | 2011 | |
|---|---|---|---|---|
| | 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) | 252 | 22.42% | 379 | 27.05% |
| Variable-yield transferable securities | 321 | 28.56% | 348 | 24.84% |
| Mixed transferable securities | 244 | 21.71% | 308 | 21.98% |
| Fund of funds | 213 | 18.95% | 223 | 15.92% |
| Cash, money market instruments and other short-term securities | 68 | 6.05% | 78 | 5.57% |
| Futures, options, warrants (derivative instruments) | 11 | 0.98% | 19 | 1.36% |
| Real estate | 8 | 0.71% | 11 | 0.78% |
| Other assets | 7 | 0.62% | 35 | 2.50% |
| **Total** | **1,124** | **100.00%** | **1,401** | **100.00%** |

# 2. MANAGEMENT COMPANIES SET UP UNDER CHAPTER 15 OF THE LAW OF 17 DECEMBER 2010

## 2.1. Evolution in number

In 2011, five applications requesting approval as management companies in accordance with the provisions of Chapter 15 of the law of 17 December 2010 (against 14 applications in 2010) were submitted to the CSSF, consisting of:

- two projects for the creation of a new management company, and
- three projects for the transformation of a management company authorised under Chapter 16 of the law of 17 December 2010 into a management company authorised under Chapter 15 of the same law.

In 2011, eleven new entities were registered on the official list of management companies authorised under Chapter 15 of the 2010 law. Seven out of the eleven new authorisations were granted to entities which are establishing in Luxembourg for the first time. Moreover, all the new authorisations concerned entities whose corporate purpose is limited exclusively to collective management within the meaning of Article 101(2) of the 2010 law.

A majority of the eleven withdrawals in 2011 resulted from the restructuring or rationalisation of Luxembourg structures initiated by the promoters of the relevant management companies, the purpose being to create synergies.

As at 31 December 2011, the number of management companies approved in accordance with Chapter 15 of the 2010 law thus remained stable at 179 entities.

**Evolution of the number of management companies set up under Chapter 15 of the 2010 law registered on the official list**

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|
| Registrations | 23 | 47 | 80 | 31 | 13 | 9 | 7 | 11 |
| Withdrawals | / | 1 | 3 | / | 4 | 6 | 20 | 11 |
| **Total** | **26** | **72** | **149** | **180** | **189** | **192** | **179** | **179** |

In 2011, three management companies extended their corporate purpose to include discretionary management and/or investment advice. However, no management company ceased an activity relating to its extended corporate scope during the year.

**Evolution of the number of management companies whose authorisation covers, in addition to the activity of collective management, one or several services provided for in Article 101(3) of the 2010 law**

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|
| Registrations | 6 | 5 | 10 | 4 | 1 | / | 3 | 3 |
| Cessation of extended activities | / | / | / | 3 | 4 | 2 | 4 | / |
| **Total** | **8** | **13** | **23** | **24** | **21** | **19** | **18** | **21** |

## 2.2. Geographical origin

The year 2011 saw no major change to the geographic origin of management companies. As in the past, management companies of German and Swiss origin remain predominant in the Luxembourg market, followed by entities from Italy and France.

| Country | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|
| Andorra | / | / | / | / | 1 | 1 | 1 |
| Austria | / | / | / | / | 1 | 1 | 1 |
| Belgium | 4 | 5 | 7 | 8 | 6 | 8 | 8 |
| Bermuda | / | / | / | / | / | / | 1 |
| Canada | / | / | 1 | 1 | 1 | 1 | 2 |
| Denmark | 2 | 3 | 3 | 3 | 3 | 4 | 4 |
| Finland | / | / | / | / | 1 | 1 | 1 |
| France | 5 | 14 | 20 | 21 | 22 | 19 | 18 |
| Germany | 15 | 39 | 42 | 46 | 46 | 44 | 41 |
| Great Britain | 6 | 7 | 8 | 10 | 11 | 11 | 12 |
| Greece | / | 1 | 2 | 2 | 3 | 3 | 3 |
| Iceland | / | 1 | 1 | 1 | 1 | 1 | 1 |
| Italy | 8 | 17 | 19 | 20 | 21 | 22 | 21 |
| Japan | / | 1 | 1 | 1 | 1 | 1 | 1 |
| Liechtenstein | / | 1 | 1 | 1 | 1 | 1 | 1 |
| Luxembourg | 1 | 8 | 9 | 8 | 8 | 5 | 8 |
| Netherlands | 3 | 3 | 4 | 3 | 4 | 4 | 3 |
| Portugal | / | / | 2 | 2 | 2 | 2 | 2 |
| Republic of Mauritius | / | / | / | / | / | / | 1 |
| Russia | / | / | / | / | / | 1 | 1 |
| Spain | 1 | 2 | 3 | 3 | 3 | 3 | 3 |
| Sweden | 4 | 5 | 6 | 6 | 6 | 6 | 6 |
| Switzerland | 18 | 35 | 44 | 45 | 42 | 32 | 31 |
| United Arab Emirates | / | / | / | / | 1 | 1 | 1 |
| United States | 5 | 7 | 7 | 8 | 7 | 7 | 7 |
| **Total** | **72** | **149** | **180** | **189** | **192** | **179** | **179** |

## 2.3. Assets under management

As at 31 December 2011, the total net assets managed by management companies set up under Chapter 15 of the 2010 law amounted to EUR 1,472.3 billion, compared with EUR 1,526.0 billion in 2010, i.e. a decrease of 3.52%. Even if the UCI industry managed to register net issues for 2011, the net assets managed by management companies decreased due to difficult financial market conditions and the fall in stock prices. Management companies set up under Chapter 15 of the 2010 law managed 70.2% of the total net assets of EUR 2,096.5 billion invested as at 31 December 2011 in Luxembourg UCIs.

### Evolution of net assets under management in management companies - in billion EUR

| | 2007 | 2008 | 2009 | 2010 | 2011 | Variation 2010/2011 |
|---|---|---|---|---|---|---|
| Total net assets | 1,476.8 | 1,107.1 | 1,293.3 | 1,526.0 | 1,472.3 | -3.52% |
| of which: | | | | | | |
| *in "fonds communs de placement"* | *657.0* | *479.4* | *515.1* | *554.0* | *508.6* | *-8.20%* |
| *in investment companies* | *819.8* | *627.7* | *778.2* | *972.0* | *963.7* | *-0.85%* |

**Breakdown of management companies in terms of assets under management as at 31 December 2011**

| Assets under management | Number of management companies | | | | |
|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 |
| < 100 million EUR | 32 | 41 | 37 | 31 | 34 |
| 100 to 500 million EUR | 26 | 33 | 34 | 36 | 30 |
| 500 to 1,000 million EUR | 25 | 21 | 21 | 20 | 19 |
| 1 to 5 billion EUR | 40 | 49 | 51 | 41 | 48 |
| 5 to 10 billion EUR | 21 | 17 | 18 | 15 | 10 |
| 10 to 20 billion EUR | 15 | 13 | 14 | 12 | 14 |
| > 20 billion EUR | 21 | 15 | 17 | 24 | 24 |
| **Total** | **180** | **189** | **192** | **179** | **179** |

## 2.4. Evolution in employment

As at 31 December 2011, the total number of management company employees was 2,516 compared with 2,339 as at 31 December 2010, representing an increase of 177 employees (+7.6%). This positive development is the result of an overall trend in the recruitment strategy of management companies in order to comply with the new requirements of the UCITS IV Directive.

## 2.5. Aggregate balance sheet and profit and loss account

The total provisional balance sheet of management companies reached EUR 7.119 billion as at 31 December 2011, compared with EUR 7.260 billion as at 31 December 2010.

The aggregate provisional net profits amounted to EUR 1.610 billion as at 31 December 2011 against EUR 1.663 billion as at 31 December 2010. This decrease is mainly the result of increased general expenses.

It should be noted that 154 of the 179 management companies ended the financial year 2011 with a profit.

## 2.6. International expansion

### 2.6.1. Freedom of establishment

Nine management companies incorporated under Luxembourg law (four in 2010) introduced an application in 2011 in order to establish a branch abroad:

- Dexia Asset Management Luxembourg S.A. for Great Britain,
- Ethenea Independent Investors S.A. for Germany,
- Eurizon Capital S.A. for Hong Kong,
- JPMorgan Asset Management (Europe) S.à r.l. for Denmark,
- La Française AM International for Italy,
- LRI Invest S.A. for Germany,
- NGAM S.A. for Spain,
- Starcapital S.A. for Germany,
- Swisscanto Asset Management International S.A. for Germany and Italy.

No management company governed by Luxembourg law closed a branch abroad during 2011.

As at 31 December 2011, the following 17 management companies were represented in one or several countries abroad by means of a branch.

| Name of the management company | Branch |
|---|---|
| AllianceBernstein (Luxembourg) S.A. | Japan |
| Assenagon Asset Management S.A. | Germany |
| Berenberg Lux Invest S.A. | Germany |
| Casa4Funds S.A. | Switzerland |
| Dexia Asset Management Luxembourg S.A. | Germany<br>Italy<br>Netherlands<br>Spain<br>Switzerland |
| Ersel Gestion Internationale S.A. | Great Britain |
| Ethenea Independant Investors S.A. | Germany |
| Eurizon Capital S.A. | Singapore |
| JPMorgan Asset Management (Europe) S.à r.l. | Austria<br>Denmark<br>France<br>Germany<br>Greece<br>Italy<br>Netherlands<br>Spain<br>Sweden |
| La Française AM International | Italy |
| LRI Invest S.A. | Germany |
| Man Investments (Luxembourg) S.A. | Switzerland |
| NGAM S.A. | France<br>Germany<br>Italy<br>Netherlands<br>Spain<br>Sweden |
| Starcapital S.A. | Germany |
| Swiss & Global Asset Management (Luxembourg) S.A. | Great Britain<br>Spain |
| Swisscanto Asset Management International S.A. | Germany<br>Italy |
| Universal-Investment-Luxembourg S.A. | Germany |

No management company of another EU Member State established a branch in Luxembourg in 2011.

### 2.6.2. Freedom to provide services

One management company incorporated under Luxembourg law notified its intention to carry out activities in one or several EU Member States under the freedom to provide services in 2011. This notification concerned discretionary portfolio management and investment advice.

In 2011, the CSSF received 19 notifications for the free provision of services within the Luxembourg territory from management companies having their registered office in another EU Member State. A majority of these notifications were submitted by French management companies followed in equal number by German, British and Spanish management companies.

Five of these notifications were related to all functions included in the activity of collective portfolio management. These companies established in a Member State other than Luxembourg may thus act under the freedom to provide services as a management company of a Luxembourg UCITS. The services which were the subject of the other 14 notifications were divided equally between discretionary management, investment advice and marketing, followed by services relating to the portfolio management, safekeeping and administration of units of UCIs.

### 2.6.3. Representative offices

In 2011, three management companies governed by Luxembourg law opened representative offices abroad, i.e. MK Luxinvest S.A. in Austria, La Française AM International in Italy and Ethenea Independent Investors S.A. in Austria. During the third quarter of 2011, La Française AM International transformed its representative office into a branch.

Institutional Trust Management Company S.à r.l., however, closed its representative office in Italy.

# 3. EVOLUTION OF THE REGULATORY FRAMEWORK

## 3.1. CSSF Regulation No. 11-04

Regulation CSSF No. 11-04 amended Regulation CSSF No. 10-5 laying down the implementing measures of the law of 17 December 2010 concerning UCIs as regards certain provisions relating to fund mergers, master-feeder structures and the notification procedure.

## 3.2. Circular CSSF 11/498

Circular CSSF 11/498 was published in January 2011 within the context of the entry into force of the law of 17 December 2010 on UCIs and Regulations CSSF No. 10-4 and No. 10-5 laying down implementing measures relating thereto. It has as objective to provide information on the structure of the new law and to present its key innovations and implications.

## 3.3. Circular CSSF 11/508

Circular CSSF 11/508, published in April 2011, relates to the new provisions applicable to management companies governed by Luxembourg law which are subject to Chapter 15 of the law of 17 December 2010 concerning UCIs and investment companies which have not designated a management company within the meaning of Article 27 of the law of 17 December 2010.

It covers the transitional period applying to management companies which were governed by Chapter 13 of the law of 20 December 2002 relating to UCIs and investment companies which have not designated a management company in order to introduce the measures to be adopted and the documents to be drawn up by these companies to comply with the provisions of the new law of 17 December 2010.

## 3.4. Circular CSSF 11/509

Circular CSSF 11/509, published in April 2011, relates to the new notification procedures to be observed by a UCITS incorporated under Luxembourg law which intends to market its shares/units in another EU Member State and by an EU UCITS which intends to market its shares/units in Luxembourg.

Indeed, Directive 2009/65/EC of 13 July 2009 on the coordination of the laws, regulations and administrative provisions relating to certain undertakings for collective investment in transferable securities, transposed into Luxembourg legislation by the law of 17 December 2010 concerning UCIs, introduced, *inter alia*, a new notification procedure for UCITS which intend to market their units in a Member State other than that in which they are established. Circular CSSF 11/509 clarifies the practical and technical arrangements which UCITS must comply with for cross-border marketing.

In particular, as regards the number of notification files dealt with by the CSSF in 2011, reference shall be made to item 1.7. of this Chapter.



## 3.5. Circular CSSF 11/512

Circular CSSF 11/512 dated 30 May 2011 firstly aims to present the main regulatory changes in risk management following the publication of Regulation CSSF No. 10-4 and the issue by ESMA of various documents providing guidelines on risk management. These documents, one of which is the document entitled "CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS" published in July 2010 (ref.: CESR/10-788), accompany and specify the provisions of the CSSF Regulation relating to risk management and to the calculation of UCITS' global exposure and counterparty risk.

This Circular also provides additional clarification on certain rules regarding risk management, such as for instance the limitation of counterparty risk exposure, the limitation of the concentration risk or the transparency as regards risk in prospectuses or annual reports.

Finally, it specifies the content and format of the risk management procedure to be communicated to the CSSF. Indeed, management companies set up under Chapter 15 of the law of 17 December 2010 and investment companies which have not designated a management company within the meaning of Article 27 of this law are required to submit to the CSSF a risk management procedure complying with the new format as set out in the annexe of this Circular for the first time by 31 December 2011. An update is then to be transmitted to the CSSF at least once a year (as per closing date of the financial year of the management company, to be submitted at the latest one month after the annual closing).

# 4. PRUDENTIAL SUPERVISORY PRACTICE

## 4.1. Prudential supervision

### 4.1.1. Standards to be observed by UCIs

One of the fundamental duties of the CSSF in the supervision of UCIs is to ensure the 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.

### 4.1.2. Instruments of prudential supervision

The CSSF's permanent supervision aims to ensure that UCIs subject to its supervision observe all legal, 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 management letters issued by the *réviseur d'entreprises* (statutory auditor), which are to be communicated to the CSSF immediately,
- the analysis of statements made in accordance with the circular on the protection of investors in the case of a NAV (net asset value) calculation error and correction of the impacts of non-compliance with the investment rules applicable to UCIs,
- on-site inspections carried out by CSSF agents.

### 4.1.3. Means of control

**• Review of semi-annual and annual reports**

The review of semi-annual and annual reports carried out by the CSSF shows that these reports are generally drawn up in accordance with the applicable legal rules.

**• Review of financial information for the CSSF and STATEC**

In accordance with Circular IML 97/136 and pursuant to Article 147 of the law of 17 December 2010 and Article 58 of the law of 13 February 2007, the central administrations of Luxembourg UCIs must transmit financial information by electronic means to the CSSF, on a monthly (tables O1.1.) and yearly (tables O4.1. and O4.2.) basis. The deadline to transmit the monthly financial information is ten 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 closing date of the financial year and the communication time limit is four months for UCIs governed by the law of 17 December 2010 and six months for SIFs.

As far as monthly financial information is concerned, the CSSF considers that UCIs must, on the one hand, strictly observe the pre-defined deadline to submit table O1.1. and, on the other hand, pay due attention when preparing this table so as to ensure that the format and content are correct. For information, the format and content of about 14,700 files, representing nearly 40,500 types of units/shares, are controlled every month.

- **Meetings**

In 2011, 256 meetings were held between representatives of the CSSF and intermediaries of UCIs. These meetings concerned the presentation of new UCI projects, restructuring of UCIs and the application of the laws and regulations pertaining to UCIs.

## 4.2. Review of the updates of the application files required by Circular CSSF 11/508

### 4.2.1. Context

Circular CSSF 11/508 of 15 April 2011 on the new provisions applicable to management companies governed by Luxembourg law subject to Chapter 15 of the law of 17 December 2010 (hereinafter the "management companies") and investment companies which have not designated a management company within the meaning of Article 27 of the law of 17 December 2010 (hereinafter the "SIAGs") required that management companies and SIAGs submit, until 1 June 2011 at the latest, an update of the application file to be completed with the new elements required by the law of 17 December 2010 and the Regulation CSSF No. 10-4. The annexe of the Circular specifies the additional documents and minimum information to be submitted to the CSSF in this respect.

These additional elements include, *inter alia*, the risk management procedure taking into account both the information required under section V of Circular CSSF 07/308 (repealed since 1 January 2012) but also the requirements of Articles 42 to 50 of Regulation CSSF No. 10-4 and ESMA's guidelines.

By way of example, the new risk management procedure to be established by management companies and SIAGs must provide further details on the existence and operation of the risk management policy as provided for in Article 43 of Regulation CSSF No. 10-4. In particular, a description of how the liquidity and operational risks are managed is required. In respect of the guidelines of ESMA, it is worth mentioning the document entitled "CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS" (ref.: CESR/10-788, July 2010) which accompanies the measures provided for in Regulation CSSF No. 10-4 by dictating a certain number of principles mainly linked to the global exposure and counterparty risk calculation.

### 4.2.2. Examination of application files by the CSSF

Between June and December 2011, the CSSF examined the files submitted by management companies and SIAGs. Within this context, comments were transmitted by mail or by telephone to the relevant participants.

### 4.2.3. Main findings within the context of the examination of the application files

Whilst the files introduced are deemed to be generally satisfactory, some shortcomings in meeting the requirements were however identified. These concern in particular the risk management procedure.

- **Omission of certain subjects**

Whilst the information required under section V of Circular CSSF 07/308 was in general included in the documents, the risk management procedures linked to the new requirements (in particular liquidity risk and operational risks) have not always been described.

- **Insufficient accuracy as regards the organisation of the risk management**

Where the risk management procedure is based on roles played by various participants (particularly in the case of delegation of the risk management function), the CSSF deemed it indispensable that the allocation of responsibilities and the relationships between the various participants are more clearly explained.

- **Lack of documentation on the due diligence assessments carried out in the event of risk management delegation**

These initial and ongoing assessments are important where the risk management function is delegated, in whole or in part, to one or several specialised third parties. Pursuant to Article 26 of Regulation CSSF No. 10-4, ongoing quality assessment methods of services provided by third parties must be established.

It should be noted that the format defined in the annexe of Circular CSSF 11/512, on which the risk management procedure shall be based no later than 31 December 2011 will help to alleviate these documentation problems.

## 4.3. *Ad hoc* surveys

During 2011, the CSSF carried out various *ad hoc* surveys, on the one hand within the context of the macroprudential supervision of UCIs, and on the other hand to meet specific information requests from ESMA.

Thus, within the context of the sovereign debt crisis in the Euro area, the CSSF carried out a first internal analysis, at the beginning of 2011, in order to determine the extent of the risks incurred by UCIs governed by Luxembourg law. This analysis was then supplemented by the organisation of meetings with various participants in August 2011 and by the evaluation of a detailed questionnaire sent to certain UCIs at the end of August 2011. These initiatives revealed that exposures of UCIs governed by Luxembourg law to issuers of countries which are the most affected by the sovereign debt crisis primarily concerned Italy, and more specifically the State sector, followed by Spain where exposures related mostly to sectors other than the State and banking sectors. However, exposures to Ireland, Portugal and Greece were relatively limited.

The sovereign debt crisis remains a matter of serious concern for the CSSF which will continue to closely monitor the developments in the financial markets. In this respect, the CSSF will maintain regular contact with some participants in the financial centre.

In April 2011, the CSSF further requested UCITS governed by Luxembourg law to fill in a questionnaire on behalf of ESMA to identify the UCITS pursuing alternative strategies and those investing principally in commodities, structured/securitised products or derivative financial instruments which do not relate to shares, bonds or interest rates.

Finally, at the request of ESMA and on the basis of a questionnaire sent to the relevant UCIs in December 2010, the CSSF carried out a quantitative analysis in 2011 of UCIs which are likely to fall within the scope of the AIFM Directive.

## 4.4. Risk management framework in compliance with the UCITS IV Directive

### 4.4.1. Regular reports to be established by the risk management function

Circular CSSF 11/508 provides under Section II.7. that the regular reports to be established by the risk management function must be submitted at least once a year to the CSSF.

In this respect, Section 1.6 of the annexe of Circular CSSF 11/512 specifically requires that a copy of the report regularly established by the permanent risk management function for its senior management, the board of directors and the supervisory function (if any) and relating to the adequacy and effectiveness of the method for risk management shall be attached to the risk management procedure to be transmitted to the CSSF.

### 4.4.2. Agreements with third parties in respect of the exercise of risk management activities

The CSSF wishes first of all to state that as regards risk management, the agreements with third parties are notably governed by Section II.7. of Circular CSSF 11/508, Article 26(4) of Regulation CSSF No. 10-4, Section III.3. of Circular 11/512 and Box 4 of ESMA's document entitled "Risk Management Principles for UCITS" (ref.: CESR/09-178).

Furthermore, the CSSF considers that the due diligence procedure which has to be carried out on the skills and abilities of third parties, as well as its documentation, are particularly important within the context of Luxembourg UCITS.

The CSSF expects that the scope of this analysis covers both organisational aspects (for instance organisation, procedures, controls) and technical aspects (for instance methods, systems), that the level of detail of these analyses will be high and that appropriate measures will be taken in order to ensure an ongoing quality control of the delegated service provision.

Consequently, Section 1.9 of the risk management procedure relating to these agreements must be extensively detailed.

### 4.4.3. Transparency regarding leverage



Box 24 (further specified in items 76 and 77 of the explanatory text) of ESMA's guidelines ("CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS", ref.: CESR/10-788, July 2010) provides that UCITS include in their prospectus the expected level of leverage and the possibility of higher leverage levels (for UCITS with a VaR approach).

In this respect, the CSSF specified in Circular CSSF 11/512 that the commitment approach may be used to determine the leverage effect to be mentioned in the prospectus.

As not all EU Member States have adopted that same approach, the harmonisation of rules could result in the ruling out of this possibility. The UCITS will then, in any event, have to use the method including the sum of the notional amounts of derivative instruments which is, where appropriate, supplemented by a leverage determined on the basis of the commitment approach.

The CSSF is aware that this subject is of paramount importance to UCITS and will communicate, where necessary, in the appropriate manner, any change in its position.

Furthermore, the CSSF noticed that the use by UCITS of certain specific strategies or certain financial derivative instruments could result in high leverage levels. In such cases, the prospectuses must include information and explanations on the reasons and impacts, in terms of risks for investors, of these high leverage levels.

Moreover, the CSSF expects that analyses of risk levels are performed in order to make sure that these leverage levels are consistent with the VaR limits and that the stress tests yield acceptable results.

### 4.4.4. Limitation of the global exposure

Pursuant to Article 46(3) of Regulation CSSF No. 10-4 and item 2 of Box 1 of ESMA's guidelines ("CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS"), the global exposure must be calculated according to the method used for the calculation of the commitment, the method used for the calculation of the VaR or any other suitable advanced risk measurement methodology, insofar as it is provided for by ESMA's guidelines.

Within this context, Article 46(2) of the CSSF Regulation and item 1 of Box 1 of ESMA's guidelines provide that the global exposure must be calculated at least once a year regardless of the frequency of publication of the NAV. This calculation includes, *inter alia*, the recognition of all positions in financial instruments generating a leverage effect (for sub-funds using the commitment approach) and giving rise to a market risk, respectively (for sub-funds using the VaR approach) in accordance with the provisions of the CSSF Regulation and ESMA's guidelines.

Moreover, it is important to remember that, pursuant to item 1 of Box 1 of ESMA's guidelines, the global exposure limit must be observed at all times.

Consequently, and notwithstanding the frequency of publication of the NAV, the CSSF considers that the NAV must thus be calculated on a daily basis:

- for UCITS using the commitment approach if there is any doubt as to whether the limit on the global exposure referred to in Article 42(3) of the 2010 law has been exceeded, and
- for all UCITS using the VaR approach to calculate the global exposure, knowing that the daily calculation of the global exposure implies, in any case, a reassessment of risk factors linked to all portfolio positions of the sub-fund.

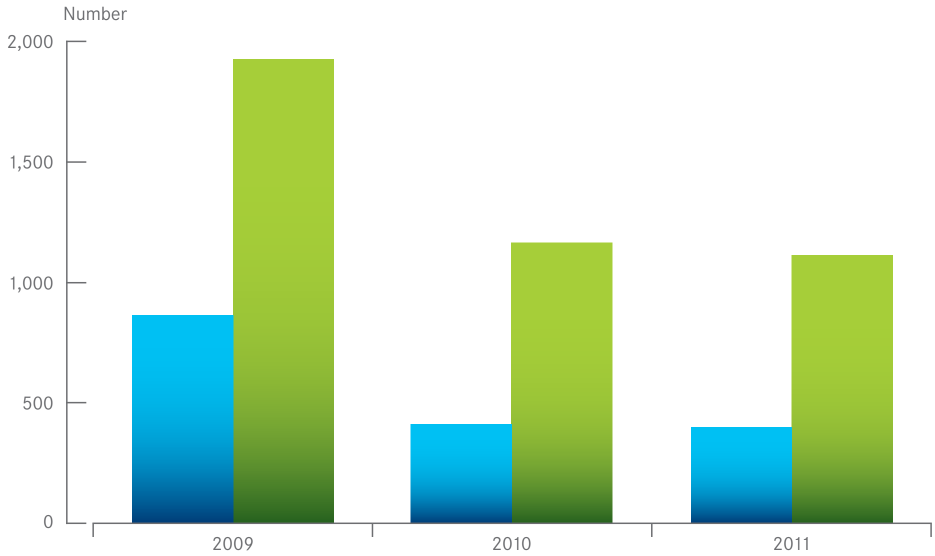
## 4.5. Circular CSSF 02/77 on the protection of investors in case of NAV calculation error and correction of the impacts of non-compliance with investment rules

### 4.5.1. Declarations made in 2011 on the basis of Circular CSSF 02/77

In 2011, the CSSF received 1,519 declarations on the basis of Circular CSSF 02/77, compared with 1,570 declarations in 2010, representing a decrease of 3.2%.

Among these declarations, 401 cases (411 in 2010) concerned NAV calculation errors and 1,118 cases (1,159 in 2010) concerned non-compliance with investment rules.

**Evolution of the number of NAV calculation errors and cases of non-compliance with investment rules notified to the CSSF over the last three years**




| | 2009 | 2010 | 2011 |
|---|---|---|---|
| NAV calculation errors | 858 | 411 | 401 |
| Non-compliance with investment rules | 1,929 | 1,159 | 1,118 |

In 2011, the number of NAV calculation errors remained practically identical to the number observed in 2010. In respect of the number of cases of non-compliance with the investment rules, a slight decrease of 3.5% was noted as compared to the previous year.

In the 2010 Annual Report of the CSSF, it was observed that the significant decrease of the figures of 2010 compared to those of 2009 was in part the result of the deployment of more efficient means of control in respect of the administrative organisation of the main participants in the central administration. The fact that the 2011 figures remained at the same level as those of 2010, or even saw a slight decrease, shows that these investments resulted in the strengthening of the administrative structures in Luxembourg with respect to these controls.

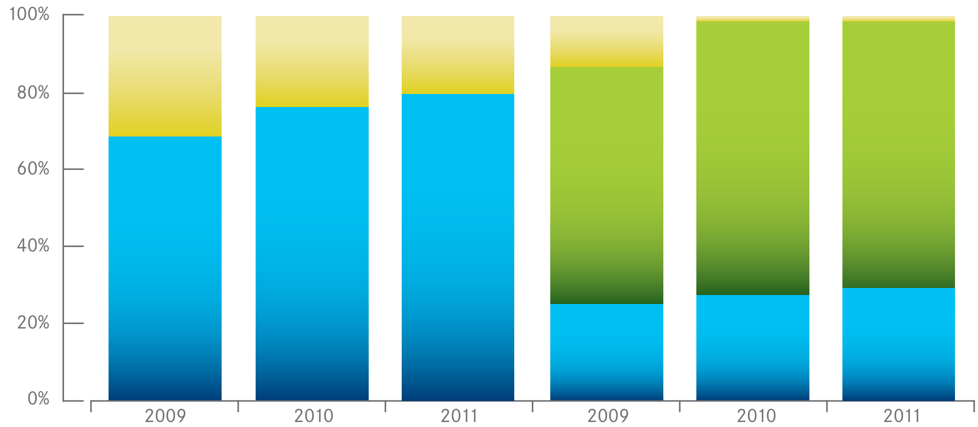
As regards more particularly the reports of NAV calculation errors received in 2011, 35 cases among the reports for which the normal procedure is applicable could not be closed on 31 December 2011. This is due to the fact that the CSSF is either still awaiting further information, or confirmations from the *réviseur d'entreprises* as provided for in Circular CSSF 02/77.

In 2011, 322 cases out of 401 NAV calculation errors (314 cases out of 411 cases in 2010) applied the simplified procedure insofar as the compensation amounts did not exceed EUR 25,000 and the amounts to be reimbursed to an investor did not exceed EUR 2,500. 321 cases out of 1,118 cases of non-compliance with the investment rules (321 cases out of 1,159 cases in 2009) also applied this procedure.

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 as well as the instances of non-compliance with investment rules that were resolved without harming either the investors or the UCIs.

05

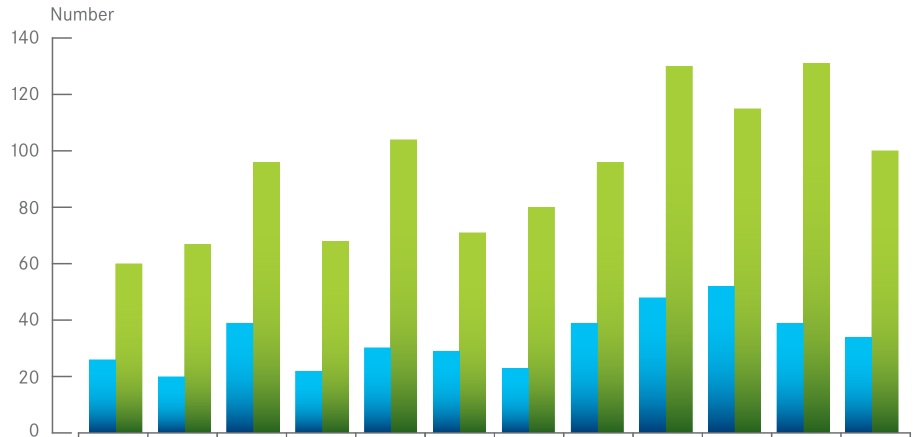
**Simplified procedure**




| | NAV calculation errors 2009 | NAV calculation errors 2010 | NAV calculation errors 2011 | Non-compliance with investment rules 2009 | Non-compliance with investment rules 2010 | Non-compliance with investment rules 2011 |
|---|---|---|---|---|---|---|
| Normal procedure | 31% | 24% | 20% | 13% | 2% | 2% |
| Non-compliance without prejudice | - | - | | 61% | 71% | 69% |
| Simplifed procedure | 69% | 76% | 80% | 25% | 28% | 29% |

The following graph sets out in detail the declarations made during 2011.

**Monthly evolution of the errors and instances of non-compliance reported in 2011**

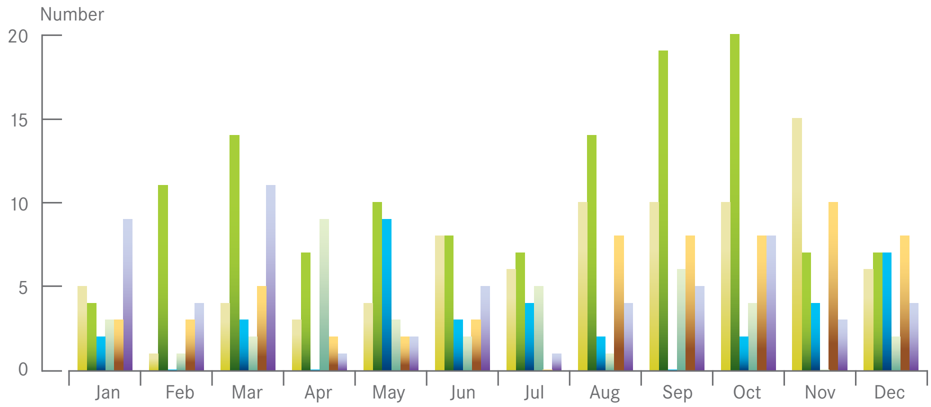



| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| NAV calculation errors | 26 | 20 | 39 | 22 | 30 | 29 | 23 | 39 | 48 | 52 | 39 | 34 |
| Non-compliance with investment rules | 60 | 67 | 96 | 68 | 104 | 71 | 80 | 96 | 130 | 115 | 131 | 100 |

The origin of NAV calculation errors can be divided into five categories: pricing errors, booking errors, errors in the calculation of costs and accruals, errors in the valuation of swaps and futures or other errors.

The following graph plots the different causes of NAV calculation errors recorded in 2011.

**Evolution of the origin of NAV calculation errors in 2011**




| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Pricing errors | 5 | 1 | 4 | 3 | 4 | 8 | 6 | 10 | 10 | 10 | 15 | 6 |
| Booking errors | 4 | 11 | 14 | 7 | 10 | 8 | 7 | 14 | 19 | 20 | 7 | 7 |
| Calculation errors in costs and accruals | 2 | 0 | 3 | 0 | 9 | 3 | 4 | 2 | 0 | 2 | 4 | 7 |
| Errors on corporate actions | 3 | 1 | 2 | 9 | 3 | 2 | 5 | 1 | 6 | 4 | 0 | 2 |
| Swaps/Futures valuation errors | 3 | 3 | 5 | 2 | 2 | 3 | 0 | 8 | 8 | 8 | 10 | 8 |
| Others | 9 | 4 | 11 | 1 | 2 | 5 | 1 | 4 | 5 | 8 | 3 | 4 |

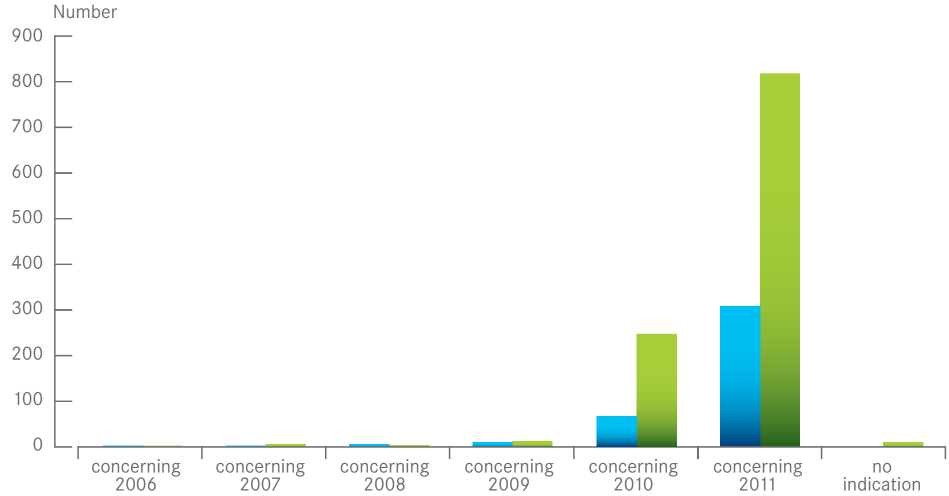
During the relevant period, NAV calculation errors were mainly due to booking errors (32%), pricing errors (20%) and errors in the valuation of swaps/futures (15%).

The following table shows the development of NAV calculation errors from 2009 and highlights that over the past three years, booking errors and errors in the valuation of securities held by UCIs were the main causes of NAV calculation errors.

**Evolution of the origin of NAV calculation errors over the last three years**

It should be noted that the reports received during 2011 do not only relate to errors and instances of non-compliance which actually occurred in 2011. They may in fact relate to errors or instances of non-compliance which were detected in 2011, but which occurred in a previous period. The following graph highlights this effect of timing difference.

**Declarations submitted in 2011**




| | concerning 2006 | concerning 2007 | concerning 2008 | concerning 2009 | concerning 2010 | concerning 2011 | no indication |
|---|---|---|---|---|---|---|---|
| NAV calculation errors | 1 | 1 | 5 | 10 | 69 | 315 | - |
| Non-compliance with investment rules | 1 | 5 | 2 | 13 | 253 | 834 | 10 |

### 4.5.2. Compensation paid following correction of NAV errors or instances of non-compliance with investment rules

The table below sets out the detailed compensation amounts notified in 2010 and 2011. It should be noted that the table is based on data available to the CSSF as at 31 December 2010 and 31 December 2011, at which point the compensation amounts for certain cases had not yet been submitted.

**Compensation paid following NAV calculation errors**

| | Investors | | UCI/Sub-fund | |
|---|---|---|---|---|
| | **2010** | **2011** | **2010** | **2011** |
| EUR | 4,454,281.57 | 1,917,412.78 | 4,722,415.83 | 2,222,576.33 |
| USD | 3,016,300.69 | 4,024,282.23 | 2,043,269.83 | 3,543,844.82 |
| GBP | 789.00 | 1,888,702.41 | 22,850.00 | 237,222.53 |
| CHF | 0.00 | 32,453.64 | 150.00 | 28,822.17 |
| Other currencies (in EUR) * | 4,288,034.31 | 52,684.11 | 2,058,074.22 | 54,967.68 |
| **Total (in EUR**)** | **11,000,604.70** | **7,368,096.91** | **8,336,321.30** | **5,324,137.21** |

* converted in EUR at the exchange rate applicable on 31 December 2010 and 31 December 2011, respectively.

** exchange rate as at 31 December 2010 and 31 December 2011, respectively.

**Compensation paid following non-compliance with investment rules**

| | Investors | | UCI/Sub-fund | |
|---|---|---|---|---|
| | **2010** | **2011** | **2010** | **2011** |
| EUR | 622,420.92 | 177,382.19 | 1,044,687.54 | 748,017.57 |
| USD | 1,641,019.79 | 154,276.13 | 349,885.80 | 1,930,429.27 |
| GBP | 0.00 | 0.00 | 3,009,335.78 | 76,534.61 |
| CHF | 0.00 | 0.00 | 6,343.39 | 293.77 |
| Other currencies (in EUR) * | 0.00 | 0.00 | 9,342.46 | 19,640.53 |
| **Total (in EUR**)** | **1,850,545.30** | **296,615.62** | **4,817,133.11** | **2,351,471.32** |

* converted in EUR at the exchange rate applicable on 31 December 2010 and 31 December 2011, respectively.

** exchange rate as at 31 December 2010 and 31 December 2011, respectively.

As regards the NAV calculation errors, an overall decrease is recorded for the compensation amounts paid out in the context of the 2011 declarations as compared to those of 2010.

A comparable decrease is observed for the compensation amounts relating to cases of non-compliance with investment rules. It partly reflects the decrease, compared to previous years, in the number of files with high compensation amounts.

## 4.6. Management letters

Chapter P of Circular IML 91/75 of 21 January 1991 states that UCIs must communicate immediately, and on their own initiative, to the CSSF the management letters issued by the *réviseur d'entreprises* in the context of the audits which the latter is obliged to undertake pursuant to Article 113 of the 2010 law.

The analysis of the management letters is based on the financial year 2010 insofar as most UCIs close their financial year on 31 December which implies that most management letters received in 2011 relates to the financial year 2010.

As in the previous years, 79% of the management letters relating to the financial year 2010 are letters in which the *réviseur d'entreprises* has not detected any irregularities in the management of the UCIs and 20% are management letters in which the *réviseurs d'entreprises* detected different types of irregularities. One percent of the management letters have not yet been submitted.

Moreover, the CSSF requires that each SIF also transmits the management letter issued by the *réviseur d'entreprises*. For SIFs, 78% of the management letters relating to the financial year 2010 are management letters in which the *réviseur d'entreprises* has not detected any irregularities and 17% of the management letters include comments. Five percent of the management letters have not yet been submitted.

The examination of management letters with recommendations shows that the irregularities reported by the *réviseur d'entreprises* can be broken down into four large categories: breaches of statutory or regulatory limits, NAV calculation errors, instances of non-compliance with investment policy and other problems in the organisation of UCIs.

### 4.7. Long form reports

Circular CSSF 02/81 of 6 December 2002 sets out the rules concerning the scope of the audit of the annual financial statements and the content of the long form reports to be drawn up pursuant to the law on UCIs. This Circular, which applies to all Luxembourg UCIs, considers that in practice, the role and functions of the *réviseur d'entreprises* constitute 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 *réviseur d'entreprises* in the course of its audit concerning the financial and organisational aspects of the UCI comprising, *inter alia*, its relationship with the central administration, depositary bank and other intermediaries (investment managers, transfer agents, distributors, etc.).

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

*Agents hired in 2011 and 2012: Department "Supervision of undertakings for collective investment"*

Left to right: Marc DONDLINGER, Géraldine BOUVY, Michael BAUST, Mireia CAMARASA, Anne-Christine DEPIENNE, Bruno DAWANCE, Serge BESCHE, Melania DINESCU, Laurence DUJIC, Patrick DA SILVA RODRIGUES

# SUPERVISION OF SICARS



## 1. DEVELOPMENTS OF SICARS IN 2011

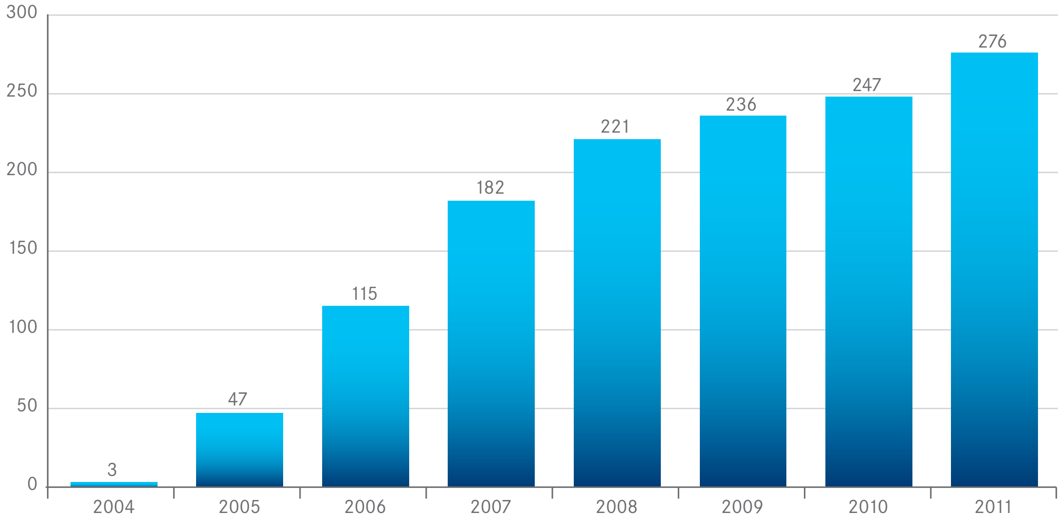
In 2011, the CSSF received 46 files from SICARs applying for registration on the CSSF's official list of SICARs, i.e. a slight increase compared to 2010 (42 files). 19 out of the 46 applications for registration related to umbrella SICARs, compared to only eight out of 42 applications in 2010. 16 files have been withdrawn, at the initiators' request, during the scrutiny process.

In 2011, 43 SICARs have been authorised, including 13 umbrella SICARs. 14 SICARs have been withdrawn from the official list for the following reasons: two SICARs abandoned their SICAR status and twelve opted for voluntary liquidation.

The number of SICARs registered on the CSSF's official list thus rose from 247 as at 31 December 2010 to 276 as at 31 December 2011. 42 out of the 276 SICARs were umbrella SICARs and totalled 67 compartments.

It should be noted that around thirty application files are still under review.

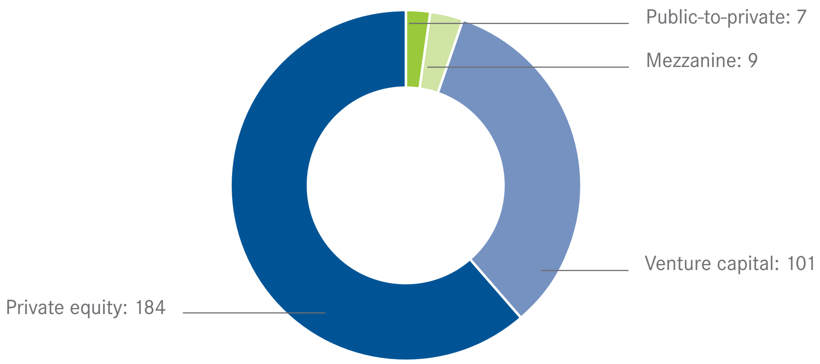
**Development in the number of SICARs**




The following statistical information is based on data available from the 234 traditional SICARs and 67 compartments of the 42 umbrella SICARs, defined hereafter as "entities".

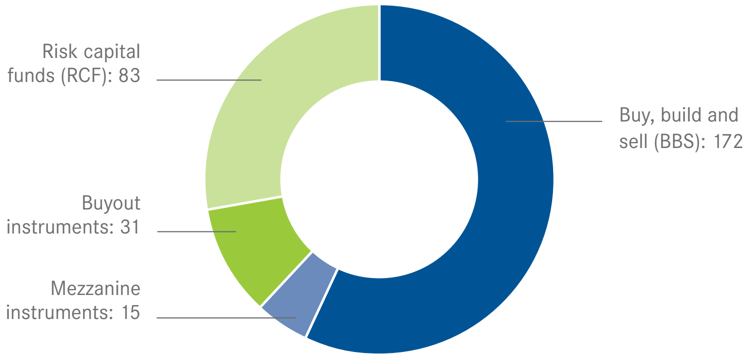
As far as the entities' investment policy is concerned, the following graph reveals a preference - in terms of entities - for private equity, even though net assets of these entities decreased by 7.76% compared to 2010. Venture capital ranks second, with net assets which rose by 2.25%.

**Investment policy - in entities**



Investment strategies inherent in the entities may be broken down into four main types: buy, build and sell; buyout instruments; mezzanine instruments and risk capital funds. In practice, combined strategies are generally used for risk capital. In terms of assets, risk capital funds recorded an increase by 19.84% in 2011, whereas buy, build and sell decreased by 9.86%. The other two sectors remained quite stable between 2010 and 2011.

### Investment strategy - in entities



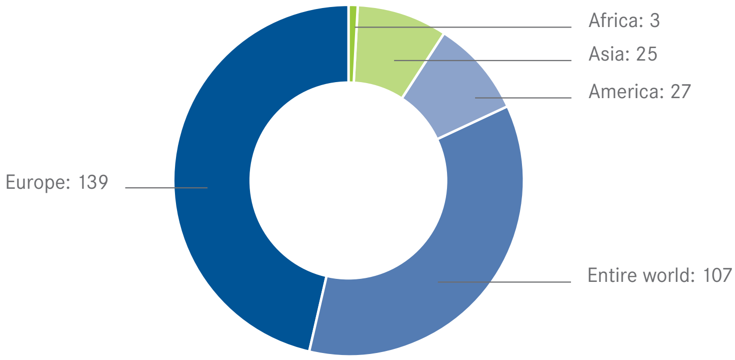

As regards the sector-based distribution, 161 entities prefer not to limit their investment policy to a particular investment sector. Among the entities having adopted a specialised policy, there is a certain concentration in the "Real estate", "Energy", "Technology" and "Services" sectors.

### Sector-based distribution - in entities

| Sector | Number | |
|---|---|---|
| All sectors | 161 | |
| Real estate | 56 | |
| Energy | 18 | |
| Technology | 15 | |
| Services | 14 | |
| Science | 11 | |
| Industry | 7 | |
| Microfinance | 5 | |
| Finance | 4 | |
| PPP | 4 | |
| Education and sports | 3 | |
| Precious metals and gemstones | 1 | |
| Sharia | 1 | |
| Security | 1 | |
| **Total** | **301** | |

As for the geographical area of investments, the majority of the 301 entities invest in Europe, whereas 36.55% of entities choose to have the possibility to invest worldwide.

**Investment region - in entities**



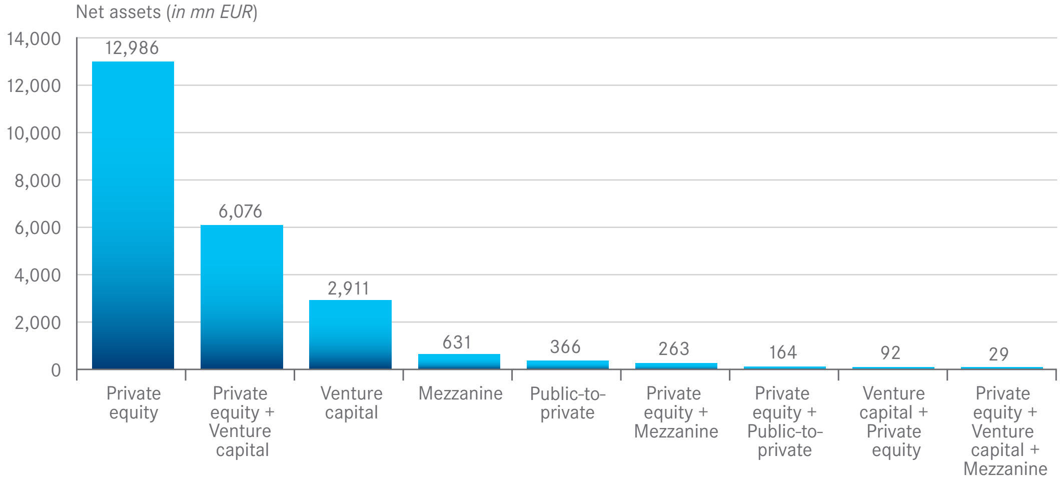

As far as the geographical origin of the initiators is concerned, those from Europe are largely predominant with 87.90%, followed by US initiators, which confirms the 2010 trend.

**Geographical origin of the initiators**

| Country | as % of total |
|---|---|
| France | 20.46% |
| Switzerland | 17.00% |
| Germany | 11.24% |
| Luxembourg | 9.22% |
| United States | 7.78% |
| Italy | 7.20% |
| Spain | 4.90% |
| United Kingdom | 4.61% |
| Belgium | 3.75% |
| Austria | 1.73% |
| Portugal | 1.73% |
| Netherlands | 1.15% |
| Denmark | 0.86% |
| Finland | 0.86% |
| Singapore | 0.86% |
| Egypt | 0.58% |
| Guernsey | 0.58% |
| Iceland | 0.58% |
| Israel | 0.58% |
| Jersey | 0.58% |
| Russia | 0.58% |
| Turkey | 0.58% |
| Argentina | 0.29% |
| Australia | 0.29% |
| Greece | 0.29% |
| Hong Kong | 0.29% |
| Hungary | 0.29% |
| India | 0.29% |
| Kuwait | 0.29% |
| Lebanon | 0.29% |
| Malta | 0.29% |
| **Total** | **100.00%** |

Based on the figures available as at 31 December 2011, the capital commitments in entities reached EUR 17.7 billion and their balance sheet total amounted to EUR 30.6 billion.

**Breakdown of net assets of entities according to the investment policy**




## 2. PRUDENTIAL PRACTICE

### 2.1. Monthly report to be provided by the liquidator of a SICAR to the CSSF

Pursuant to Article 20(1) of the law of 15 June 2004 relating to the investment company in risk capital, SICARs shall remain subject to the supervision of the CSSF in the case of a non-judicial liquidation (voluntary liquidation). In this context, the CSSF requires the liquidator of a SICAR to inform it on a monthly basis on the liquidation process. The liquidator shall also spontaneously notify the CSSF of any issues arising and provide to the CSSF, in due time, its report including the audited liquidation accounts as well as any other document required by the CSSF.

### 2.2. Annual fees due for SICARs in voluntary liquidation

In the context of a SICAR which decides on a voluntary basis to proceed to its liquidation, the CSSF reminds that Article 20(1) of the law of 15 June 2004 provides that SICARs shall, after their dissolution, be deemed to exist for the purpose of liquidation. As SICARs remain under the supervision of the CSSF, the annual fees to be levied based on Grand-ducal regulation of 18 December 2009 are due for all SICARs concerned as long as the non-judicial liquidation has not been completed. Moreover, Article 3(2) of the above Grand-ducal regulation provides that the annual lump-sum fees referred to in Article 1 are due in entirety each calendar year, even if the person liable for payment was supervised by the CSSF only for part of the year.

### 2.3. Information on the type of well-informed investor to be provided by SICARs in the half-year reporting

The CSSF would like to emphasise that point 3) "*Type d'investisseurs*" in sheet "*IF actions*" of the half-year reporting table to be transmitted by SICARs must provide information on the actual analysis of shareholdings on the date of establishment of the reporting. The information must not refer to the type of investors eligible based on the initial constitutive documents.

### 2.4. Electronic transmission of the half-year reporting

The CSSF points out that the LUXTRUST certificate used for the electronic signature of the reports must be registered with the CSSF prior to any transmission of the electronic reporting of a SICAR, in accordance with the procedure set out in Circular CSSF 08/334 and adapted to SICARs through Circular CSSF 08/376. It should be noted that this certificate is only valid for a limited time period and that its renewal must be requested before expiry.

# SUPERVISION OF SECURITISATION UNDERTAKINGS



## 1. DEVELOPMENTS OF AUTHORISED SECURITISATION UNDERTAKINGS

During 2011, the CSSF received four applications for registration on the official list of authorised securitisation undertakings subject to the law of 22 March 2004 on securitisation.

Three securitisation undertakings were granted authorisation by the CSSF in 2011, namely the following multiple-compartment securitisation undertakings:

- Synapsia S.A.
- dnA
- Agate Assets S.A.

As at 31 December 2011, 28 securitisation undertakings were registered on the official list of securitisation undertakings, against 26 entities at the end of 2010. Three application files of securitisation undertakings were still being processed at the end of 2011. The balance sheet total of authorised securitisation undertakings exceeded EUR 14.4 billion at the end of 2011, i.e. an increase of EUR 1.7 billion against 2010.

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

In general, the securities issued by securitisation undertakings are 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 execute securitisations by issuing shares. Some securitisation undertakings also have the possibility to issue warrants.

To date, no application file for a securitisation fund has been submitted to the CSSF. The CSSF has neither received any application file for 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 investors' interests.

The CSSF expects a moderate upturn in the securitisation activities in 2012, a trend that is being confirmed by the application files currently under review.

### • Decision to refuse to register ARM Asset Backed Securities S.A. on the official list

On 29 August 2011, the CSSF decided to refuse the registration of the securitisation undertaking ARM Asset Backed Securities S.A. (ARM) on the official list of authorised securitisation undertakings and notified its decision to the undertaking specifying that the CSSF considers that its decision entails a suspension of any payment by ARM and the prohibition for ARM, under penalty of voidance, to take any measures other than protective measures, unless otherwise authorised by the CSSF acting as supervisory commissioner (*commissaire de surveillance*). On 10 November 2011, at the CSSF's request, the Luxembourg District Court, sitting in commercial matters, decided (i) that the protective measures listed in Article 28 of the law of 22 March 2004 on securitisation are applicable to the Luxembourg *société anonyme* ARM, (ii) that the request of the CSSF to be replaced as supervisory commissioner is well-founded, and (iii) to appoint Ernst & Young as supervisory commissioner of ARM, replacing the CSSF. ARM has lodged an appeal against the District Court's judgement.

Following its informal appeal to the CSSF to review its decision to refuse the registration, ARM brought a petition (*recours administratif*) before the Luxembourg administrative tribunal (*tribunal administratif*) on 29 November 2011 to obtain judicial review of the CSSF's decision.

• **Withdrawal of Lifemark S.A. from the official list of authorised securitisation undertakings**

On 10 February 2012, the CSSF withdrew the securitisation undertaking Lifemark S.A. from the official list of authorised securitisation undertakings, as the provisional administrator (*administrateur provisoire*) of the company, whose mandate had been extended six times, came to the conclusion that a restructuring of Lifemark S.A. was not possible.

The CSSF's decision having become final on 10 March 2012, the District Court dealing with commercial matters shall, as a consequence thereof, be requested by the State Prosecutor to pronounce the dissolution and order the liquidation of Lifemark S.A..

Please refer to the CSSF's website, section "Publications", sub-section "Press releases" for any news relating to ARM and Lifemark S.A..

## 2. PRUDENTIAL SUPERVISORY PRACTICE

### 2.1. Regulatory aspects

There has been no change in 2011 to the legislation applicable to securitisation undertakings and to the practice of prudential supervision.

The CSSF is currently reviewing some general principles published in its Annual Report 2007, among others in the light of the development in European regulations as regards investment funds and financial markets. At the outcome of this process, an "FAQ" will be published on the CSSF's website.

### 2.2. On-site inspections

In 2011, the CSSF carried out three on-site inspections at securitisation undertakings under its supervision so as to analyse, *inter alia*, the adequacy of their administrative and accounting organisation.

On-site inspections are an efficient tool for understanding and assessing the authorised securitisation undertakings' situation and practical functioning. This supervisory tool is therefore expected to be used more frequently.

*Agents hired in 2011 and 2012: Departments "Supervision of pension funds, SICARs and securitisation undertakings", "Personnel, administration and finance", "Information systems and supervision of support PFS" and "General secretariat"*

Left to right: Julie LAGRANGE, Joëlle HOMMEL, Daniel HAMES, Tanja HELTEN, Ylenia GAMBUTO, Manon HOFFMANN, Kristel GILISSEN, Vanessa MARINIER, Marc FEIEREISEN, Yamina AGOUNI, Jill RODEN

# SUPERVISION OF PENSION FUNDS



# 1. DEVELOPMENTS OF PENSION FUNDS IN 2011

## 1.1. Pension funds

During 2011, no changes were registered on the official list of 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). The total number of pension funds subject to the law of 13 July 2005 remained unchanged at fifteen entities as at 31 December 2011.

Total assets of pension funds governed by the law of 13 July 2005 reached EUR 730 million at the end of the year 2011 against EUR 683 million as at 31 December 2010.

While the setting-up of new pension funds stagnated in 2011, the CSSF expects a slow but positive development of the pension funds activity in 2012, mainly through the development of cross-border activities of existing pension funds and through the establishment of new entities in Luxembourg.

## 1.2. Liability managers

In 2011, no entity has been registered on the official list of professionals authorised to act as liability managers for pension funds subject to the law of 13 July 2005. Consequently, the number of liability managers for pension funds authorised by the CSSF amounted to fourteen as at 31 December 2011.

# 2. INTERNATIONAL COOPERATION

## 2.1. European Insurance and Occupational Pensions Authority (EIOPA)

The European Insurance and Occupational Pensions Authority (EIOPA) is composed of representatives of the twenty-nine authorities from the EEA (Member States of the EU, Norway and Iceland) which supervise insurance and occupational pensions. EIOPA assists the European Commission in the preparation of technical measures relating to EU legislation on insurance and occupational pensions. Its mission is to ensure the harmonised and continuous application of the European legislation in the Member States. One main objective of EIOPA is the protection of the policyholders as well as of the members and beneficiaries of occupational pension schemes.

The CSSF is a member of EIOPA as it is the competent authority for the supervision of 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).

In 2011, the CSSF contributed to EIOPA's works on occupational pensions by participating in the following committees and working groups:

- Occupational Pensions Committee (OPC);
- OPC working groups dealing with different aspects of the European Commission's advice requests;
- Review Panel.

### 2.1.1. Occupational Pensions Committee (OPC)

As regards occupational pensions, in 2011, the works of EIOPA mainly focused on the review of the Directive 2003/41/EC on the institutions for occupational retirement provision (IORP Directive). Indeed, in April 2011, the European Commission called for EIOPA's technical advice on 23 different aspects of the IORP Directive. As a member of the OPC, the CSSF participated in EIOPA's answer at the OPC's level as well as at the level of the four *ad hoc* sub-working groups created in order to analyse the different aspects of the call for advice.

In the framework of these works, EIOPA carried out two public consultations on the content of its answer to the European Commission's call for advice before submitting its final advice to the European Commission on 15 February 2012. The documents relating to EIOPA's public consultations and the final advice are available on EIOPA's website (https://eiopa.europa.eu/consultations/consultation-papers/2011-closed-consultations/october-2011/response-to-call-for-advice-on-the-review-of-iorp-directive-200341ec-second-consultation/index.html).

### 2.1.2. Review Panel

The Review Panel is responsible for assisting EIOPA in its task to ensure consistent and harmonised implementation of EU legislation in the Member States.

In 2011, the CSSF contributed to the works carried out within the working group Occupational Pensions Peer Review Project of the Review Panel. The purpose of the works is the drawing-up of a self-assessment questionnaire to be completed by the national supervisory authorities in order to gather information on the intervention means and powers of the national supervisory authorities to carry out the prudential supervision of the occupational retirement institutions. The results of the questionnaire will be subject to a peer review process in 2012.

### 2.1.3. Future works

In the months following the submission of its final advice on the review of the IORP Directive to the European Commission, EIOPA will carry out Quantitative Impact Studies (QIS) in order to support the European Commission's proposals for a reviewed IORP Directive.

In parallel, EIOPA will be responsible for ensuring the consistent transposition of the different requirements of the IORP Directive as amended by Directive 2010/78/EU (Omnibus I Directive). In this context, EIOPA will start works in order to draft implementing technical standards under Article 20(11) of the IORP Directive and prepare the implementation of the structures necessary for EIOPA to maintain the registers relating to IORP.

# SUPERVISION OF SECURITIES MARKETS

1. Approval of prospectuses relating to offers to the public or admissions to trading on a regulated market
2. Takeover bids
3. Supervision of issuers of securities of which the CSSF is the competent authority
4. Enforcement of financial information
5. Supervision of markets and market operators
6. Investigations and cooperation

# 1. APPROVAL OF PROSPECTUSES RELATING TO OFFERS TO THE PUBLIC OR ADMISSIONS TO TRADING ON A REGULATED MARKET

## 1.1. Application of the Prospectus law

The number of files submitted in 2011 for the approval of prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market slightly increased compared to 2010. This increase is particularly due to the nearly 10% increase in the number of filed supplements to be published pursuant to Article 13 of the law of 10 July 2005 on prospectuses for securities (Prospectus law). Indeed, since the financial crisis, it appears that the issuers have been attaching more importance to providing investors with information which shall be as complete and accurate as possible.

As in previous years, the CSSF attached great importance to communication with the filing entities, which is evidenced, in particular, by the high number of requests for advice which was dealt with by the department "Supervision of securities markets" in 2011. Thus, 147 requests for advice were submitted to this department, most of which were related to financial information to be provided concerning issuers or guarantors and the applicability of Articles 5.2, 5.3 and 6.2 of the Prospectus law for the exemption from the obligation of publishing a prospectus. Some positions adopted by the CSSF within the context of these requests for advice are detailed under item 1.3. of this Chapter.

In 2011, the requests for the omission of information pursuant to Article 10 of the Prospectus law, submitted to the CSSF, were even fewer than in 2010. The four requests in question were all granted. This decrease is consistent with the trend already observed in 2010 and seems to support the view that issuers have become more careful in taking all the necessary actions to provide as much information as possible in order to enable possible investors to fully assess the assets and liabilities, the financial situation, the results and prospects of the issuer and possible guarantors as well as the rights attaching to the offered transferable securities.

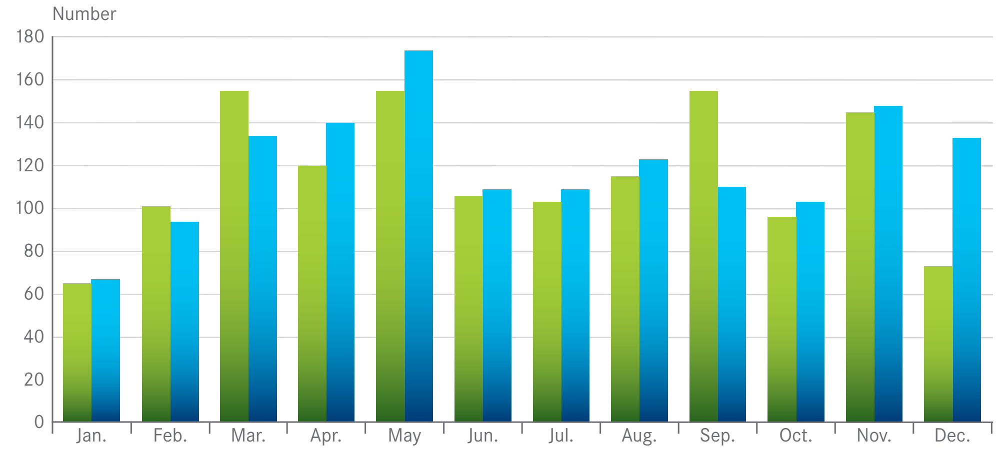
Moreover, and in accordance with Article 23.4 of Regulation (EC) No 809/2004 (Prospectus regulation), the CSSF approved four prospectuses subject to information omission due to non-pertinence.

## 1.2. Approvals and notifications in 2011

### 1.2.1. Documents approved by the CSSF in 2011

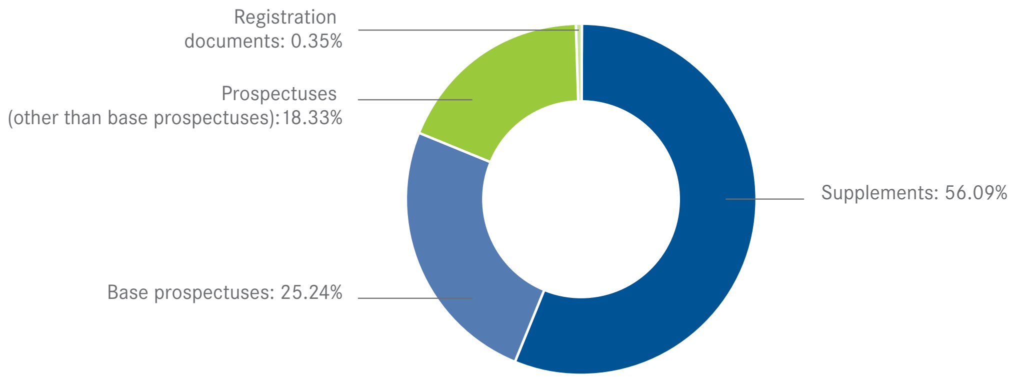
The number of documents approved by the CSSF slightly increased compared to 2010, amounting to a total of 1,446 approved documents in 2011 (of which 265 prospectuses, 365 base prospectuses, 5 registration documents and 811 supplements) against 1,390 the previous year (+4.03%).

**Development in the number of documents approved by the CSSF**




| | Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2010 | 65 | 101 | 155 | 121 | 155 | 106 | 103 | 115 | 155 | 96 | 145 | 73 |
| 2011 | 66 | 94 | 134 | 140 | 174 | 112 | 109 | 123 | 110 | 103 | 148 | 133 |
| Variation in % | 1.54% | -6.93% | -13.55% | 15.70% | 12.26% | 5.66% | 5.83% | 6.96% | -29.03% | 7.29% | 2.07% | 82.19% |

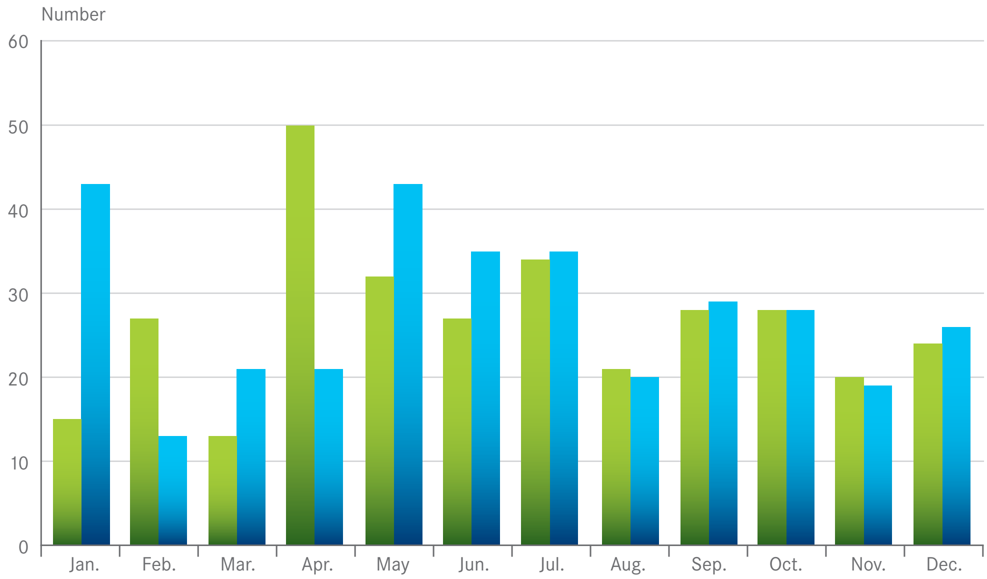
### Distribution of documents approved in 2011




## 1.2.2. Documents drawn up under the European passport regime in 2011

In 2011, the CSSF received 1,904 notifications (relating to 333 prospectuses and base prospectuses and 1,571 supplements) from the competent authorities of several EU Member States against 1,062 notifications (relating to 318 prospectuses and base prospectuses and 744 supplements) in 2010, representing a 79.28% increase. This significant increase results from the large number of supplements notified to the CSSF whereas the increase of the number of prospectuses and base prospectuses is limited to 1.04%.

### Development in the number of notifications (prospectuses and base prospectuses) received by the CSSF

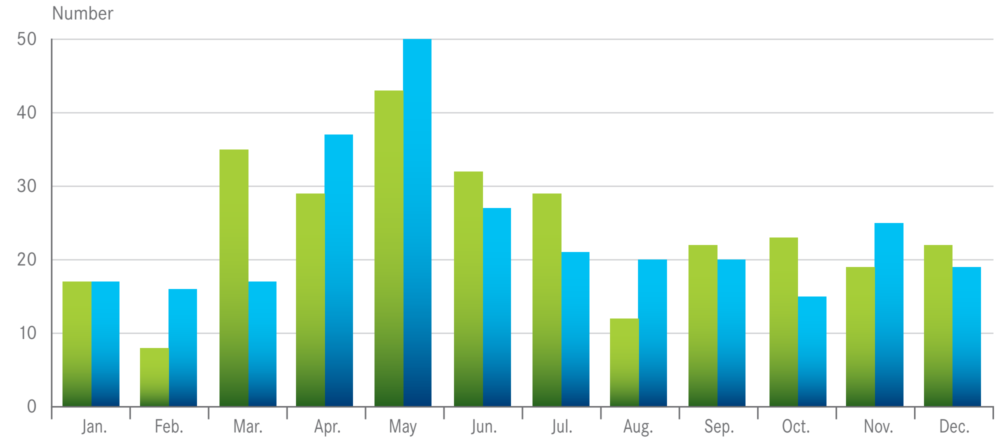



| | Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2010 | 15 | 27 | 13 | 50 | 32 | 27 | 34 | 21 | 27 | 28 | 20 | 24 |
| 2011 | 43 | 13 | 21 | 21 | 43 | 35 | 35 | 20 | 29 | 28 | 19 | 26 |
| Variation in % | 186.67% | -51.85% | 61.54% | -58.00% | 34.38% | 29.63% | 2.94% | -4.76% | 7.41% | 0.00% | -5.00% | 8.33% |

In 2011, the CSSF sent notifications for 758 CSSF-approved documents[1] (284 prospectuses and base prospectuses and 474 supplements) to the competent authorities of the EU Member States, against 715 documents[1] (291 prospectuses and base prospectuses and 424 supplements) in 2010, representing a 6.01% increase.

[1] This figure is the number of documents for which the CSSF sent one or several notifications. Where notifications were sent at different dates and/or in several Member States, only the first notification is included in the statistical calculation. Each document notified in one or several Member States is thus only counted once.

**Development in the number of notifications (prospectuses and base prospectuses) sent by the CSSF**




| | Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2010 | 17 | 8 | 35 | 29 | 43 | 32 | 29 | 12 | 22 | 23 | 19 | 22 |
| 2011 | 17 | 16 | 17 | 37 | 50 | 27 | 21 | 20 | 20 | 15 | 25 | 19 |
| Variation in % | 0.00% | 100.00% | -51.43% | 27.59% | 16.28% | -15.63% | -27.59% | 66.67% | -9.09% | -34.78% | 31.58% | -13.64% |

### 1.2.3. Approvals

In 2011, the approval of files relating to derivatives and securitisation transactions widely dominated. The CSSF approved 161 files relating to Luxembourg issuers, among which 50 prospectuses and 58 base prospectuses. It should be noted that 19 of these files were submitted for the offer or admission of shares.

Among the special files, it is worthwhile mentioning the base prospectus relating to a certificate programme to be issued by the European Sovereign Bond Protection Facility (ESBPF), filed with the CSSF for approval on 13 December 2011. The European Financial Stability Facility (EFSF) holds 30% of the issuer of these certificates which was incorporated in the form of a *société anonyme* in Luxembourg to create a leverage effect at the level of the EFSF's resources. According to its articles of incorporation, the ESBPF proposes to admit for trading on the regulated market of the Luxembourg Stock Exchange and offer to the public certificates entitling to certain payments or the delivery of financial instruments which may be distributed with sovereign debts or separately in order to facilitate the financing of the Member State concerned by the relevant certificates. This base prospectus was approved by the CSSF on 17 February 2012 enabling thus the ESBPF to admit certificates to trading and to make offers to the public in due time.

### 1.2.4. Filing and control of the Final Terms

In 2011, the CSSF continued to perform *a posteriori* random controls on the Final Terms that were filed with its departments. In this context, it issued an injunction against an issuer to remedy the situation found in respect of the obligation to file the Final Terms as well as in respect of the content of the Final Terms concerned. The random controls in the course of being carried out at the level of other issuers support the CSSF in its efforts to strengthen *a posteriori* controls of the Final Terms.

### 1.2.5. Use of different languages to draw up a prospectus

Pursuant to Article 20(1) of the Prospectus law, the CSSF may approve documents in Luxembourgish, French, German or English. In practice, this provision enables the CSSF to accept multilingual documents for approval. Nevertheless, it appears that when notifying these documents to the competent authorities of host Member States, the CSSF must inform these authorities in relation to this fact for the purposes of transparency and cooperation between competent authorities.

## 1.3. Questions regarding prospectuses raised in 2011

### 1.3.1. Supplement in the event of a credit rating change

In 2011, the question whether the CSSF requires the preparation of a supplement to documents approved in case of a change in the rating of the issuer was often raised by the filing entities. In principle, it is the issuer's responsibility to assess the need for the publication of a supplement pursuant to Article 13 of the Prospectus law. Due to its supervisory powers relating to the Prospectus law, the CSSF considers that a change in the rating of the issuer or its securities is generally qualified as a significant and material change capable of affecting the assessment of the securities, thereby triggering the application of Article 13 of the Prospectus law. This general approach may not be appropriate only in specific duly justified and motivated cases.

### 1.3.2. Incorporation by reference of a registration document in a prospectus

Up to now, the interpretation of Article 12 of the Prospectus law has led the CSSF to refuse the incorporation by reference of registration documents in full prospectuses. However, this article does not refer to cases where the registration document was approved by the competent authority of another Member State. In addition, pursuant to the provisions of Article 19 of the Prospectus law, a registration document cannot be notified in another Member State, which means that a registration document approved by the competent authority of another Member State cannot be used in a prospectus including separate documents to be approved by the CSSF. Yet, according to the provisions of Article 15, a registration document approved by the competent authority of another Member State may be validly incorporated by reference in a prospectus to be approved by the CSSF, provided that the registration document in question has been filed with the CSSF pursuant to the Prospectus law. Therefore and more specifically in order to provide a level playing field for all filing entities, the CSSF decided in 2011 to also enable issuers having a registration document approved by the CSSF to incorporate it by reference in a prospectus.



## 1.4. Implementation of the revised Prospectus directive

Directive 2010/73/EU of 24 November 2010 amending Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 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 (reviewed Prospectus Directive) must be transposed into national law by 1 July 2012 at the latest. The CSSF actively contributed to the preparation of the draft law which was introduced in the *Chambre des Députés* (Luxembourg Chamber of Deputies) on 12 August 2011.

It is planned to enter into force a limited number of provisions before the deadline of 1 July 2012 in order to afford the persons concerned the opportunities offered by certain provisions of the reviewed Prospectus Directive. It was thus noted that the provisions relating to the determination of the threshold which triggers the obligation to prepare a prospectus under Part II of the Prospectus law as well as the provision relating to the repeal of the requirement of an annual document enter into force on the day of the publication of the law transposing the revised Prospectus Directive into Luxembourg law in the *Mémorial* while all other provisions will enter into force on 1 July 2012.

# 2. TAKEOVER BIDS

## 2.1. Offer documents approved by the CSSF

In 2011, the CSSF approved one offer document related to a takeover bid under the law of 19 May 2006 implementing Directive 2004/25/EC of 21 April 2004 on takeover bids (law on takeover bids).

On 14 April 2011, after the purchase of units in ProLogis European Properties (PEPR) from a major institutional investor, the American company ProLogis (ProLogis) announced that it holds 38% of the units and voting rights in PEPR. Consequently, pursuant to Article 5(1) of the law on takeover bids, ProLogis had to launch a mandatory takeover bid for the remaining units of PEPR and for the convertible preference units which are not yet held by ProLogis.

The offer document was approved by the CSSF and recognised by the competent authority of the Netherlands (AFM) on 21 April 2011. ProLogis's offer was finally launched on 22 April 2011. A negative reasoned opinion was also published by the Board of Directors of the target company in compliance with the law on takeover bids.

On 6 May 2011, after the purchase of PEPR units by ProLogis at a price above the offer price, the latter was adjusted pursuant to the law on takeover bids and the offer period was extended. On 9 May 2011, a supplement to the offer document was approved by the CSSF and recognised by the AFM. A revised reasoned opinion was also published.

After the closing of the offer, on 18 May 2011, ProLogis held 89.58% of the ordinary units and voting rights as well as 94.62% of the convertible preference units.

## 2.2. Offer file not falling under the scope of the law on takeover bids

One offer has been made outside the scope of the law on takeover bids, namely the cash purchase offer of SA SIPEF NV (SIPEF) for the shares of Jabelmalux S.A. (Jabelmalux) not yet held by SIPEF.

Upon preliminary discussions on the content of the document to be used, the offer document was submitted on 14 March 2011 to the CSSF in its capacity as competent authority under Luxembourg law, in accordance with, in particular, the law of 23 December 1998 establishing a supervisory commission of the financial sector and the law of 13 July 2007 on markets in financial instruments.

The offer period started on 15 March 2011 and, after the completion of the offer on 29 April 2011, SIPEF held 97.12% of the capital and the voting rights. Jabelmalux's shares were withdrawn from the official stock exchange listing and from trading on the Luxembourg regulated market on 27 June 2011.

It should be noted that this offer was governed by the general provisions of the Luxembourg financial law without falling within the scope of the law on takeover bids, as SIPEF aimed to strengthen its control over Jabelmalux, which it already exercised before this offer.

## 2.3. File under review

Upon preliminary discussions and negotiations, the American company TPG Capital, LP. (TPG) announced on 1 February 2012 that it would launch a voluntary friendly takeover bid for the entire capital of the Luxembourg company GlobeOp Financial Services S.A. (GlobeOp).

It should be noted that the shares of GlobeOp are not admitted to trading on a regulated market in Luxembourg, and consequently, the CSSF is only competent as authority of the Member State in which the target company has its registered office. As the shares of GlobeOp are admitted to trading on the regulated market in London, the UK Takeover Panel is thus competent for supervising the takeover bid, while the CSSF is competent for issues relating, in particular, to company law and ensuing matters (including the right of squeeze-out and the right of sell-out).

## 2.4. Questions regarding the law on takeover bids raised in 2011

In the context of the acquisition of Exceet Group AG (Exceet) by Helikos S.E. (Helikos), on 25 July 2011, the CSSF granted three waivers to the obligation to launch a takeover bid for the shares of Helikos in accordance with Article 5(1) of the law on takeover bids. These waivers were granted to the founding shareholders of Helikos, as well as to the shareholders of Exceet who sold their holdings, acting alone or in concert. Taking into account the transparency of the takeover transaction, the provisions regarding the related voting procedures and the possibility of exit for the shareholders, the CSSF indeed considered that the interests of the minority shareholders were sufficiently protected without the application of the provisions of Article 5(1) of the law on takeover bids.

The CSSF also dealt with one request for advice concerning an underwriting agreement signed between a company, which increased its capital by issuing a significant number of shares, and intermediary financial institutions. The CSSF considers that the subscription and acquisition of securities by intermediary financial institutions from an issuer under an underwriting agreement, with a view to resell, may, in principle, not fall within the scope of an acquisition of control of the said issuer.

# 3. SUPERVISION OF ISSUERS OF SECURITIES OF WHICH THE CSSF IS THE COMPETENT AUTHORITY

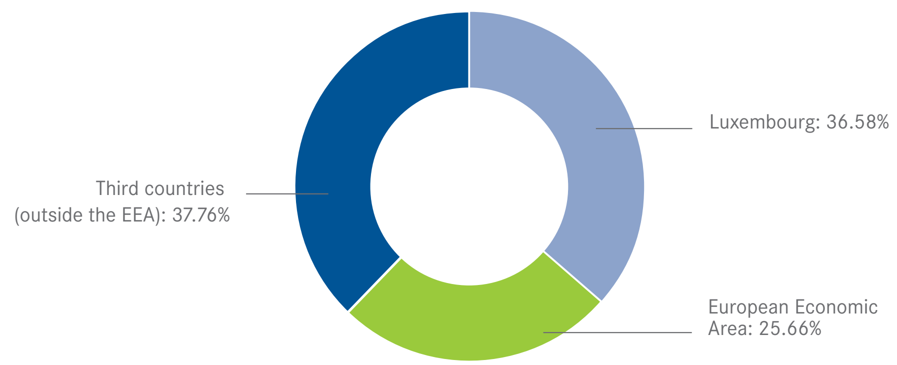
## 3.1. Issuers subject to supervision

Pursuant to the Transparency law, the CSSF supervises the issuers which fall within the scope of this law. As at 8 March 2012, 678 issuers were subject to the supervision of the CSSF as Luxembourg was their home Member State within the meaning of this law. In 2011, Luxembourg was confirmed as the home Member State for 51 issuers, whereas 93 issuers no longer fall within the scope of the Transparency law, mainly because the securities issued by these entities matured or were redeemed early. The list of issuers supervised by the CSSF is published on the CSSF's website (section "Supervised entities").

Out of the 678 issuers supervised by the CSSF, 248 are Luxembourg issuers, of which 52 issuers of shares and one issuer whose shares are represented by Fiduciary Depositary Receipts admitted to trading on a regulated market. Among the Luxembourg issuers, 16 are banks, 11 are securitisation undertakings authorised pursuant to Article 19 of the law of 22 March 2004 relating to securitisation, 53 are unauthorised securitisation undertakings and seven are UCIs.

174 issuers have their registered office in an EEA Member State and 256 issuers are established in a third country (outside the EEA).

**Breakdown of issuers according to country**

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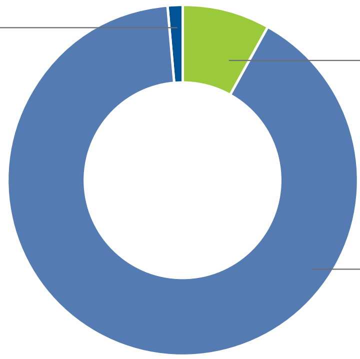
As regards the breakdown according to the type of listed securities, most issuers subject to the supervision of the CSSF, i.e. 614 entities, issue debt securities.

**Breakdown of issuers according to the type of securities admitted to trading**




In 2011, five issuers of shares, of which four Luxembourg issuers, were excluded from the scope of the Transparency law, either because the issuer decided to delist or because the issuing company was liquidated or has transferred its registered office.

On the other hand, eleven Luxembourg issuers of shares have been added to the list of issuers subject to the supervision of the CSSF since the beginning of 2011. The shares of two of these issuers were admitted to trading on the regulated market of the Luxembourg Stock Exchange, the shares of the other issuers being admitted to trading on other regulated markets established or operating in the EEA.

## 3.2. Review of financial reports

As announced in the 2010 Annual Report of the CSSF, the reviews of periodic information have been intensified since the publication of the annual reports for the financial years ending on 31 December 2010 or thereafter, to be established by issuers of which Luxembourg is the home Member State pursuant to the Transparency law. Following these reviews, the CSSF sent more than 100 reminders, issued about 50 injunctions and more than 20 administrative fines pursuant to Article 25 of the Transparency law.

In two cases, the CSSF published a press release pursuant to Article 25(2) of the Transparency law in order to disclose the names of the issuers in question. Indeed, as the issuers failed to publish several consecutive financial reports, it was essential to draw the public's attention to their situation.

Moreover, the CSSF published a list of Luxembourg issuers subject to the Transparency law, which failed to publish their annual report for the financial years ending on 31 December 2010 or thereafter. Registration on this list is triggered as soon as a delay in the publication is noted, without prejudice to its reasons or origins.

Finally, the CSSF also required the suspension of the bonds of a Luxembourg issuer from trading on the regulated market of the Luxembourg Stock Exchange.

## 3.3. Specific questions relating to the Transparency law

### 3.3.1. Change in the denomination per unit provided for in Article 7(1)b) of the Transparency law relating to certain exemptions in respect of periodic information

Pursuant to Article 9 of the draft law No 6319 amending the Prospectus law as well as the Transparency law, the provisions of Chapter 2 of the draft law relating to the amendment of the Transparency law will enter into force on 1 July 2012.

Consequently, issuers which issued debt securities with a denomination per unit below EUR 100,000 (or its equivalent in any other currency) on 31 December 2010 or thereafter, will be subject as from 1 July 2012 to the transparency requirements that apply since the entry into force of the Transparency law to issuers having issued debt securities with a denomination per unit below EUR 50,000 (or its equivalent in any other currency). Thus, these issuers will, henceforth, have to prepare and publish annual and half-yearly financial reports.

For all the reports referred to above which relate to the periods starting on 1 July 2012 or thereafter, all provisions laid down in the Transparency law, i.e. both those relating to the content of the reports and those relating to the procedures and deadlines for their dissemination, their availability at an OAM (Officially Appointed Mechanism) and their filing with the CSSF, must be complied with.

For reports which relate to periods having started prior to 1 July 2012 and ending thereafter, as well as for reports published on 1 July 2012 or thereafter and which relate to periods ended before said date, the CSSF considers that the provisions of the Transparency law must only be complied with as to the procedures and deadlines for dissemination, the availability at an OAM and filing with the CSSF. Thus, the CSSF considers that the content of these reports may correspond, where appropriate, to the laws and regulations applicable before the above-mentioned amendments. However, the CSSF would like to emphasize that from the moment the issuer has to comply with all the provisions of the Transparency law, it must provide comparative figures of the preceding financial year.

### 3.3.2. Obligation of a shareholder to file the relevant regulated information with the CSSF

Pursuant to Article 18 of the Transparency law, information which the shareholders or holders of depository receipts are required to notify to the issuer in question in accordance with Articles 8, 9 and 12 must be filed with the CSSF at the same time.

Yet, the CSSF recently noticed that many holders seem to file notifications which they are required to make pursuant to these articles only with the issuer which then sends them to the CSSF.



However, the holder has a legal obligation to make its notification as soon as possible and at the latest within six trading days[2] of a transaction or within four days of information of an event changing the breakdown of voting rights by the issuer by sending it to the issuer **and** the CSSF.

## 3.4. Review of the Transparency Directive

On 25 October 2011, the European Commission published a proposal for amendment of the Transparency Directive, the main points of which are as follows:

- abolition of the obligation to publish quarterly information;
- introduction of a new obligation to publish an annual report for issuers which have activities in the extractive or logging of primary forest industries to disclose in a separate report on an annual basis payments made to the governments in the countries in which they operate;
- extension of the scope of the obligations in respect of notification of major holdings in listed companies as well as further harmonisation in this field;
- definition of the home Member State as well as definition of the notion of "issuer"; and
- reinforcing and harmonising of the various sanctioning regimes at European level.

For further detail, please refer to item 1.11. of Chapter XV "Banking and financial laws and regulations".

[2] The six-day time limit results from the joint reading of Article 11(2) of the Transparency law and Article 10 of the Grand-ducal regulation relating thereto.

# 4. ENFORCEMENT OF FINANCIAL INFORMATION

## 4.1. Consistent enforcement of accounting standards

### 4.1.1. General framework

#### • Legal and regulatory framework

Within the context of its mission of supervising securities markets, the CSSF is in charge of examining the financial information published by issuers of securities. Through this activity, generally known as "enforcement", the CSSF ensures that the financial information complies with the relevant reporting framework, i.e. the applicable accounting standards.

The CSSF accomplishes its enforcement mission pursuant to Article 22(2)(h) of the Transparency law which empowers the CSSF to examine the financial information published by issuers of securities falling under its scope of application. Enforcement then constitutes an *ex post* examination of the financial information published by the issuers.

Moreover, the CSSF also examines the financial information presented in the prospectuses in the event of an offer to the public or admission to trading on a regulated market, pursuant to Article 7 of the Prospectus law which establishes the CSSF's responsibility for the approval of these prospectuses. Enforcement is then similar to an *ex ante* examination prior to any publication of financial information within the context of the prospectus by the issuer applying for the approval thereof.

Consequently, the financial information subject to the supervision of the CSSF within the context of enforcement mainly includes financial statements, such as annual, half-yearly or quarterly, individual or consolidated reports, as well as the financial data included in the prospectuses. It should be noted that enforcement relates both to the financial information issued in accordance with the national accounting standards (for European issuers drawing up their statutory accounts under a local standard) and that prepared according to International Financial Reporting Standards (IFRS) or according to other accounting standards considered as equivalent to IFRS standards (for instance the American accounting standards US GAAP).

In practical terms, the implementation of the enforcement by the CSSF is based on the guidelines defined in two standards developed by CESR, ESMA's predecessor. These standards are currently being reviewed within a dedicated working group in which the CSSF participates.

The European cooperation in respect of enforcement is also continuing with the participation of the CSSF in the EECS group (European Enforcers Coordination Sessions) within ESMA. The group's mission is to obtain convergence and harmonisation of the enforcement activities within the EEA.

#### • Objectives pursued

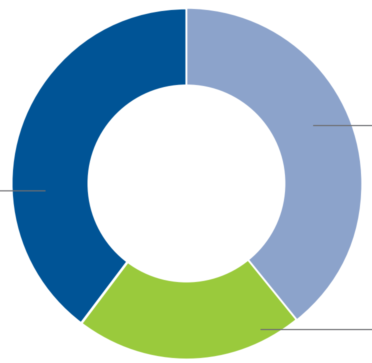
Within the context of the Transparency law, the enforcement missions carried out by the CSSF aim to identify and address the infringements in the compliance of the financial information published after the admission of the securities of an issuer to trading on a regulated market. Where enforcement is performed within the context of the approval of a listing prospectus, it aims to ensure that the financial information which will be published in the prospectus complies with the applicable accounting standard.

These missions aim to protect the interests of the users of the financial information published by the issuers and to increase public confidence in European securities markets through better quality, comparability and reliability of the financial information published. They also contribute to the convergence of the application of the accounting standards used by the issuers at the European level.

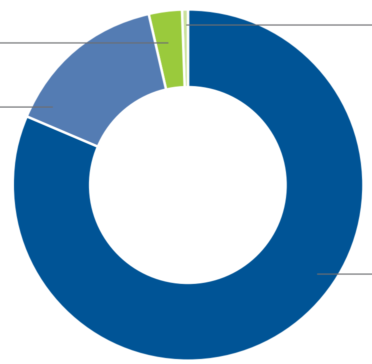
### • Population subject to enforcement

Under the Transparency law, and by taking into account the exemptions provided for in Article 7 of this law, the population of issuers falling within the scope of enforcement as at 1 January 2011 amounted to 319 entities with the following characteristics.

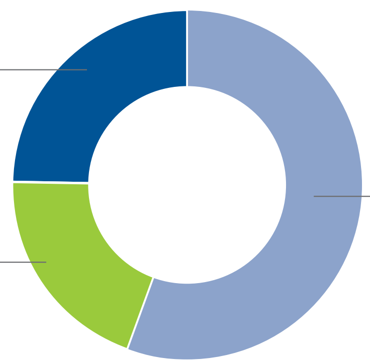
**Breakdown of the 319 issuers according to registered office**




**Breakdown of the 319 issuers according to the type of securities admitted to trading**




**Breakdown of the 319 issuers according to the accounting framework used for the preparation of financial information**

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### 4.1.2. Remit of the CSSF and appropriate measures

#### • Powers and penalties

The powers and penalties available to the CSSF as regards enforcement are set out in Articles 22, 25 and 26 of the Transparency law.

The principles applied by the CSSF aim to take appropriate measures and, where applicable, formally request a correction where a material infringement is identified in the financial information. The measures taken must be effective, appropriate and proportionate to the infringement committed and are aimed to improve market integrity and confidence.

Depending on the results of the reviews performed, the CSSF decides whether or not to take an enforcement decision, and, where applicable, administrative measures or penalties, or even to initiate criminal proceedings *vis-à-vis* the issuer pursuant to the Transparency law.

Thus, where errors are identified in the financial information published, the CSSF may require, depending on the materiality of the infringement:

- that the infringement be corrected or the information improved in the subsequent documents to be issued by the issuer;
- that the identified infringement and/or correction to be made public, through the press or any other appropriate means;
- that the identified infringement be immediately corrected and that a new financial information be submitted and published.

These decisions and actions are communicated in the form of recommendations, formal requests or orders.

When enforcement reviews are related to the financial information included in a prospectus in the process of being approved, the powers and penalties available to the CSSF in this respect are provided for in Article 22, 25 and 26 of the Prospectus law. The decisions taken by the CSSF are then intended to request the potential issuer to correct, amend or improve the information included in the prospectus before its final approval and thus its publication.

#### • Types of reviews

For the selected issuers within the context of the Transparency law, the actual reviews follow a risk-oriented approach as the degree of intensity of the controls carried out is correlated with the acknowledged risky and sensitive nature of the issuer.

The review programme, formally defined and revised every year for the selected issuers covers:

- either a global review of the proper application of the accounting standards applicable to the issuer (hereafter "general review");
- or a review of specific problems (proper application of a standard, treatment of a specific subject, etc.) predefined according to their importance, their potential impact, etc. (hereafter "specific review").

Depending on the intensity of work or the cases analysed, these reviews will include on-site inspections, meetings and direct contacts with representatives of the issuer and/or its external auditor in order to analyse the most sensitive problems and issues and obtain information, documents and other objective evidence required to perform the review.

### 4.1.3. Enforcement process

**• Selection mode**

The selection mode for issuers subject to enforcement within the context of the Transparency law follows a risk-oriented approach, based on risks which were defined as resulting from:

- the probability of an error in the published financial information; and
- the impact this error could have on investor protection and market confidence.

This approach is completed by a rotation and a random sampling method, whose objective, among others, is to subject all issuers concerned by the enforcement and considered as the riskiest to a review every three years.

The CSSF takes into account, *inter alia*, the following risk factors to assess the probability of an error in the financial information published by the issuer:

- compliance history (aspects linked to the review of accounts, complaints, claims, legal proceedings, etc.);
- financial structure of the entity;
- existence of specific or accounting problems.

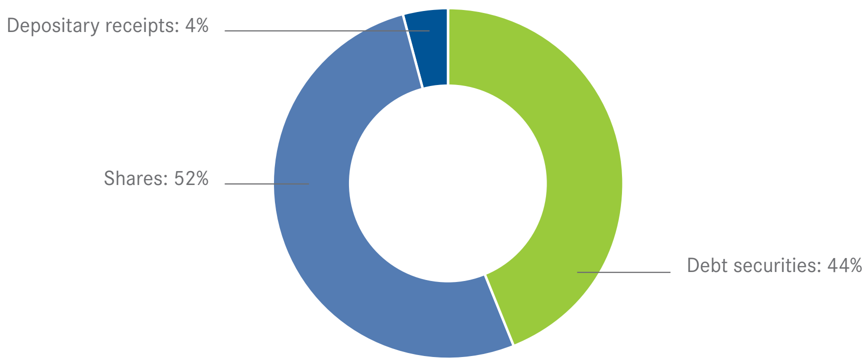
In order to assess the impact of an error in the financial information of an issuer on market confidence and investor protection, the CSSF identifies the following risk factors:

- type of securities issued;
- market capitalisation;
- number/nature of investors and average free float;
- issuer profile.

**• Reviews performed in 2011**

In 2011, general reviews were performed on more than one third of the issuers which the CSSF considers, on the basis of its risk-oriented approach, as the riskiest. These reviews mainly focussed on the 2010 annual financial statements as well as the half-yearly financial statements for the financial years 2010 and 2011, if these were available at the date the reviews were performed. It should also be noted that all issuers concerned by these reviews published their consolidated financial information according to IFRS standards.

**Breakdown of general reviews carried out in 2011 by issuer type (according to the type of securities admitted to trading)**



Three specific reviews were performed in 2011:

- Review of the presentation of the annual financial statements prepared in accordance with IFRS standards: based on a sample of 146 issuers whose financial statements for the year 2010 were prepared in accordance with IFRS standards, the CSSF reviewed compliance with certain minimum disclosure requirements regarding the following IFRS standards: IAS 1 “Presentation of Financial Statements”, IAS 10 “Events after the Reporting Period” and IFRS 8 “Operating Segments”.
- Review of the presentation of the half-yearly financial statements prepared in accordance with IFRS standards: based on a sample of 116 issuers whose financial statements for the year 2011 were prepared in accordance with IFRS standards, the CSSF reviewed compliance with certain minimum disclosure requirements regarding IAS 34 “Interim financial reporting”.
- Review of the information relating to exposures to sovereign debt presented in the 2010 annual and 2011 half-yearly financial statements prepared according to IFRS standards for certain Luxembourg credit institutions: within the context of the work carried out by ESMA, the CSSF analysed the information relating to exposures to sovereign debt presented in the 2010 annual and 2011 half-yearly financial statements prepared according to IFRS standards for certain Luxembourg credit institutions.

## 4.2. Findings and prospects

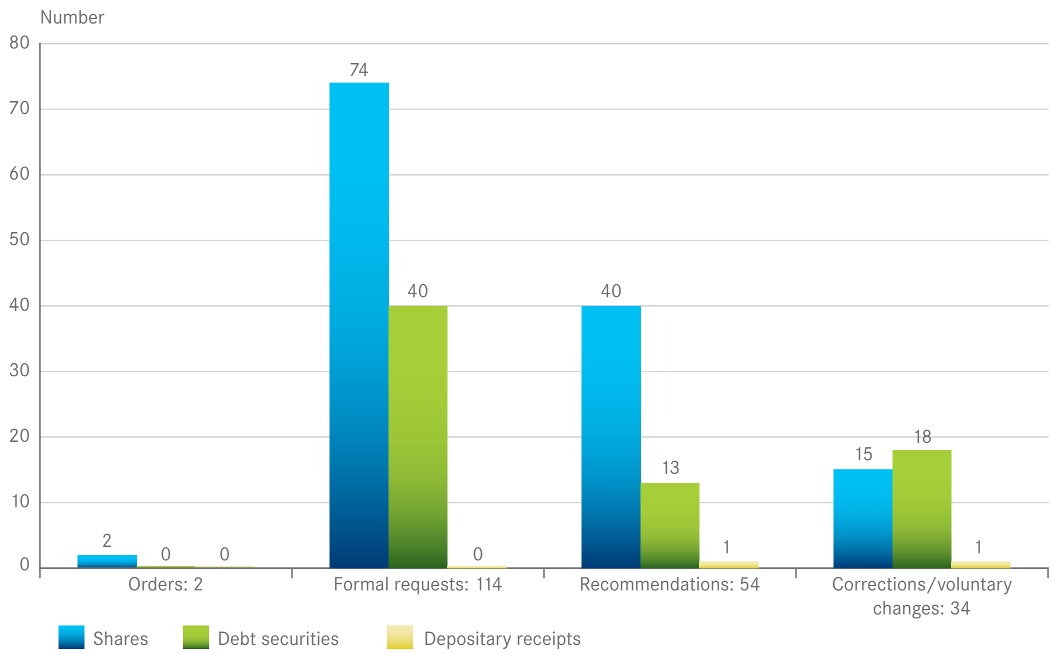
### 4.2.1. Result of works carried out in 2011

#### • General reviews

Within the context of these reviews, the CSSF had to take decisions in the form of orders, formal requests and recommendations *vis-à-vis* certain issuers, aiming to either correct the identified errors or amend and improve the subsequent published financial statements.

In respect of the figures detailed in the graphs below, it should be noted that each issuer having been reviewed may have received several formal requests, recommendations or may have undertaken to amend or correct by itself several identified infringements.

**Breakdown of decisions taken by the CSSF after the general reviews carried out in 2011 by issuer type (according to the type of securities admitted to trading)**



The following graphs break down the formal requests and recommendations issued in 2011 according to the relevant IFRS standards.

**Breakdown of the formal requests issued in 2011 according to the relevant IFRS standards**

| Standards | Number |
|---|---|
| IFRS 7 | 52 |
| IAS 1 | 11 |
| IAS 19 | 10 |
| IAS 39 | 9 |
| IAS 10 | 3 |
| IAS 24 | 3 |
| IAS 40 | 3 |
| Others | 23 |
| **Total** | **114** |

**Breakdown of the recommendations issued in 2011 according to the relevant IFRS standards**

| Standards | Number |
|---|---|
| IFRS 7 | 20 |
| IAS 1 | 10 |
| IAS 24 | 4 |
| IAS 39 | 3 |
| IFRS 8 | 3 |
| IAS 17 | 2 |
| IAS 19 | 2 |
| IAS 40 | 2 |
| Others | 8 |
| **Total** | **54** |

### • Specific reviews

*Review of the presentation of the annual financial statements prepared in accordance with IFRS standards*

The results of this review led the CSSF to publish a press release on 29 June 2011, recalling certain minimum requirements regarding information to be included in the financial statements prepared according to IFRS standards, and in particular on compliance with IAS 1 "Presentation of the Financial Statements", IAS 10 "Events after the Reporting Period" and IFRS 8 "Operating Segments".

*Review of the presentation of the half-yearly financial statements prepared in accordance with IFRS standards*

The results of this review also led the CSSF to publish a press release on 9 December 2011, recalling certain requirements of IAS 34 "Interim Financial Reporting", regarding the presentation and information to be provided, to be complied with in the half-yearly financial statements prepared according to IFRS standards.

*Review of the information relating to exposures to sovereign debt presented in the 2010 annual and 2011 half-yearly financial statements prepared according to IFRS standards for certain Luxembourg credit institutions*

Following this review and within the context of the close collaboration with ESMA, the CSSF published, through its press release of 29 November 2011, ESMA's statements of 25 November 2011 relating to the accounting treatment of the sovereign debt in the financial statements prepared according to IFRS standards. This press release highlighted:

- the main elements in relation to exposure to sovereign debt which should have been taken into account by the issuers and their auditors in the 2011 annual financial statements; and
- ESMA's opinion based on a survey undertaken among the national competent authorities (including the CSSF) in respect of the accounting treatment of the Greek sovereign debt in the 2011 half-yearly IFRS financial statements of some EEA issuers.

ESMA published this information in order to promote a consistent application of the European regulation applicable to securities and markets, and in particular IFRS standards. They followed the press release of 28 July 2011 in which ESMA warned the issuers about the necessity of greater transparency and application of the relevant IFRS standards in their financial statements on exposures to sovereign debt.

**• Reviews within the context of the issue of prospectuses**

During 2011, enforcement reviews were performed within the context of the prospectus approval process, and in particular in the event of an application for the admission to trading on a regulated market. The subjects and the issues dealt with mainly covered:

- preparation of *pro-forma* data;
- treatment of business combinations under common control;
- consolidation;
- equivalence to IFRS standards.

### 4.2.2. Main findings and recommendations

In general, the CSSF recommends issuers to favour in the notes to their financial statements the relevance of the information disclosed rather than an essentially exhaustive approach, aiming to entirely include the requirements and descriptions as presented in the standards, which does not allow or barely allows the identification of the important issuer specific issues and topics.

Within the context of the enforcement reviews carried out, the recurring identified infringements mainly cover the following topics:

- judgements and assumptions adopted when preparing the financial statements and the valuation methods of the financial instruments measured at fair value;
- methods applied for the identification, valuation and accounting for the impairments of the assets held, in particular for the available-for-sale securities:

Given the relevance of these data for the comprehensive understanding of the financial statements, the CSSF requests the issuers to make sure that they provide clear, precise and detailed information on the judgements, assumptions and methods adopted, as required by IFRS standards applicable in this respect.

- quality and comprehensiveness of the information disclosed on risk management:

IFRS 7 "Financial Instruments: information to be provided" requires the issuers to provide information in their financial statements in order to allow the users to assess the nature and extent of the risks arising from financial instruments to which the issuer is exposed as well as the way it manages these risks. The CSSF also requests the issuers to ensure the quality and relevance of the information provided in this respect.

- quality and comprehensiveness of the process applied for employee benefits and the related information disclosed:

IAS 19 “Employee benefits” requires the issuers to present various items of information, including some assumptions, in particular on the post-employment obligations.

- comprehensiveness of the information disclosed for operating segments:

IFRS 8 “Operating Segments” requires the issuers, including those presenting only one single operating segment, to provide specific entity-wide information.

- presentation and comprehensiveness of the information provided in the context of the interim financial statements:

IAS 34 “Interim Financial Information” specifies, *inter alia,* the minimum content of the interim financial statements as well as the periods during which this information must be presented. It also deals with the accounting and valuation methods as well as the information to be provided in the explanatory notes.

### 4.2.3. Prospects for the 2012 campaign

The enforcement campaign for the financial year 2012 follows an approach similar to the one of the preceding financial years. The population of issuers falling within the scope of enforcement according to the Transparency law is stable compared to the preceding financial year. For the selected issuers subject to the enforcement reviews, an alternation of general and more targeted specific reviews is planned.

In addition, within the context of the 2011 closing of accounts, the CSSF decided to alert, through a press release published on 6 January 2012, the issuers preparing their financial statements in accordance with IFRS standards, to a certain number of topics and issues which will be specifically monitored during its 2012 enforcement review campaign.

Thus, in a difficult market environment, characterised by strong tensions and a high volatility, the CSSF will pay particular attention to the information to be disclosed in respect of risks arising from financial instruments as well as issues related to the valuation and potential impairment of assets. These problems mainly relate to:

- financial instruments;
- non-financial assets, with specific attention given to the accounting for deferred tax assets on losses carried forward and for impairments on tangible and intangible assets, including goodwill.

The reviews will focus as much on the recognition and measurement of these valuations and potential impairments as on the disclosures in the financial statements related to the methods and assumptions used.

Moreover, further to the enforcement reviews carried out 2011, the CSSF will continue to monitor the implementation of recently introduced standards, such as IFRS 8 on operating segments and IFRS 3 (revised) on business combinations.

Finally, in a more general way, the management reports prepared by issuers will be subject to particular attention in order to ensure that both their form and their content are in line with the applicable legislation and regulation, in particular with regard to the relevant requirements of the law on takeover bids for Luxembourg issuers of shares.

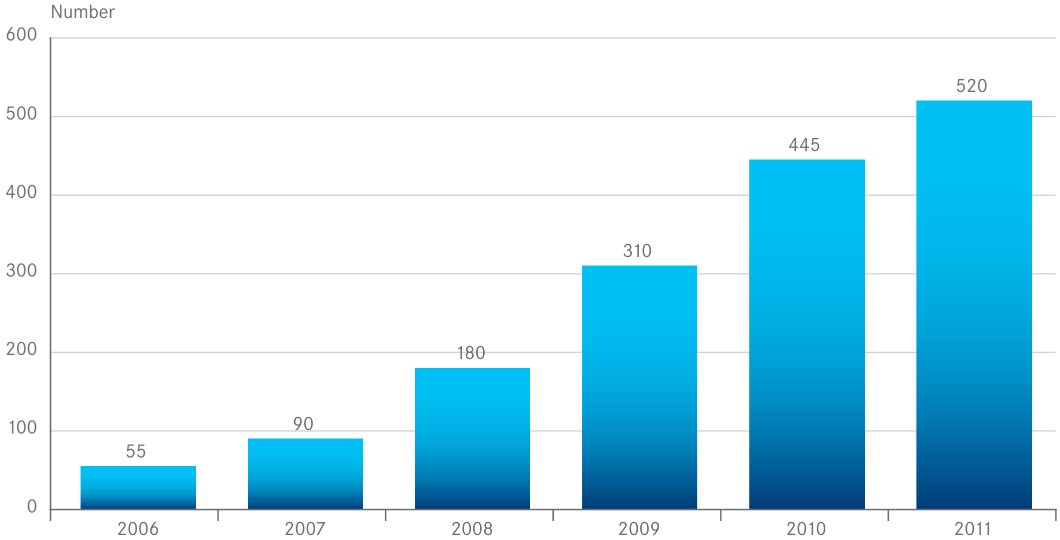
## 4.3. European cooperation: CRSC's works (Corporate Reporting Standing Committee) on the financial and accounting information

ESMA's work in the field of accounting, auditing, periodic information and storage of the regulated information is led by the CRSC (cf. item 2.2.3. of Chapter I "General supervision and international cooperation"). Enforcement-specific topics are discussed within the EECS group (European Enforcers Coordination Sessions).

The EECS is composed of 38 members representing the different national competent authorities in the enforcement field. It is aimed to list and share the main decisions on the application of IFRS standards to guarantee a convergent approach of the supervision, by the national competent authorities, of the application of IFRS standards by companies listed on a regulated market.

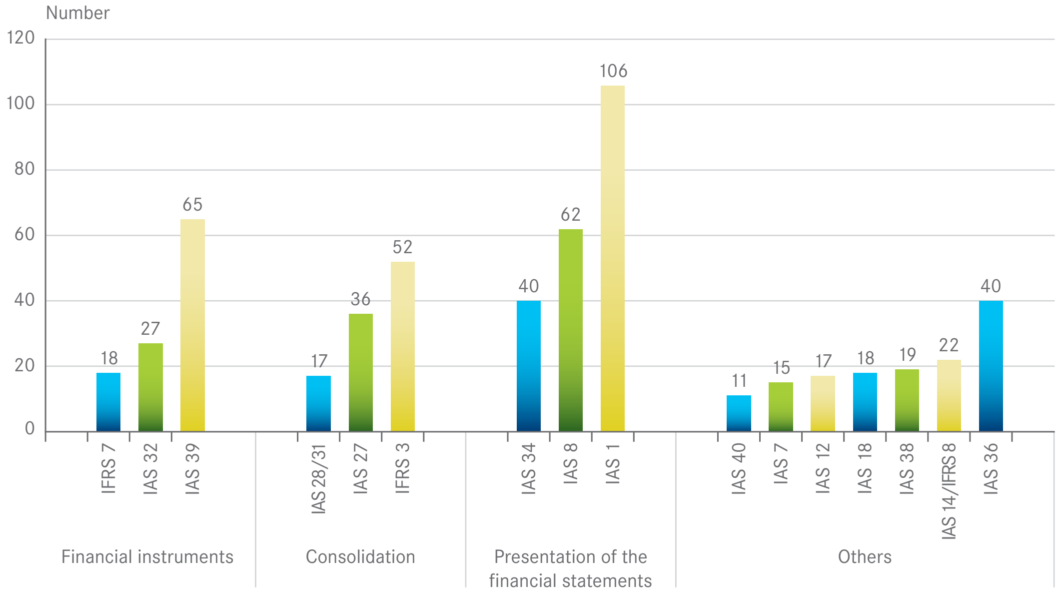
The decisions presented and discussed during the EECS meetings are entered into a dedicated database of 520 decisions as at 31 December 2011.

**Developments in the number of decisions since the establishment of the EECS database**



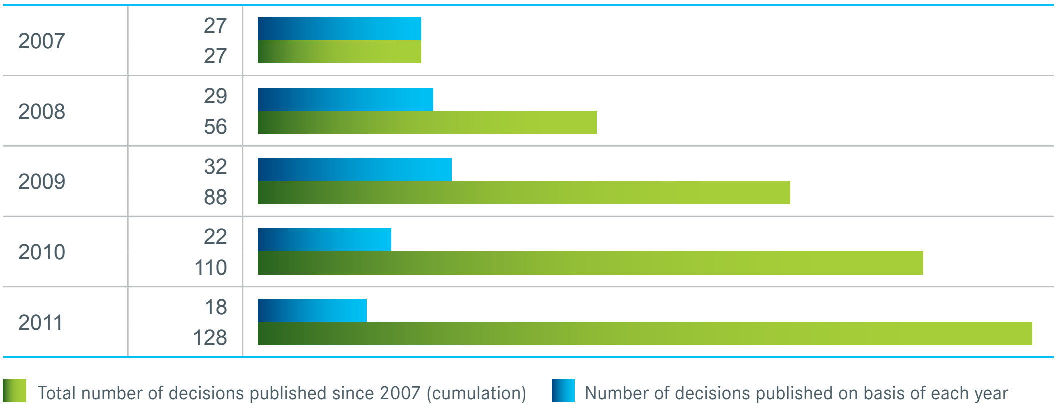

These decisions break down according to the main relevant standards as follows (it should be noted that the same decision may be related to several standards).

**Main standards concerned by the decisions in the database as at 31 December 2011**



Since 2007, the EECS has been publishing extracts of its database on a regular basis. Thus, two additional extracts, including a total of 18 decisions were published in 2011, bringing the number of decisions published to 128.

**Published decisions**




## 5. SUPERVISION OF MARKETS AND MARKET OPERATORS

### 5.1. Reporting of transactions in financial instruments

#### 5.1.1. Obligation to report transactions in financial instruments

The reporting regime in respect of transactions in financial instruments is mainly set down in Article 28 of the law of 13 July 2007 on markets in financial instruments (MiFID law) which transposes Article 25 of Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (MiFID Directive). This article lays down the obligation for credit institutions and investment firms to report to the CSSF the transactions in financial instruments admitted to trading on a regulated market. The details set out in Article 28 were completed by the implementing measures of Regulation (EC) No 1287/2006 of 10 August 2006 implementing the MiFID Directive and clarified by the instructions set out in Circular CSSF 07/302.

Within the context of the review of the MiFID Directive, the European Commission published a proposal for a regulation (MiFIR) on 20 October 2011, which includes new obligations regarding the reporting of transactions in financial instruments to competent authorities. According to this proposal, all transactions in financial instruments should be reported to the authorities, except those on the financial instruments which are not traded in an organised way and which are not likely to result in market abuse. The reports will moreover include details on the identity of the clients on behalf of which credit institutions and investment firms carried out transactions, as well as data on the identity of persons responsible for the execution of transactions. Credit institutions and investment firms will also have to transmit data to identify the clients when placing orders to be executed by other entities. If they decide not to transmit details on the identity of clients, they will have to report details on the transmitted orders to the competent authority.

#### 5.1.2. Credit institutions and investment firms concerned by the obligation to report transactions in financial instruments

As at 31 December 2011, 239 entities (credit institutions and investment firms incorporated under Luxembourg law and Luxembourg branches of credit institutions and investment firms incorporated under foreign law) fell within the scope of Article 28 of the MiFID law and were potentially concerned by the transaction reporting regime (238 entities in 2010), including 142 banks (144 in 2010) and 97 investment firms (94 in 2010). It should be noted that among investment firms, only those authorised to carry out transactions in financial instruments, i.e. commission agents, private portfolio managers, professionals acting for their own account, market makers, underwriters of financial instruments and distributors of units/shares of investment funds, are subject to the reporting obligation.

As at 31 December 2011, 102 entities (103 in 2010), of which 88 banks (89 in 2010) and 14 investment firms (*idem* in 2010), were required to send their transaction reports to the CSSF as their interventions are to be considered as "executions of transactions" within the meaning of the MiFID law, as specified by Circular CSSF 07/302. The difference compared to the number of entities that are potentially concerned by the reporting regime results from the fact that, in practice, a certain number of entities, mainly investment firms, are not subject to the obligation to report transactions in financial instruments because they do not conclude immediate market facing transactions and do not execute transactions on own account.

In 2011, the CSSF continued its controls on the quality of the data submitted by the entities subject to the obligation to report transactions in financial instruments. The reports of transactions in financial instruments of 15 entities were thus subject to detailed reviews by the CSSF. These reviews were mainly decided following shortcomings identified at the level of the respective reportings of these entities within the context of the daily market supervision. The main non-compliant elements identified within the context of the reviews were non-reported transactions falling within the scope, erroneous execution venues and counterparties to the transaction, missed reporting deadlines, "executions of transactions" within the meaning of Circular CSSF 07/302 gathered into one single transaction report as well as non-corrected rejected transaction reports.

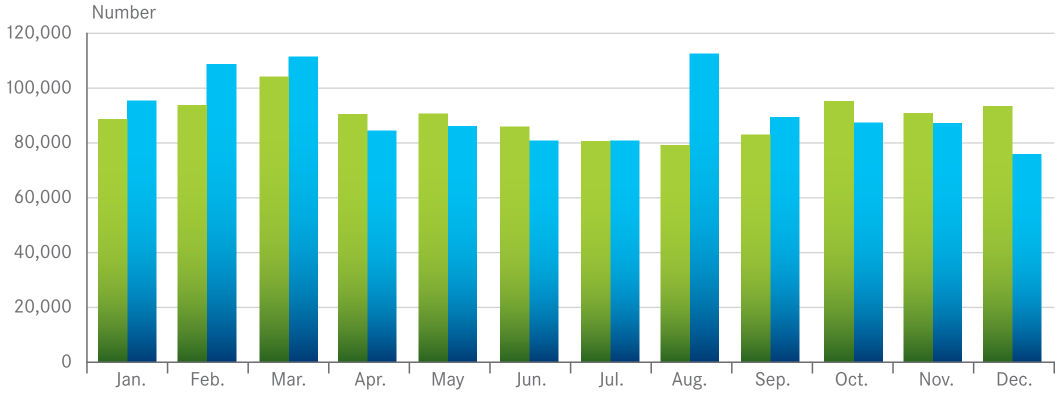
Along with the individual review of the reporting performed by the aforementioned entities, the CSSF carried out more general controls covering all entities subject to the obligation to report transactions in financial instruments. These controls were based on different types of errors and/or irregularities and were carried out for the purpose of detecting the following irregularities: missed reporting deadlines, reporting gaps, non-corrected rejected transaction reports, unlikely prices and/or quantities in the transaction reports and erroneous counterparties in the event of internalisation of transactions.

Observation letters were sent to the concerned entities for the purposes of clarifying and correcting the identified irregularities. In this context, one meeting was also organised in the premises of the CSSF. In some cases, a second intervention of the CSSF has proven necessary for the purposes of correcting errors and/or irregularities and improving the reporting systems of the concerned entities.

### 5.1.3. Development in the number of transaction reports in financial instruments

In 2011, the number of transaction reports sent by the entities and accepted by the CSSF reached 1,101,007 (+2.33% compared to 2010).

**Monthly volume of MiFID reports accepted in 2010 and in 2011**




| | Jan. | Feb. | Mar. | Apr. | May | Jun. | Jul. | Aug. | Sep. | Oct. | Nov. | Dec. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2010 | 88,538 | 93,737 | 104,174 | 90,597 | 90,815 | 86,020 | 80,299 | 79,251 | 83,015 | 95,297 | 90,635 | 93,522 |
| 2011 | 95,539 | 108,881 | 111,586 | 84,466 | 86,123 | 80,573 | 80,976 | 112,635 | 89,505 | 87,510 | 87,319 | 75,894 |

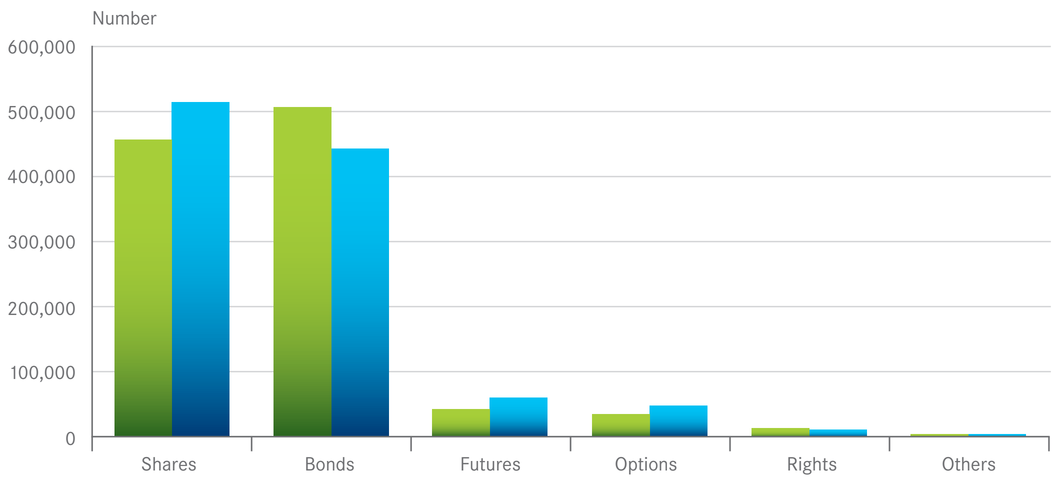
### Breakdown of transactions by month and by type of instrument in 2011

| | Shares | Bonds | Futures | Options | Rights | Others | Monthly total |
|---|---|---|---|---|---|---|---|
| **CFI Code** | **(Exxxxx)** | **(Dxxxxx)** | **(Fxxxxx)** | **(Oxxxxx)** | **(Rxxxxx)** | **(Mxxxxx)** | |
| January | 49,654 | 37,509 | 3,202 | 3,430 | 1,595 | 149 | 95,539 |
| February | 59,254 | 41,295 | 3,508 | 3,527 | 954 | 343 | 108,881 |
| March | 55,084 | 42,964 | 7,239 | 4,403 | 1,670 | 226 | 111,586 |
| April | 44,637 | 33,553 | 2,744 | 2,420 | 1,019 | 93 | 84,466 |
| May | 38,093 | 39,890 | 3,026 | 3,595 | 1,153 | 366 | 86,123 |
| June | 40,454 | 31,296 | 3,784 | 3,783 | 1,014 | 242 | 80,573 |
| July | 39,388 | 32,682 | 3,331 | 4,362 | 975 | 238 | 80,976 |
| August | 59,899 | 34,451 | 10,711 | 6,458 | 838 | 278 | 112,635 |
| September | 37,074 | 37,876 | 9,250 | 4,284 | 588 | 433 | 89,505 |
| October | 36,394 | 41,675 | 4,999 | 3,276 | 775 | 391 | 87,510 |
| November | 33,728 | 43,220 | 5,468 | 4,081 | 591 | 231 | 87,319 |
| December | 30,784 | 35,245 | 4,059 | 4,859 | 624 | 323 | 75,894 |
| **Annual total** | **524,443** | **451,656** | **61,321** | **48,478** | **11,796** | **3,313** | **1,101,007** |

In relative terms, the majority of reports in 2011 concerned transactions in shares (47.63%), followed by transactions in bonds (41.02%). Transactions in other types of instruments represented only a small part (futures: 5.57%, options: 4.40%, rights: 1.07%, others: 0.30%).



### Annual comparison of transactions by type of instruments




| | Shares | Bonds | Futures | Options | Rights | Others |
|---|---|---|---|---|---|---|
| 2010 | 465,602 | 516,646 | 43,366 | 35,149 | 13,058 | 2,079 |
| 2011 | 524,443 | 451,656 | 61,321 | 48,478 | 11,796 | 3,313 |

This data as well as the evaluation of the information received *via* TREM (Transaction Reporting Exchange Mechanism), set up between competent authorities for their respective supervisory missions, reveal the trends on European markets and, particularly, on the Luxembourg market. The main purpose of the supervision of the 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 are drawn up on the basis of the received reports. These *ex post* analyses of transactions in financial instruments can be used as a starting point for the CSSF's inquiries.

## 5.2. Supervision of stock exchanges

The establishment of a regulated market in Luxembourg is subject to a written authorisation of the Minister of Finance. Chapter 1 of Title 1 of the MiFID law sets out the authorisation conditions and requirements applicable to regulated markets. Where the operator of such a regulated market is established in Luxembourg, he must also obtain an authorisation as specialised PFS in accordance with the law of 5 April 1993 on the financial sector. The acts relating to the organisation and operation of the regulated market are supervised by the CSSF.

Pursuant to the provisions of the MiFID law, the operation of a multilateral trading facility (MTF) is part of the investment services and activities defined in that law. MTFs may be operated either by a market operator, or by a credit institution or investment firm.

There are currently two markets operated in Luxembourg by the same operator, namely Société de la Bourse de Luxembourg S.A. (SBL): a first market named *Bourse de Luxembourg* (Luxembourg Stock Exchange) which is a regulated market within the meaning of the European Directives and a second market called "Euro MTF", the operating rules of which are defined in the Rules and Regulations of SBL.

SBL is also the only company holding an authorisation as operator of a regulated market authorised in Luxembourg as defined in Article 27 of the law of 5 April 1993 on the financial sector. As such, SBL is registered on the official list of professionals of the financial sector and is part of the specialised PFS.

As far as its supervisory mission is concerned, the CSSF has had several meetings and exchanged mails with SBL. On the basis of the analytical reports transmitted by SBL and the electronic access to the information on stock market transactions, the CSSF also monitors the market activities and the problems encountered in relation to these activities. The development of SBL's financial situation is monitored, in particular, *via* the monthly reporting sent by SBL.

As at 31 December 2011, SBL had 67 members. As far as market activities are concerned, the trading turnover on both markets operated by SBL reached EUR 262.44 million in 2011 against EUR 219.16 million in 2010, which represents a 19.75% increase. This development is mainly due to a substantial rise in the trades in respect of fixed-income securities which represented 55.02% of the volume traded in 2011.

In 2011, SBL stabilised its position with regard to the admission to the official listing of international securities. 9,045 new issues were admitted, against 9,350 in 2010, representing a slight decrease of 3.26%. Amongst these issues, 7,982 issues were admitted on the regulated market *Bourse de Luxembourg* (Luxembourg Stock Exchange) and 1,063 on the Euro MTF market. Instruments admitted in 2011 can be broken down as follows: 5,921 bonds, 2,269 warrants, 822 UCIs and 33 shares, units and certificates.

As at 31 December 2011, the two markets operated by SBL totalled 44,369 listings, against 44,916 in 2010, divided into 29,243 bonds, 8,346 warrants, 6,440 UCIs and 340 shares, units and certificates. In the segment of shares, GDRs (Global Depositary Receipts) continue to represent a majority of the listed instruments.

As far as distribution services offered by SBL were concerned, more than 25,000 official notices were published on the SBL portal and 456 depositors and 505 issuers use SBL's OAM (Officially Appointed Mechanism).

The LuxX index closed the financial year 2011 with 1,135.10 points and thus shows a 26.39% decrease over a year. In respect of the composition of the pool used as a basis for the calculation of the LuxX index, the Executive Committee of SBL concluded that Aperam is included therein as from 1 March 2011 and that Dexia is no longer included since 2 January 2012.

# 6. INVESTIGATIONS AND COOPERATION

The CSSF is the administrative authority competent to ensure that the provisions of the Market Abuse law are applied. The purpose of this law is to combat insider dealing and market manipulation 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.

In the context of its supervision of securities markets, the CSSF either initiates inquiries itself or conducts them following a request for assistance from a foreign administrative authority within the framework of international cooperation.

## 6.1. Investigations initiated by the CSSF

In 2011, the CSSF opened six investigations into insider dealing and/or price manipulation. Within the context of the collection of information relating to national investigation files, the CSSF organised six hearings of persons involved. Such hearings allow affected persons to present arguments in fact and in law, and in particular to explain the reasons to initiate the executed transactions and to provide the CSSF with additional information in order to better assess the case.

The various items of information and documents obtained during the investigations enabled the CSSF to conclude in one investigation file that an insider dealing had been committed and to sanction it accordingly, to transmit two files to the judicial authorities and to close the remaining files. Verifications in relation to one investigation file will continue to be carried out in 2012.

Moreover, the CSSF strengthened its control of the compliance with the obligation arising from Article 17 of the Market Abuse law and issued five injunctions *vis-à-vis* managers concerned.

## 6.2. Investigations conducted by the CSSF upon request of a foreign authority

### 6.2.1. Inquiries into insider dealing

In 2011, the CSSF processed 34 inquiries into insider dealing (against 29 in 2010). The CSSF handled all these requests with the necessary diligence befitting cooperation between authorities and, within that scope, organised in Luxembourg five hearings of affected persons in which agents from the foreign competent authorities could partly participate.

### 6.2.2. Inquiries into price manipulation, breaches of the requirement to report major shareholdings and other breaches of the law

The CSSF received seven inquiries into price manipulations (eight in 2010), five inquiries into breaches of the requirement to report major shareholdings (*idem* in 2010) and fifteen inquiries relating to Luxembourg companies and/or their managers (four in 2010). The CSSF responded to all these requests within the scope of its legal competence.

## 6.3. Suspicious transaction notifications

In accordance with Article 12 of the Market Abuse law, any credit institution or other professional of the financial sector established in Luxembourg shall notify the CSSF if it reasonably suspects that a transaction might constitute insider dealing or market manipulation. Circular CSSF 07/280, as amended, sets out the application of this Article. Non-compliance with this requirement may result in an administrative fine from EUR 125 to EUR 150,000.

Based on the aforementioned Article 12, the CSSF received 17 suspicious transaction reports in 2011 (16 in 2010). For underlying financial instruments admitted to one or several foreign markets, the notified information was transmitted to the competent authorities of the market(s) concerned, thereby observing the cooperation obligation referred to in the Market Abuse law and multilateral cooperation agreements. This information can, where necessary, lead these authorities to open investigations.

In 2011, the CSSF received eight notifications of suspicious transactions transmitted by foreign authorities (five in 2010) and analysed them with the necessary diligence.

***Agents hired in 2011 and 2012: Departments "Supervision of securities markets", "Public oversight of the audit profession" and "Internal audit"***

Left to right: Carine BRANDENBURGER, Cédric MARCHAL, Jacqueline PICARD, Antonio COLINO, Valérie LECOINTE, Stefan WEYAND, Mathieu ANTOINE, Hanna KLATTENHOFF, Robert NOSSEK

# SUPERVISION OF INFORMATION SYSTEMS



# 1. ACTIVITIES IN 2011

This Chapter deals with the supervision of information systems of financial professionals, including mainly credit institutions, investment firms and specialised PFS. As regards the specific supervision of support PFS, please refer to item 3. of Chapter III "Supervision of PFS".

## 1.1. Participation in national groups

In 2011, the department "Information systems and supervision of support PFS" represented the CSSF within the following committees, commissions, associations or working groups:

- ABBL - Payments, ICT & Standardisation Committee. The Committee, in which the CSSF participates as an observer, dealt with topics relating to payment and clearing systems, bank cards, direct debits and especially the European project SEPA (Single European Payment Area) coordinated by the EPC (European Payment Council). The vulnerabilities specific to the use of financial services *via* the Internet are also reviewed.
- CRP Henri Tudor and the INNOFinance programme, initiated in 2007.
- Luxembourg Institute for Standardisation, Accreditation, Safety and quality of products and services (Institut Luxembourgeois de la Normalisation, de l'Accréditation, de la Sécurité et qualité des produits et services, ILNAS). This authority, under the responsibility of the Minister of Economy, has been created by the law of 20 May 2008 and started its activities on 1 June 2008.
- Operational Crisis Prevention Group for the financial sector (OCPG) under the aegis of the Luxembourg Central Bank. The mission of OCPG consists in identifying the risks supported by the financial sector in relation to critical infrastructures, in order to suggest measures enabling to prevent a possible operational crisis which would disrupt the functioning of the financial professionals and jeopardise the proper settlement of monetary operations.

## 1.2. International cooperation

### 1.2.1. Cooperation within the ESFS

Following the creation of the European System of Financial Supervision (ESFS), an adaptation of the EBA's and ESMA's information systems was required in order to process the information coming from national supervisory authorities. Several IT projects in relation to the supervision of financial markets were identified. Their aim is to harmonise the exchange of financial information through a centralised platform located in one of these two new institutions.

In order to coordinate these pan-European projects, the CSSF is a member of the governance bodies related to the technology of information systems, i.e. the IT Management and Governance Group (ITMG) of ESMA and the Information Technology Sounding Board (ITSB) of the EBA. These groups are made up of persons responsible for information technology within the supervisory authorities of the Member States and met eight times during 2011.

Since the deadlines for the implementation of the new reporting types are very short, the EBA decided to outsource its information system with a national authority, namely the Banque de France. This system may process several reporting types in XBRL format (FINREP, COREP and KRI). A working group was created under the responsibility of ITSB to standardise the XBRL taxonomies (cf. also item 3. of Chapter XVI "Internal organisation of the CSSF").

In parallel, works are in progress to draw up a register of the European financial institutions. This register will allow checking the key risk indicators of each EEA financial institution.

Since 2007, ESMA has had its own information system mainly used to exchange data on securities transactions according to the requirements defined in the MiFID Directive. Since 2011, the TREM network has also been used to gather information from credit rating agencies in order to supply a central electronic reference database containing data on the rating activities. The purpose of this system called CEREP (Central Rating Repository) is to improve transparency and contribute to investor protection by providing coherent and comparable information on the historical performance of ratings given by the credit rating agencies (cf. http://cerep.esma.europa.eu/cerep-web/statistics/ratingActivity.xhtml).

At the end of 2011, ESMA launched a feasibility study in order to analyse high frequency trading. High frequency trading involves transactions executed in microseconds using powerful computers and represents 50% to 80% of the volumes exchanged on the markets. A working group of ITMG was entrusted to study the technical requirements in order to implement a supervisory system for these transactions.

### 1.2.2. IT Supervisory Group

The CSSF has been participating in the international working group IT Supervisory Group (ITSG) for several years. At the annual international meeting, which was held under the aegis of the Mexican authorities, regulators took stock of and exchanged information on topics related to methodological supervisory and audit tools based on the risk analysis, to hacking, to the availability of IT systems and applications, to payment card frauds, to outsourcing, particularly in the framework of cloud computing for the financial sector and to other recurring or current topics that impact on the prudential supervision regarding IT.

In 2011, the CSSF organised the European meeting of ITSG in which representatives of eight countries (Germany, Belgium, Spain, Italy, Luxembourg, Norway, Netherlands, United Kingdom) participated and during which the topics were discussed in a more targeted manner by taking into account the specificities of the EU legal framework.

### 1.2.3. The European Forum on security of retail payments (Forum SecuRe Pay)

Created in 2011 upon the initiative of the Payment and Settlement Systems Committee (PSSC) of the European Central Bank (ECB), the Forum is chaired by the ECB. Luxembourg is represented by the CSSF and the Luxembourg Central Bank as active members. The Forum is a voluntary cooperation between authorities in order to facilitate common knowledge and understanding, particularly between the national central banks and the supervisory authorities of the payment service providers, of the risks and challenges concerning the security of retail payments. The Forum deals with the challenges concerning the electronic payment instruments and services available within the EU/EEA Member States or provided by service providers located in an EU/EEA Member State. The purpose of the Forum's works is the complete processing chain of the electronic retail payment services (except cheques and cash), irrespective of the payment channel used. The Forum particularly focuses on the areas showing important weaknesses and vulnerabilities and, where appropriate, issues recommendations in order to remedy these weaknesses and vulnerabilities. Its final goal is to promote the setting-up of a harmonised security level within the EU between the authorities concerned. The members of the Forum undertake to support the implementation of the recommendations issued by the Forum in their respective jurisdictions.

In its first year of activity, the Forum focused on the security of online payment services. The experience of regulators, legislators, payment service providers and the public shows that online payments have higher fraud levels than the traditional payment methods. The Forum is currently finalising the draft of its first report which sets out recommendations in order to improve the security of online payment services within the EU. This report will be subject to a public consultation and its official publication is expected in the last quarter of 2012.

## 1.3. Developments in the regulatory framework

In 2011, the CSSF published one single circular concerning the supervision of information systems, namely Circular CSSF 11/504 on frauds and incidents due to external computer attacks.

This circular replaces the circular-letter of 2007 regarding information on frauds and incidents relating to online financial services to be transmitted to the CSSF. Thus, the purpose of this circular is to request all the supervised establishments to report to the CSSF as soon as possible any frauds and any incidents due to external computer attacks and to keep at their own initiative this information up to date after the date of this report. This survey is carried out for statistical purposes. Due to the regular occurrence of new external computer attacks which may result in frauds or incidents, the CSSF deems appropriate to draw up a regular assessment of the situation in order to:

- follow the development of the phenomenon more closely;
- be able to inform the supervised entities on the types and frequency of the attacks;
- anticipate as much as possible the cycles in relation to attack phases as well as the probable consequences for the financial centre;
- contribute to a better protection of the activity of the financial centre through recommendations adapted to the reported incidents.

The circular specifies that an incident shall be reported as soon as an actual attack succeeded (e.g. confirmed attempt of embezzlement, corrupted IT system) even if the attack did not lead to a fraud (e.g. absence of actual misappropriation of funds).

It should be borne in mind that phishing attacks are excluded from the perimeter and shall therefore not be reported.

The circular also provides that even though the online financial services are the preferred target for computer attacks, the latter may also aim at other types of service or internal activity. Thus, the reports concern any fraud or incident following an external computer attack in relation to:

- financial services provided through Internet which include all the online services provided by a Luxembourg entity, *via* Internet, by direct or indirect way to private or professional clients irrespective of the fact that the IT platform is operated by the entity itself or by third parties;
- any other internal or external service or activity of the supervised entity, in order to include in the perimeter the attacks through Internet targeting for example the internal network, internal servers or data exchanges between an entity and a third party (partner, correspondent, parent company, subcontractor, etc.).

Finally, the circular lists the information that the supervised entities shall transmit to the CSSF when they report a fraud or an incident due to an external computer attack.

The CSSF circular on the new supervisory framework relating to support PFS, called Circular RBA (Risk Based Approach), is in the final phase of being drafted. Its publication is expected in the second quarter of 2012, in order to be applicable to support PFS as from 2013. The circular provides the setting-up, by the supervised entity, of a risk management system aimed at clients of the financial sector and based on a self-assessment. It also specifies the mission of the external auditor in the preparation of a long form report. The methodological elements of risk management are improved by a standard necessary to rate risks and impacts. Aware of the fact that the circular may create additional work for support PFS, the CSSF envisages two different phases: one for the submission of the report on risk management to be drawn up by the support PFS and another for the submission of the long form audit report drawn up by the external auditor. The time frame between the submission of these different reports will be used to establish the implementation of a risk management process through a dialogue between the CSSF and the support PFS in order to respond to the difficulties or questions arisen from the new approach.

## 2. SUPERVISORY PRACTICE OF INFORMATION SYSTEMS

The supervision includes the verification that supervised entities comply with the legal and regulatory framework, with the direct or indirect purpose to maintain or improve the professionalism of their activities. It focuses, in particular, on the technologies implemented for the information systems and takes into account the specificities of the outsourcing of these services with support PFS or third parties, outside or within the group.

### 2.1. Central administration of payment institutions and electronic money institutions

The law of 10 November 2009 on payment services defines, among others, the legal framework of payment institutions and electronic money institutions incorporated under Luxembourg law.

In the framework of the review of these institutions' application files, the CSSF noticed a clear trend to relocate the computer processing and thus the IT infrastructures supporting the services provided in relation to the authorisation. Insofar as the activities of the payment institutions and electronic money institutions mainly depend on the use of an efficient IT application and technical platform, the CSSF pays special attention to these elements and considers that the outsourcing conditions granted to the financial professionals as described in Circular CSSF 05/178 are applicable and that their local presence is important for a central administration according to Article 11(1) of the law of 10 November 2009.

Point 4.5.2.2. of Circular CSSF 05/178 specifies that "the outsourcing shall contractually be entrusted to the parent undertaking (or, in the case of branches, to the head office) or to a subsidiary of the parent undertaking or to a company specialised in IT processing controlled by the group to which the financial professional belongs. The entity responsible for the service provision must fall under the scope of the prudential supervision performed by a foreign supervisory authority. It is not mandatory for the processing centre to be physically located on the premises of the responsible entity. Where the processing centre is physically located on the premises of or operated by a legal entity other than the one to which the processing has been entrusted with contractually, the financial professional shall ensure that the supervised entity, contractually responsible, complies with the principles indicated under point 4.5.2.1.. The financial professional shall ensure to provide the CSSF with any elements proving that the sub-outsourcing process is under control. To this end, it shall present a document indicating the awareness of the other relevant supervisory authorities of this outsourcing, specifying whenever possible, the extent of their supervision in this context.".

This safety measure allows the CSSF to ensure that the relocated outsourcing falls within the scope of the prudential supervision beyond the central administration established in Luxembourg. When these conditions cannot be observed, the CSSF decides on a possible derogation only after having assessed the overall situation of the financial institution and the preventive measures suggested by the latter in order to guarantee the perenniality and quality of the relocated service provisions.

Due to the activity of payment institutions and electronic money institutions which is often cross-border, the CSSF does not authorise the outsourcing of core functions (like IT) abroad if it does not have sufficient means to ensure the effective supervision of the authorised entity.

## 2.2. Use of cloud computing by financial institutions

Among all the prudential principles applicable to financial professionals, some are particularly important when using cloud computing because they are specific to the issues of the cloud-based outsourcing and applicable as soon as the processing or storage relate to the core activities of the financial professional.

For these purposes, at least three principles shall be pointed out, i.e.:

- the financial institutions shall always have their activities under control from a technical and operational perspective;
- the risks shall be correctly assessed, reduced, transferred or accepted;
- the residual risks shall be known and accepted.

Irrespective of the outsourcing limitations related to professional secrecy, a financial professional intending to use a service provider through cloud computing shall ensure that the subcontractor(s) is(are) perfectly transparent as regards the modalities for the cloud implementation: geographical location, inter-sectoral mutualisation, mechanisms for segregating environments, management of environments with or without virtualisation, segregation of network segments, allocation of resources and others. The full transparency towards the providers from the subcontracting chain (from the application provider to the one housing the physical equipments) shall be ensured.

Concerning its obligation of business continuity, the financial professional shall also consider getting back or transferring these service provisions to another cloud in case a provider of the chain stops its activities. Its due diligence obligations are thus particularly difficult to comply with when using cloud computing and, therefore, the CSSF considers that the problem does not lie with the technological or commercial aspect of the cloud (billing according to consumption with no or little capital expenditure), but with the number of participants and the possible dilution of the responsibilities between them which prevent the financial professionals from being able to keep control of the activities, notably technical.

Moreover, the youth of the cloud concept and the implemented technologies (not only the virtualisation, but also the almost dynamic combination of the mutualisation and parameter tools of the resources) create difficulties in correctly assessing the risks and, in particular, the residual risks which are subject to acceptance by the financial professional. Where the vulnerabilities and threats are not identified, the risk cannot be correctly assessed because they are part of the equation risk R = vulnerability x probability of a threat x impact.

However, the CSSF would like to point out that a lot of control elements to be taken into account by the financial professional are solved when the cloud provider is a support PFS because the latter shall apply these same prudential principles and is subject to the same legal framework as its client of the financial sector. The entire chain of providers shall have an authorisation as support PFS as soon as they manage even part of the information system. Only the last provider which offers "white" rooms (housing facilities) does not need the status if it does not work on the IT equipments. The support PFS are responsible for ensuring the correct segregation of environments and their business continuity. Thus, a financial professional wishing to use cloud computing with a support PFS shall contractually ensure two aspects, particularly *vis-à-vis* professional secrecy: (1) the guarantee that the processing takes place and that the data is on the Luxembourg territory in order to minimise the risks related to possible legal differences between jurisdictions and (2) the support PFS participating in the management of the cloud commit to remain compliant with the obligations of their status. Thus, the prudential chain is continuous and the CSSF carries out its tasks within all the participants under its supervision.

Consequently, the support PFS which put in place a cloud offer even outside the financial sector shall present it to the CSSF from a commercial as well as technical perspective.

## 2.3. Internet threats

The year 2011 was marked by an increase of hacking in the financial sector (in the EU and the United States) and outside the financial sector (Diginotar, RSA, Sony, etc.).

Some attacks against e-banking services from abroad were possible due to a combination of interactive phishing and a Trojan "Man-in-the-browser" which allowed the hackers to manipulate the HTML content coming from the bank before the navigator showed it on the screen. This attack occurred despite a strict authentication procedure provided by the bank to the client. Some transfer transactions have been misappropriated and validated by the user her/himself, victim of interactive phishing, during the hacked e-banking session.

This weakness results from the implementation of the banking solution not requiring stronger mechanisms such as signed and stable Java applets and is based on the client's inattentiveness who does not expect to be a victim of phishing during her/his e-banking session.

These attacks show that enhanced due diligence remains important for financial institutions and computer scientists when designing and implementing e-banking applications as well as for clients who have to be made aware of the diversity of the threats and to remain attentive during the reading of the screens and the validation of the transactions. It is also important that the clients inform their financial professional of any anomalies in their e-banking application.

The works carried out by the European institutions (e.g. ENISA - European Network and Information Security Agency) and the central banks in the context of online payment transactions purpose to reach a more consistent and more efficient minimum security within the EEA. These works emphasise the players' interaction (application providers, financial institutions, clients, public institutions, etc.) and the importance for each one of them to contribute to this diligence by raising awareness of the challenges in cyber-security.

As regards more particularly Luxembourg, the CSSF listed only a limited number of succeeded attacks on e-banking websites based on Circular CSSF 11/504.

***Agents hired in 2011 and 2012: Department "Supervision of undertakings for collective investment"***

Left to right: Amandine HORDEBISE, Pierre HILBERT, Agnès GURY, Anne WIRARD, Urbain HEVER, Gisèle DETAILLE, Angelica FORMICA, William LEBEC, Julien GAGEONNET, Ariane GUIGNARD, Joy FLICK

Absent : Marisa GARCIA FERNANDES

# PUBLIC OVERSIGHT OF THE AUDIT PROFESSION

1. Regulatory framework of the audit profession
2. Quality assurance review
3. Overview of the population of *réviseurs d'entreprises* (statutory auditors) in Luxembourg

# 1. REGULATORY FRAMEWORK OF THE AUDIT PROFESSION

## 1.1. Developments in the regulatory framework in 2011

During the year 2011, the CSSF contributed to the development of the regulatory framework governing the exercise of activities reserved to *réviseurs d'entreprises agréés* (approved statutory auditors) and *cabinets de révision agréés* (approved audit firms) by adopting in Luxembourg the clarified international standards on auditing issued by the International Federation of Accountants (IFAC) without awaiting their adoption by the European Commission.

In this context, CSSF Regulation No. 10-01, the purpose of which was to maintain continuity in the regulatory framework when the law of 18 December 2009 on the audit profession entered into force ("Audit Law"), was repealed and replaced by CSSF Regulation No. 11-01 of 8 July 2011.

CSSF Regulation No. 11-01 is divided into three chapters, supplemented by annexes:

- the purpose of the first chapter is to adopt standards relating to the activities referred to in Article 1(29)(a) of the Audit Law, in accordance with Article 57(3)(d) of this Law. These standards apply for the financial years starting on 1 January 2011;
- the second chapter adopts standards relating to the other missions reserved by the Audit Law exclusively to *réviseurs d'entreprises agréés* (contribution other than cash, merger/demerger auditor, liquidation auditor, interim dividend distribution, control on production expenditures eligible to obtain investment audiovisual certificates and selective financial support);
- the third chapter adopts standards on ethics and standards on internal quality control of *cabinets de révision agréés* in accordance with Article 57(3) (e) of the Audit Law.

This regulation is completed by Circular CSSF 11/527 which concomitantly specifies and/or supplements the binding rules of the standards as well as the standards' annexes, thus representing the best practice principles which guide the CSSF's quality assurance reviews.

The international standards on audit, the international standard for quality control as well as the Code of Ethics of the International Ethics Standards Board for Accountants (IESBA) are published on the CSSF's website in English. The English version prevails as there is no official translation into other EU languages.

In 2011, the CSSF also published two other CSSF regulations:

- CSSF Regulation No. 11-02 relating to the establishment of a list of Master's degrees or diplomas corresponding to equivalent training which satisfy the requirements referred to in Article 2(1) and (2) of Grand-ducal regulation of 15 February 2010 determining the requirements for the professional qualification of *réviseurs d'entreprises*, and
- CSSF Regulation No. 11-03 relating to the establishment of a list of approvals referred to in Article 1, Section B of Grand-ducal regulation of 15 February 2010 determining the requirements for the professional qualification of *réviseurs d'entreprises*.

## 1.2. Works in progress within the *Comité Technique d'Audit* (Audit Technical Committee, CTA)

At the end of 2011, the CTA started considering the minimum audit works to be carried out relating to the valuation of significant investments for which no objective price is available on an active market. Determining the fair value of such investments, according to the applicable accounting framework, has become a complex exercise, characterised by an important judgement. First, it is the duty of the bodies responsible for preparing the annual accounts to perform this valuation based on sufficient, appropriate and reliable information. Then, the *réviseurs d'entreprises agréés* should control the valuation based on the recommendations of the standard ISA 540 (Auditing accounting estimates, including fair value accounting estimates and related disclosures), adopted through CSSF Regulation No. 11-01.

First, the CSSF noted, based on the quality assurance reviews carried out, that the extent and nature of the audit diligence performed could vary between *réviseurs d'entreprises agréés* and were not always sufficient. This results in an inappropriate use of an emphasis of matter paragraph in the reports of the entities concerned by this issue. In particular, an emphasis of matter paragraph must not be used to state the impossibility to perform certain audit diligences, considered necessary by the *réviseur d'entreprises agréé* who should, in such cases, consider issuing a modified audit report.

The subject is far-reaching and concerns several types of entities, including UCIs (in particular those governed by Part II of the law of 17 December 2010 on undertakings for collective investment), specialised investment funds, investment companies in risk capital, non regulated legal entities operating in private equity and banks. Representatives of the CSSF's departments that supervise entities concerned by this subject have been involved in the CTA's works, in order to gather more views.

Secondly, based on discussions within the CTA, a circular concerning the determination of the materiality threshold within the framework of statutory audits of UCIs is being drawn up. It aims at regulating the practice of quantified materiality thresholds by emphasising the importance of the professional judgement of the *réviseur d'entreprises agréé* in order to assess the suitability of these thresholds in the context of the individual audits under his responsibility. Moreover, it specifies the notion "clearly trivial" within the meaning of paragraph 5 of standard ISA 450 (Evaluation of misstatements identified during the audit).

Thirdly, the CTA is currently discussing the difficulties to apply ISA 550 (Related Parties), also within the framework of statutory audits of UCIs. Indeed, based on the definition of "related party" laid down in ISA 550 and according to which an entity with no capital link with the UCI must be considered, where applicable, as a related party, several service providers are likely to be deemed as "related parties". In this context, the CSSF emphasises how important it is that *réviseurs d'entreprises agréés* be critical when assessing whether the relations and transactions with related parties may not have been disclosed to the auditor.

Finally, the CTA is also involved in discussions concerning the modified audit reports issued in the context of umbrella funds. These discussions concern in particular the link between the opinion of the *réviseur d'entreprises agréé* concerning the figures presented in the UCI's annual accounts relating to a particular sub-fund and the opinion concerning the figures relating to all the sub-funds considered as a whole. The CSSF is of the opinion that if the *réviseur d'entreprises* issues a qualified opinion, a disclaimer of opinion or an adverse opinion in relation to the figures of a sub-fund, the *réviseur* should assess the impact on the opinion issued in relation to the aggregated figures of the fund based on a materiality threshold similar to those used for the individual sub-funds.



## 1.3. Amendment of the regulatory provisions concerning the qualification requirements of *réviseurs d'entreprises*

In February 2012, following the opinion of the Consultative Committee for the Audit Profession, the CSSF transmitted to the Minister of Finance a proposal for a Grand-ducal regulation aiming to replace Grand-ducal regulation of 15 February 2010 establishing the qualification requirements of *réviseurs d'entreprises*.

The proposed amendments are based, on the one hand, on the identification of improvement areas for regulatory provisions based on the CSSF's experience with respect to the implementation for two years of that regulation, and, on the other hand, on the need to make the access conditions to and the conditions for the organisation of the training period more restrictive, given the increased failure rate observed since the entry into force of the new regulation.

The main changes relating to the training period of the *réviseurs d'entreprises* are: justification of minimum theoretical prerequisites before being admitted to training, limitation of the period within which the trainee *réviseurs d'entreprises* must complete the certificate of complementary training organised by the University of Luxembourg and a maximum number of permissible failures in every single test for the certificate.

## 1.4. Proposal for the reform of audit by the European Commission

The release on 13 October 2010 of the Green Paper "Audit policy: lessons from the crisis" by the DG Internal Market and Services of the European Commission under Mr Michel Barnier, European commissioner, was followed on 30 November 2011 by the publication of a proposal for a European directive amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and a proposal for a European regulation on statutory audits of Public Interest Entities (PIEs).

While the European Commission had launched a broad consultation in relation to the Green Paper, calling for the opinion of stakeholders such as representatives of the audit profession, supervisory authorities, academics and companies, it is clear that it has not systematically taken into account the comments received and the discussions held.

Moreover, many stakeholders observed that the European Commission proposes a comprehensive reform, although the last recast of the Audit Directive is very recent and its impact has not yet been measured in practice.

The European Commission aims at clarifying the role of the auditors and introducing more stringent rules for the audit sector in order to strengthen the independence of auditors and introduce greater diversity into the audit market. Furthermore, the European Commission proposes to create a single market for statutory audit services allowing auditors to exercise their profession freely across Europe once licensed in one Member State. The single market also aims at ensuring that all statutory auditors and audit firms comply with international auditing standards when carrying out statutory audits. Nevertheless, the proposal also allows for a proportionate application of standards in the case of small and medium-sized companies.

Other proposals relate to the removal of any requirement in terms of minimum capital or voting rights held by statutory auditors or other audit firms, the European supervision of the audit sector and the coordination of auditor supervisory activities by ESMA.

The key proposed measures concerning the statutory audit of PIEs include:

- mandatory rotation of audit firms after a maximum engagement period of six years (unless otherwise specified), which can be extended to nine years if joint audits are performed, and cooling-off period of four years;
- mandatory open and transparent tenders when selecting a new auditor. The audit committee of the audited entity should be closely involved in the selection procedure;
- reinforcing the audit committee's independence through the provision that a majority of its members must not be part of the executive body of the firm and that at least one member must have in-depth knowledge of audit and another one must have had training in audit and/or accounting;
- prohibition for audit firms to provide non-audit services to audit clients. In addition, these audit firms will have to separate their audit activities from other activities in order to avoid any conflict of interest; large audit firms must give up those other activities;
- prohibition of "Big 4"[1]-only contractual clauses;
- establishment of binding rules in terms of presentation and content of the audit report which should cover at least 23 points and of the internal report submitted to the audit committee covering 14 points. The annual "transparency" report must be available on the statutory auditor's website for at least five years and be associated with a report of the PIE's governance;
- establishment of the disclosure of audit fees and limits regarding the income generated by a single client.

The CSSF will take part in the development of this major project within the different European bodies.

[1] Deloitte, Ernst & Young, KPMG and PWC.

# 2. QUALITY ASSURANCE REVIEW

## 2.1. Scope

### 2.1.1. General framework

By virtue of the Audit Law, *réviseurs d'entreprises agréés* and *cabinets de révision agréés* are subject to a quality assurance review, organised according to the terms laid down by the CSSF in its capacity as supervisory authority of the audit profession, for engagements concerning statutory audits as well as for all such other tasks which are exclusively entrusted to them by the law.

The quality assurance review takes place at least every six years. This cycle of review has been brought down to three years for *réviseurs d'entreprises agréés* and *cabinets de révision agréés* that audit PIEs.

**Population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* concerned by the quality assurance review**

The population of *cabinets de révision agréés* and *réviseurs d'entreprises agréés* that carry out statutory audits and other tasks conferred exclusively upon them by the law is as follows (as at 31 December 2011):

- Number of audit firms: 65, including 12 that audit PIEs;
- Number of independent auditors: 11, none of which audits PIEs.

Based on the data collected through the "Annual Annexes" for the year 2011, the statutory audit engagements break down as follows between *cabinets de révision agréés* and independent *réviseurs d'entreprises agréés*:

- 79% of the engagements are carried out by the "BIG 4";
- 11% of the engagements are carried out by middle-sized audit firms[2] , and
- 10% of the engagements are carried out by the other audit firms and independent *réviseurs*.

### 2.1.2. Scope of the quality assurance review

The CSSF follows a global approach of control in which the audit firm is the entry point for the periodical quality assurance review.

The global control of the audit firm consists in:

- appraising the existence within the firm, of an organisation, policies and procedures aimed to ensure the quality of the statutory audit engagements and the fact that it is designed and operating effectively and the independence of the *réviseur d'entreprises agréé / cabinet de révision agréé* in accordance with the International Standard on Quality Control ISQC 1;
- verifying, based on a sample of engagements, the proper execution of certain engagements by the audit partners (*réviseurs d'entreprises agréés*) to ensure, on the basis of this selection, the existence and efficiency of the procedures and internal quality control system, and
- assessing the content of the transparency report for *cabinets de révision agréés* that are required to draw up such a report, based on the review work performed.

### 2.1.3. Organisation of the quality assurance review

The quality assurance review of an audit firm includes several stages:

- collection of preliminary information from audit firms;
- elaboration of a control plan;
- on-site inspections;
- presentation of the observations made;
- gathering the audit firm's responses to the CSSF's observations, and
- writing and issuing the report.

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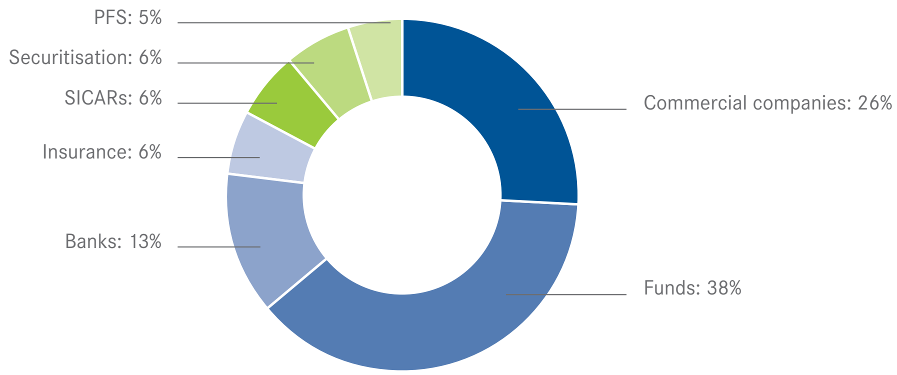
[2] Firms that carry out more than 100 engagements reserved by the law to *réviseurs d'entreprises agréés* and *cabinets de révision agréés*. As at 31 December 2011, five firms are concerned.

## 2.2. Activity programme for 2011

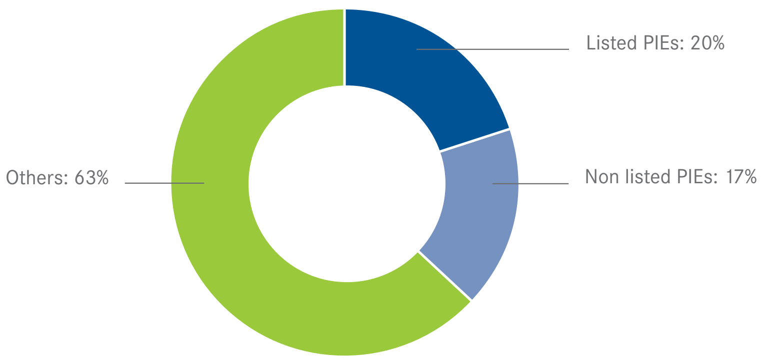
The CSSF set down a multiannual programme for the control of *cabinets de révision agréés/réviseurs d'entreprises agréés*, aiming at observing the legal quality assurance review cycle. All the firms that audit PIEs will be controlled before 31 December 2012; audit firms and independent *réviseur*s that do not audit PIEs will be controlled before 31 December 2015. This programme was based on the information transmitted by audit firms and *réviseur*s through the "Annual Annexes" relating to their activity.

| Activity programme for 2011 | Key data |
|---|---|
| The quality assurance reviews according to the 2011 programme covered:<br>- the understanding and documentation of the organisation, policies and procedures established by the reviewed firms in order to assess compliance with the International Standard on Quality Control (ISQC 1);<br>- a sample of engagements relating to statutory audit of the financial year 2010 (or 2009 where applicable); and<br>- the follow-up on observations made in 2010 for *cabinets de révision agréés* subject to a quality assurance review spread over three years due to the substantial volume of managed files. | 7 reviewed firms that audit PIEs and that are members of an international network |
| The seven reviewed audit firms have[3] a total of 7,235 mandates falling within the scope of public oversight of the CSSF, including 419 in relation to PIEs. These mandates include 6,435 statutory audits, of which 370 concern PIEs. | 203 controlled mandates including 74 PIEs and 129 other entities |
| The quality assurance reviews started in April 2011 and were carried out by seven CSSF inspectors with professional audit experience and expert knowledge in the business areas of the financial centre. | 5,266 hours |

**Breakdown of statutory audits reviewed by the CSSF in 2011 per sector**




**Breakdown of statutory audits reviewed by the CSSF in 2011 per entity type**




[3] Based on the statements of *cabinets de révision agréés* (Annual Annexes) as at 31 December 2010.

## 2.3. Results of the 2011 reviews

The major issues identified during these quality assurance reviews are detailed below.

### 2.3.1. International standard on quality control (ISQC 1)

The *cabinets de révision agréés* must improve the monitoring of their quality control system. The CSSF underlines that this component covers two aspects:

- an ongoing assessment of the other components of the quality control system, and
- a periodic quality control of a sample of completed engagements.

As regards ongoing assessment, the CSSF expects that the aspects described in paragraph A65 of ISQC 1 are monitored and assessed at least annually.

Quality must be an important criterion in assessing the performances and in defining the remuneration of all the staff members of a *cabinet de révision agréé*.

The CSSF insists on the importance of the final assembly and the documentation of audit files within 60 days as laid down by the standard, while ensuring confidentiality, safe custody, integrity, accessibility and retrievability of the documentation.

### 2.3.2. Audit files

As already stressed in 2010, the time spent by the person in charge of the engagement quality control review (EQCR) and the related documentation must be improved.

Analytical procedures, whether they are used as risk assessment procedures (ISA 315 §6 and A7), substantive procedure (ISA 520 §5) or as a means to form an overall conclusion on financial statements (ISA 520 §6), must be implemented in compliance with the goals and rules described in these two standards.

The auditor must ensure to apply the appropriate diligence laid down in the standard relating to accounting estimates and, in particular, as regards the fair value measurements.

As regards the auditor's responses to assessed risks, the CSSF underlines that the audit file must clearly state:

- the identified risks, including significant risks;
- knowledge of the controls of these risks as performed by the entity;
- procedure tests implemented where the auditor relies on controls; these tests must validate a control and must not be confused with tests of detail;
- the impact of the results of the validation of the controls on the substantive tests.

Where an audit report issued by another auditor or firm, member of the network, is used, this report must be treated with a critical mind.

The CSSF reiterates that where fraud in the revenue recognition is not considered as a risk of significant misstatement, appropriate evidence must be documented in the audit file. Similarly, the risk of inappropriate override of controls by the management is a non rebuttable risk of significant misstatement.

The audit of subsequent events must result in in-depth diligences in accordance with the requirements of ISA 560. These diligences must be performed and adequately documented until the date of signature of the audit report.

The audit documentation must enable an experienced auditor having no previous connection with the audit file, to understand:

- the nature, timing and extent of the audit procedures performed to comply with the ISA standards and to applicable legal and regulatory requirements;
- the results of the audit procedures performed and audit evidence obtained; and
- the significant matters arising during the audit and the conclusions reached thereon.

The CSSF emphasises the importance of professional scepticism and professional judgement when planning and performing an audit of financial statements.

The CSSF specifies that the items above have been uniformly identified in large and small sized firms.

#### 2.3.3. Transparency reports

With reference to Article 73 of the Audit Law, the CSSF stresses the importance of having an adequate clients' identification and classification system in order to present a correct and complete list of PIEs for which the *réviseur d'entreprises agréé* or the *cabinet de révision agréé* performs statutory audits.

#### 2.3.4. Scope of Article 26 of the Audit Law

The CSSF draws the attention of the *cabinets de révision agréés* and *réviseurs d'entreprises agréés* on the fact that the provisions of Article 26 of the Audit Law only apply in the context of a dismissal and/or resignation of the *cabinet de révision agréé* or the *réviseur agréé* during the mandate. The non-renewal of the appointments by the general meeting does not fall under the scope of this Article.

The CSSF specifies that, without prejudice to more stringent provisions as defined in the financial sector laws, Article 69(1) (a) of the law of 19 December 2002 on the Trade and Companies Register and the accounting and annual accounts of undertakings applies.

## 3. OVERVIEW OF THE POPULATION OF *RÉVISEURS D'ENTREPRISES* (STATUTORY AUDITORS) IN LUXEMBOURG

Within the scope of its public oversight of the audit profession, the CSSF assumes the following responsibilities:

- access to the profession and organisation of the examination of professional competence;
- granting the professional title of *réviseur d'entreprises* and *cabinet de révision*;
- granting the approval and registration of *réviseurs d'entreprises agréés* and *cabinets de révision agréés*;
- registration of third-country auditors and third-country audit entities; and
- maintaining the public register.

In this regard, the following statistics have been extracted for the year 2011.

### 3.1. Access to the profession

#### 3.1.1. Activities of the Consultative commission for the access to the audit profession

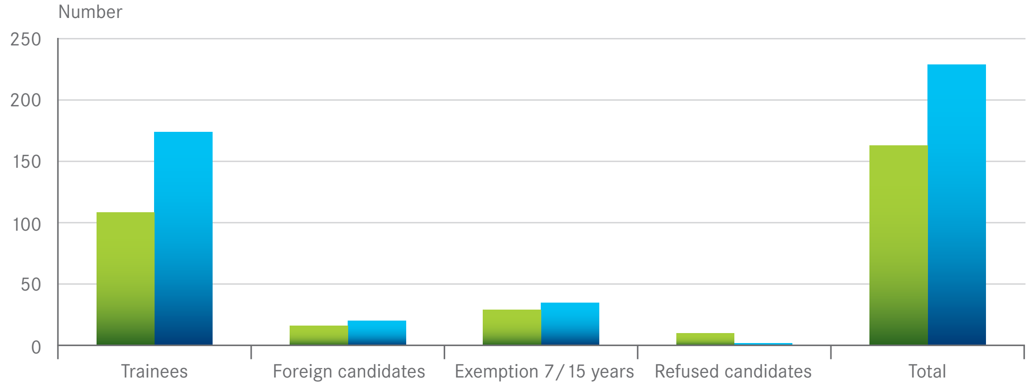
The Consultative commission was established through CSSF Regulation No. 10-02 of 6 April 2010. Its task is notably to verify the theoretical and professional qualification of candidates to the access to the profession in Luxembourg, as well as that of service providers from other Member States wishing to exercise by way of free provision of services.

The commission met seven times in 2011 and analysed the files of 230 candidates, against 164 in 2010, representing an increase of more than 40%.

There are four categories of candidates:

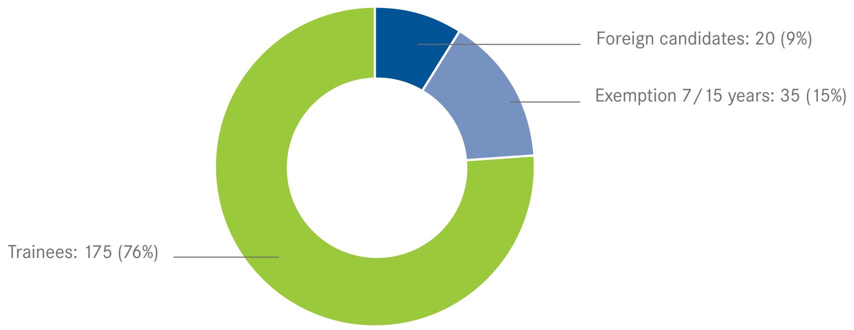
- trainee *réviseurs d'entreprises*;
- foreign candidates;
- candidates applying for exemptions based on their professional experience of either seven or fifteen years; and
- candidates requesting to exercise engagements reserved by the law to *réviseurs d'entreprises agréés* and *cabinets de révision agréés*, by way of the free provision of services (no such file has been analysed in 2011).

## Development in the number of candidates presented to the Consultative commission

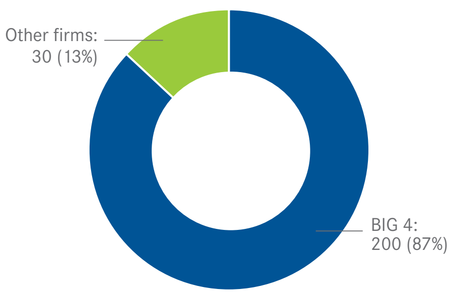



| | Trainees | Foreign candidates | Exemption 7 / 15 years | Refused candidates | Total |
|---|---|---|---|---|---|
| 2010 | 109 | 16 | 29 | 10 | 164 |
| 2011 | 175 | 20 | 35 | 0 | 230 |

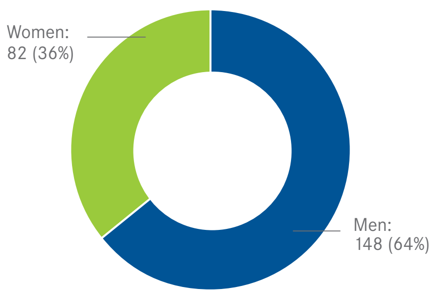
## Breakdown of candidates per category



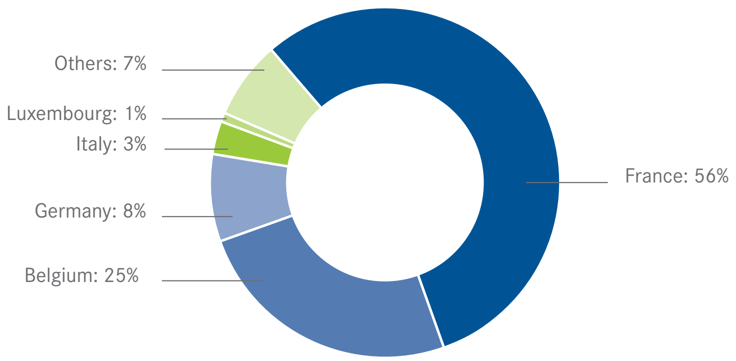

## Breakdown of applications per firms




## Breakdown of applications per gender




## Breakdown of candidates per nationality



### 3.1.2. Examination of professional competence 2011

The CSSF administrates the examination of professional competence in accordance with Articles 5 and 6 of the Grand-ducal regulation of 15 February 2010 establishing the professional qualification requirements of *réviseurs d'entreprises*.

In this context, the examination jury communicated the following results with respect to the examination of professional competence 2011 to the CSSF:

- Out of the 54 registered candidates, one candidate, excused, did not take the exam.
- Ordinary session: 53 candidates took the written exam, 29 of whom were admitted to the oral exam. In total, 18 candidates passed the exam, 11 failed partially (possibility to take the extraordinary session) and 24 failed completely.
- Extraordinary session: eleven candidates took the written exam, ten of whom were admitted to the oral exam. In total, five passed the exam and six failed completely.

Thus, all sessions included, 23 candidates passed the examination of professional competence in 2011 successfully.

Having passed this examination, candidates may request to be granted the title *réviseur d'entreprises* from the CSSF.

The graduation ceremony was held on 29 February 2012 in the presence of the Minister of Finance Mr Luc Frieden.

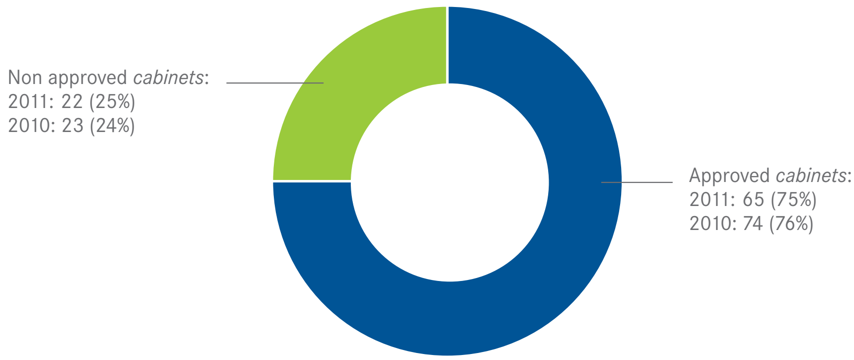
## 3.2. Public register

The public register of *réviseurs d'entreprises agréés*, *cabinets de révision agréés* and third-country auditors and audit entities is available on the CSSF's website in the section "Public oversight of the audit profession", sub-section "Public register".

### 3.2.1. National population as at 31 December 2011

**• Development in the number of *cabinets de révision* and *cabinets de révision agréés***

The total number of *cabinets de révision* and *cabinets de révision agréés* amounted to 87 as at 31 December 2011 against 97 as at 31 December 2010, i.e. a 10.3% decrease.




Several *cabinets de révision agréés* merged in the second half of 2011:

- Audit & Compliance merged by absorption with PricewaterhouseCoopers;
- KPMG Audit and KPMG Peat Marwick merged by absorption with KPMG Luxembourg;
- FIDEWA-CLAR S.A. is the firm created through the merger of two firms: COMPAGNIE LUXEMBOURGEOISE DES AUDITEURS REUNIS (CLAR) S.A. and FIDEWA Audit S.A..

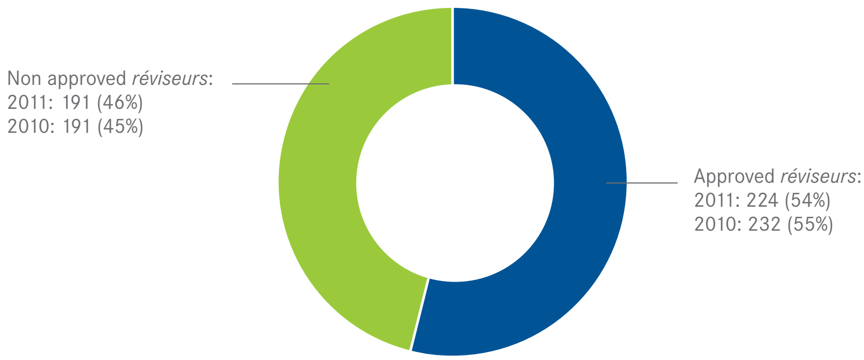
The following firms requested their approval in 2011:

- A3T
- FIDEWA-CLAR S.A.
- Fiduciaire Kohn Révision S.à r.l.
- FPS Audit S.à r.l.
- GSL Révision S.à r.l.
- Mazars Luxembourg S.A.

In 2011, ten firms gave up their approval, seven of which have also abandoned the title of *cabinet de révision*.

### • Development in the number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés*

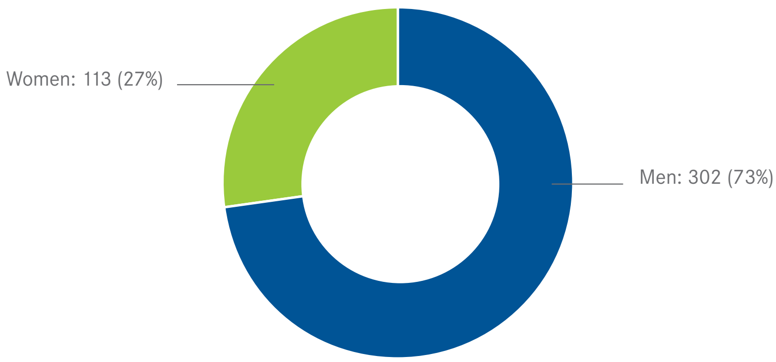
The total number of *réviseurs d'entreprises* and *réviseurs d'entreprises agréés* amounted to 415 as at 31 December 2011, against 423 as at 31 December 2010, which is a 1.9% decrease.




In 2011, the CSSF granted the title *réviseur d'entreprises* to 25 persons and an approval to 16 *réviseurs d'entreprises*.

During the year under review, 27 *réviseurs d'entreprises* gave up their approval, including 12 that gave up their title.

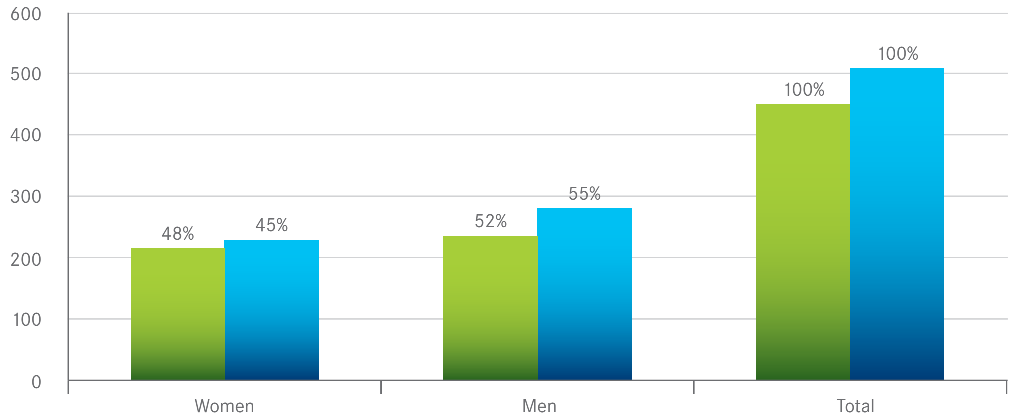
**Breakdown of *réviseurs* per gender**




The average age of *réviseurs* is 40.2 years for women and 43.8 years for men.

### • Development in the number of trainee *réviseurs d'entreprises*

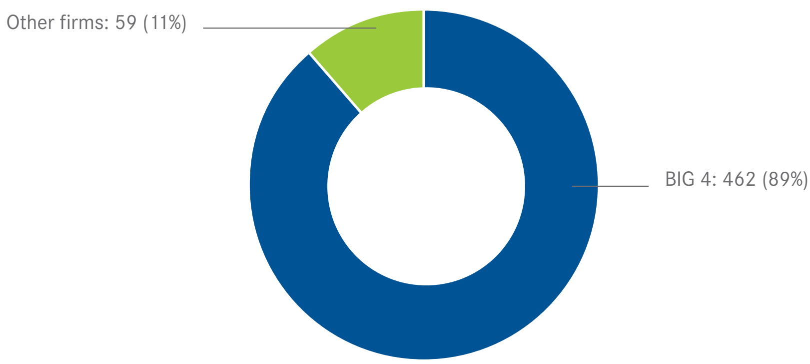
The total number of trainee *réviseurs d'entreprises* amounted to 521 as at 31 December 2011, against 461 as at 31 December 2010, which is a 13% increase.



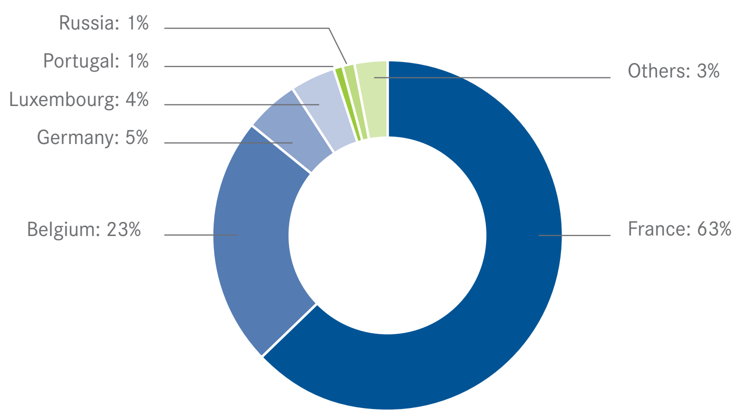

| | Women | Men | Total |
|---|---|---|---|
| 2010 | 220 | 241 | 461 |
| 2011 | 234 | 287 | 521 |

The average age of trainees is 28.4 years for women and 28.8 years for men.

**Breakdown of trainees per audit firms**




**Breakdown of trainees per nationality**



### 3.2.2. Third-country auditors and third-country audit entities

The registration procedure for third-country auditors and audit entities that provide an audit report on the annual or consolidated accounts of a company incorporated outside EU Member States, whose securities are admitted to trading on the regulated market of the Luxembourg Stock Exchange ("third-country auditors") continued in 2011.

Thus, the CSSF received five new applications for registration, including:

- four from auditors located in transitional third countries within the meaning of Decision 2011/30/EC of the European Commission of 19 January 2011 which extended the transitional period initially granted from 1 July 2010 to 31 July 2013 for twenty countries; and
- one from an auditor located in another third country.

These five files resulted in a registration.

Moreover, except for three third-country auditors whose activities did not fall anymore within the scope of Directive 2006/43/EC, all the third-country auditors previously registered have renewed their registration for 2011.

The public register of all the third-country auditors registered by the CSSF (53 as at 31 December 2011, including 24 from equivalent third countries, 22 from transitional third countries and seven from other third countries) is available on the CSSF's website.

In addition, the CSSF continued its efforts to identify third-country auditors in order to ensure that registrations are exhaustive.

# MEANS OF ADMINISTRATIVE POLICE



## 1. LEGAL FRAMEWORK

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 Finance to impose administrative fines on the persons in charge of the administration or management of the establishments concerned;
- under certain conditions, apply to the District Court (*Tribunal d'Arrondissement*) sitting in commercial matters for suspension of payments of an establishment;
- ask the Minister of Finance to refuse registration on or to withdraw registration from the official list of credit institutions or 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 registration on or withdraw registration from the official list of undertakings for collective investment, pension funds, management companies (Chapter 15 of the law of 17 December 2010), 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;
- under precise conditions laid down by law, request the District Court sitting in commercial matters to order the dissolution and the winding-up of an establishment.

Moreover, the CSSF informs the State Prosecutor of any instance of non-compliance with legal provisions relating to the financial sector, giving rise to criminal sanctions and that could, where applicable, entail prosecution against the implicated persons. The following cases are concerned:

- persons performing an activity of the financial sector without holding the required licence;
- persons operating in the field of domiciliation of companies without belonging to any of the professions entitled to carry out this activity pursuant to the law of 31 May 1999 governing the domiciliation of companies;
- persons other than those entered in official lists of the CSSF, who use a title or name, thereby breaching Article 52(2) of the law of 5 April 1993 on the financial sector, purporting to indicate that they are authorised to perform any of the activities reserved to persons entered in such a list;
- attempted fraud.

## 2. DECISIONS TAKEN IN 2011

### 2.1. Credit institutions

Pursuant to Article 59(1) of the law of 5 April 1993 on the financial sector, the CSSF imposed two injunctions on credit institutions which continuously did not meet the deadlines allotted for the submission of prudential documents required by the CSSF.

In 2011, the CSSF imposed five administrative fines pursuant to Article 63 of the aforementioned law, including two amounting to EUR 2,500 each against persons in charge of the management of credit institutions and three (of EUR 5,000, EUR 10,000 and EUR 15,000, respectively) against credit institutions for non-compliance with the professional obligations as regards the fight against money laundering and terrorist financing.

Pursuant to Article 7(3) of the law of 5 April 1993 on the financial sector, the CSSF refused authorisation for one person proposed as a member of the Board of Directors of a credit institution.

Moreover, in 2011, the CSSF filed four complaints with the State Prosecutor related to the illegal exercise of banking and financial activities by non-authorised entities.

### 2.2. PFS

#### 2.2.1. Investment firms

In accordance with Article 63 of the law of 5 April 1993 on the financial sector, the CSSF imposed an administrative fine of EUR 1,250 on the manager of an investment firm for breach of the professional obligations as regards the fight against money laundering and terrorist financing. Furthermore, the CSSF imposed an administrative fine of EUR 1,250 on each of the two authorised managers of an investment firm showing shortcomings in the establishment of an anti-money laundering and terrorist financing framework provided for by the law of 12 November 2004 relating to the fight against money laundering and terrorist financing. Two administrative fines of EUR 1,500 and EUR 15,000, respectively, were imposed on another investment company for not having complied with some legal requirements provided for by the law of 5 April 1993 on the financial sector.

During 2011, the CSSF did not exercise the right of suspension under Article 59 of the law of 5 April 1993 on the financial sector.

However, the CSSF used its right of injunction, in accordance with Article 59 of the above-mentioned law, on one occasion. The injunction was issued in respect of non-compliance with the professional obligations relating to the fight against money laundering and terrorist financing.

Furthermore, in 2011, the CSSF filed 12 complaints with the State Prosecutor regarding entities which provided investment services without authorisation.

#### 2.2.2. Specialised PFS

Pursuant to Article 59(1) of the law of 5 April 1993 on the financial sector, the CSSF imposed an injunction on four specialised PFS in 2011. These injunctions concerned shortcomings identified in respect of the procedures and/or compliance with the professional obligations concerning the fight against money laundering and terrorist financing, the absence of domiciliation contracts as well as substantial delays suffered in the approval, filing and disclosure of the annual accounts of domiciled companies.

Moreover, pursuant to Article 63 of the aforementioned law, the CSSF imposed an administrative fine of EUR 12,500 on a specialised PFS after an on-site inspection carried out when monitoring compliance with the professional obligations as regards the fight against money laundering and terrorist financing.

In 2011, the CSSF decided that a sole shareholder and manager in charge of the day-to-day management of a specialised PFS, and administrator and manager responsible for the day-to-day management of an authorised securitisation undertaking did not act within the scope of his duties according to the professional standing required under Article 19 of the law of 5 April 1993 on the financial sector and under Article 20(2) of the law of 22 March 2004 on securitisation. As a result of this decision, the person concerned is no longer qualified to serve as an accountable manager or to exercise any other function subject to approval, with an entity supervised by the CSSF.

With respect to specialised PFS, the CSSF filed two complaints with the State Prosecutor in 2011, pursuant to Articles 23(2) and 23(3) of the Code of Criminal Procedure.

### 2.2.3. Support PFS

During 2011, the CSSF imposed administrative fines amounting to EUR 1,500 each on five persons in charge of the day-to-day management of two support PFS for non-communication, within the deadlines set, of the information required by the CSSF.

## 2.3. Undertakings for collective investment

Pursuant to Article 148(1) of the law of 17 December 2010 on undertakings for collective investment and Article 51(1) of the law of 13 February 2007 on specialised investment funds, respectively, the CSSF imposed administrative fines of EUR 500 each on the 17 managers of 5 UCIs and the 109 managers of 32 SIFs for non-filing of financial reports within the statutory deadlines, on the four managers of one UCI and the 52 managers of 15 SIFs for non-transmission of recommendation letters within the regulatory deadlines and on the three managers of one UCI for non-filing of the annual report within the regulatory deadlines.

In addition, the CSSF imposed fines of EUR 500 each against 20 managers of two UCIs, 17 managers of five SIFs and one liquidator for non-filing of information within the deadline set.

During 2011, the CSSF decided to withdraw seven SIFs from the official list for non-compliance with the legal provisions governing specialised investment funds.

## 2.4. Management companies set up under Chapter 15 of the law of 17 December 2010

In 2011, the CSSF did not impose administrative fines on managers of management companies subject to Chapter 15 of the law of 17 December 2010.

However, a sanction was imposed on a management company subject to Chapter 15 based on shortcomings in terms of organisation. This sanction consisted of a partial suspension of the activities of the management company until corrective measures were taken.

## 2.5. Investment companies in risk capital (SICARs)

In accordance with the provisions of Article 17 of the law of 15 June 2004 relating to the investment company in risk capital (SICAR), the CSSF imposed 51 administrative fines amounting to EUR 500 each, during 2011. These fines were imposed, on an individual basis, on managers of 17 SICARs for non-filing or late filing of audited annual reports and recommendation letters and on managers of 4 SICARs for non-delivery or late delivery of the financial information to be transmitted by the SICARs pursuant to Circular CSSF 08/376.

## 2.6. Securities markets

Pursuant to the Prospectus law, the CSSF imposed an injunction on one issuer. This injunction was related to non-compliance with the provisions applicable to the final terms in respect of an issuance programme.

The review of financial reports under the Transparency Law led the CSSF to issue 51 injunctions, mainly due to delays in the disclosure and filing of annual and half-yearly financial reports. As a result of the non-compliance with some of these injunctions, 21 administrative fines totalling EUR 110,125 were imposed pursuant to Article 25 of the Transparency Law. Moreover, the CSSF required the suspension of bonds of a Luxembourg issuer from trading on the regulated market of the Luxembourg Stock Exchange. In respect of the decisions taken in relation to the consistent enforcement of the accounting standards, reference should be made to point 4.2.1. of Chapter IX "Supervision of securities markets".

Concerning market abuse, five injunctions on the obligation arising from Article 17 of the law on market abuse were imposed on the managers concerned. Moreover, the various information elements and documents obtained during the inquiries enabled the CSSF to transmit two files to the State Prosecutor and to conclude, in one file, that an insider dealing was committed and sanction it accordingly.

## 2.7. Public oversight of the audit profession

In accordance with Article 67(c) of the law of 18 December 2009 on the audit profession, the CSSF imposed in 2011, six administrative fines of EUR 1,500 each for failure to disclose the requested documents or other information. These fines were published in *Mémorial* B – No. 33 of 14 April 2011 and *Mémorial* B – No. 41 of 10 May 2011.

In accordance with Article 67(e) of the law of 18 December 2009 on the audit profession, the CSSF imposed in 2011 (and following sanctions already imposed in 2010) on a *réviseur d'entreprises agréé* (approved statutory auditor) the final withdrawal of his authorisation. This penalty was published in *Mémorial* B – No. 28 of 22 March 2011. As the *réviseur d'entreprises agréé* in question did neither reply to the multiple communications which were addressed to him, nor did he respond to the sanctions imposed, the CSSF considers that he did not act according to the professional standing required for a professional authorised to carry out statutory audits. The recognised loss of professional standing applies, by extension, to any function subject to approval at an entity supervised by the CSSF. The *réviseur d'entreprises agréé* was also permanently removed from the public register maintained by the CSSF.

Pursuant to Article 62 of the law of 18 December 2009 on the audit profession, the CSSF imposed an injunction on a *cabinet de révision agréé* (approved audit firm) to resign from its mandate as statutory auditor of the annual accounts of a public interest entity taking into account the breach of the principle of independence as defined in Article 19 of the above-mentioned law.

Pursuant to Articles 60 and 63 of the law of 18 December 2009 on the audit profession, the CSSF called a *réviseur d'entreprises agréé* and a *cabinet de révision agréé* to order as they did not comply with a safeguard decided by the CSSF in its report issued after the quality assurance review of the audit firm in question.

***Agents hired in 2011 and 2012: Department "Supervision of undertakings for collective investment"***

Left to right: Julien WARRANT, Marc RUNAU, Siobhan RONAN, Philippe POLFER, Sarah VILLAIN, Yannick ROUBY, Sonia MILOCHE, Quentin PARISSE, Isabelle WAGNER, Jérôme MOUSNY

# FINANCIAL CONSUMER PROTECTION



# 1. CONSUMER PROTECTION

## 1.1. Consumer protection at international level

The year 2011, which was marked by economic and financial difficulties, high market volatility and an increasing loss of investor confidence in the financial system in general, was a pivotal year in respect of awareness of the need for greater protection of financial consumers. In light of huge outcry on the very foundations of the financial system and the pressure by public opinion, political authorities reacted and expressed their profound determination to stop certain excessive financial practices which some consider to have led to the current financial and economic crisis.

Indeed, the efficiency of the financial markets, financial stability and economic growth depend on the consumer confidence in professionals of the financial sector.

Consumer protection is now one of the main objectives of policy-makers and supervisory authorities, alongside financial stability.

Therefore, the desire expressed by the Ministers of Finance and Central Bank Governors of the G20 countries to start the debate on financial consumer protection during their meeting in Paris in February 2011 is in line with this reasoning. After this meeting, the OECD and the Financial Stability Board were mandated to establish common consumer protection principles in the area of financial services.

The coordination work of the OECD relating to these principles was mainly carried out within the Focus Group on financial consumer protection. At the summit held on 3 and 4 November 2011 in Cannes, the G20 Member States approved ten principles in respect of financial consumer protection.

These principles aim to reach the following goals: legal recognition of the financial consumer protection, creation of supervisory authorities having the necessary powers and resources to properly perform their tasks, fair and equitable treatment of consumers, publication of information and transparency, education and awareness-raising of consumers on financial issues, responsible behaviour by financial service providers and authorised agents, protection of consumers' assets as well as data relating to their private life, consumer protection against concerted actions by financial sector players, establishment of sound management mechanisms for complaints and appeals.

At European level, the need to ensure consumer protection was also acknowledged. Thus, the three new European supervisory authorities which became operational in January 2011, i.e. the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), have the common mission to ensure the enforcement of consumer or investor rights, in their respective areas. Indeed, each of these authorities was mandated to protect the interests of consumers pursuant to Article 9 of its respective founding regulation.

It should be noted that the concern for financial consumer protection already appeared in several directives adopted by the European authorities in recent years. The MiFID Directive and the Directive on payment services show that the determination to protect consumers did not just begin last year. However, 2011 was a breakthrough year for consumer protection at European institutional level.

## 1.2. Consumer protection at national level

At national level, many legal and regulatory texts substantially expanded the CSSF's missions and competences as regards consumer protection. The Consumer Code introduced by the law of 8 April 2011 confirms the role of the CSSF in this area.

Moreover, the CSSF's mission as the competent authority in respect of consumer protection in order to ensure that persons subject to its supervision comply with the laws protecting consumer interests is set in Article 2 of the law of 23 December 1998 establishing a financial sector supervisory commission (*Commission de surveillance du secteur financier*).

It should be noted that the Consumer Code provides, *inter alia*, that the President of the Chamber of the District Court (*tribunal d'arrondissement*) sitting in commercial matters may, upon request by the CSSF or other authorities and interested parties, take measures in the event of unfair commercial practices, unfair terms or abuses as regards consumer credit agreements or distance contracts on financial services excluding insurance.

However, the various laws governing the financial sector and its activities confer more direct powers to the CSSF concerning sanctions and actions to be taken in case of violation of applicable texts.

In light of these developments, the CSSF created a platform for discussing financial consumer protection in 2011.

## 2. OUT-OF-COURT DISPUTE SETTLEMENT

The establishment of sound management mechanisms for consumer complaints and appeals is one of the goals set by the G20 members.

Article 58 of the law of 5 April 1993 on the financial sector already defined the CSSF as a mediator in respect of customer complaints against entities under its supervision.

Article 27 of the law of 8 April 2011 introducing the Consumer Code strengthens the role of the CSSF in its function as a mediator by entrusting it with the task of settling out-of-court complaints lodged by customers of lenders falling under its supervision and by providing that any other interested party, including consumer associations, may lodge complaints with the CSSF in the event of alleged violation of the laws or regulations as regards consumer credit agreements.

Article 27 also provides that in case of cross-border disputes, the CSSF is entitled to cooperate with authorities of other Member States entitled to settle consumer complaints for the purpose of an amicable settlement of complaints.

It should finally be noted that with the new law on mediation and the draft directive on the out-of-court settlement of consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC and the proposal for a European regulation relating to the online settlement of consumer disputes, the legislative and regulatory landscape of mediation in Luxembourg may experience some changes in the near future, which will certainly have an impact on the CSSF's work.

### 2.1. Statistical data

In 2011, the CSSF received 443 complaints concerning entities under its supervision. It closed 350 files, including 160 files that were taken over from the previous years.

**Outcome of the CSSF's intervention / reasons for closing the files**

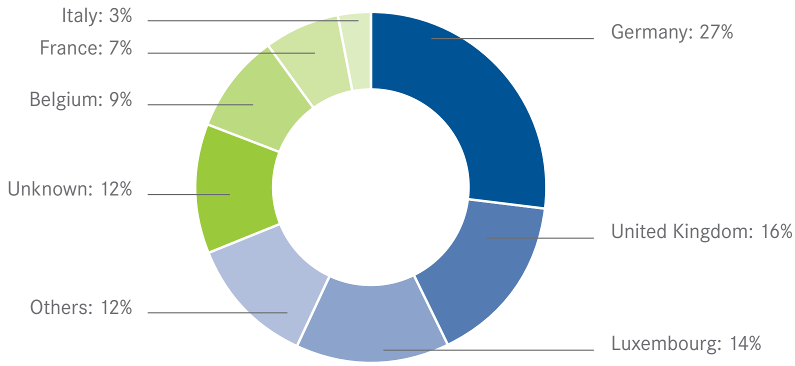
| Outcome | Number | |
|---|---|---|
| Referral to the Court | 4 | |
| Contradictory positions of the parties | 7 | |
| Amicable settlement following the CSSF's opinion | 8 | |
| Outside the scope of the CSSF's powers | 16 | |
| Amicable settlement prior to the CSSF's opinion | 29 | |
| Withdrawal by complainants | 31 | |
| Opinion of the CSSF in favour of professionals | 66 | |
| Acknowledgment of receipt where the complainant did not revert to the CSSF | 189 | |
| **Total** | **350** | |

The figures for 2011 confirm that the CSSF's goal consisting of reaching an amicable settlement for the parties to the dispute is often achieved. If a relatively substantial number of acknowledgements of receipt sent by the CSSF resulted in closing the files without any further action, this is probably due to the fact that complainants often obtained satisfaction from professionals after having contacted the manager appointed to deal with complaints as indicated by the CSSF in the acknowledgement of receipt.

The relatively large number of disputes settled in favour of professionals is notably due to the fact that professionals often take precautions by making their customers sign the documents which are likely to exempt professionals from any liability in the event of a dispute.

It should be noted that the CSSF settles a dispute by holding the professional liable only where it finds that the professional was at fault, the complainant suffered an actual harm and that there is a causal connection between the professional's fault and the actual harm suffered by the complainant. As it is the complainant's responsibility to produce this triple evidence, the cases where the CSSF holds the professional liable are relatively few. Where the CSSF withholds the professional's wrongful behaviour, the latter proposes in general an amicable settlement acceptable to the complainant.

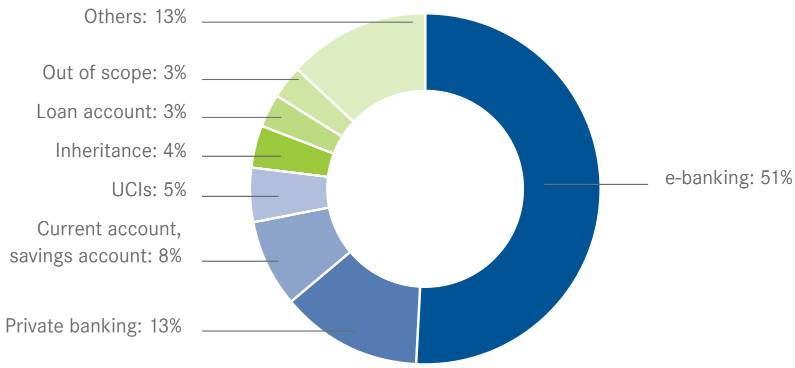
### Breakdown of the complaints according to the complainant's country of residence




Most complainants live in Luxembourg or in the neighbouring countries. The relatively high percentage of disputes from British residents is due to the number of disputes linked to e-banking services.

The country of residence of the complainants is not identified in 12% of the cases mainly due to the fact that these complainants addressed the CSSF by way of emails without indicating their country of residence. Furthermore, the category "Others" covers about forty different countries.

### Breakdown of complaints according to their object



In 2011, most complaints related to e-banking issues. The trend of the previous years was thus confirmed in 2011. Moreover, the significant number of complaints relating to private banking activities shows that these activities represent a substantial part of the banking industry in Luxembourg. It should be noted that the number of complaints regarding UCIs is relatively small compared to the importance of the UCI sector in Luxembourg.

## 2.2. Analysis of the complaints dealt with in 2011

From a general point of view, it can be noted that customers of professionals increasingly consider themselves as consumers of financial products and services with rights *vis-à-vis* professionals. Thus, the complainants are more and more inclined to rely on consumer protection as the very foundation of their claims. The CSSF, in its role as a mediator, is then considered as a neutral third party which is financially literate and responsible for restoring the balance between consumers and financial service providers when the latter are likely to jeopardise this balance by possible abuses.

Moreover, the analysis of the cases dealt with in 2011 is focused on the following points:

- forged transfer orders;
- asset management by the customer;
- obligation of the financial professional to inform the customer;
- the clause providing for compensation in the event of an early repayment of a mortgage;
- inadmissibility of complaints within the meaning of Article 58 of the law of 5 April 1993 on the financial sector.

### 2.2.1. Forged transfer orders

Within the context of the handling of the complaints relating to forged transfer orders, the CSSF based, *inter alia*, on the 2009 Annual Report of the Financial Intelligence Unit (FIU) of the State Prosecutor's office of the Luxembourg District Court which mentions "four typological indicators" to identify forged transfer orders, i.e.:

- false transfer order received by fax or by email;
- unusual transfer order (amount/destination of assets) for the account to be debited;
- information that the passport and signature of the person who holds a power over the account changed and transmission of the new data;
- transfer to a country other than the country of residence of the customer/subscriber.

Thus, in one case, the CSSF resolved the complaint against a bank because the examination of the facts revealed that the transfer order sent by email presented clues which should have prompted the bank to proceed with caution. Indeed, the disputed transfer order gathered three of the aforementioned "typological indicators" insofar as:

- it was received by email;
- it was unusual in its amount and the destination of assets;
- it was executed to a country other than the country of residence of the customer.

The CSSF further identified the following circumstances incriminating the bank:

- the transfer order was sent from an email address other than that from which the complainant usually sent his messages to the bank;
- the message accompanying the transfer order was written in broken French reminiscent of that used within the context of so-called "Nigerian" attempted frauds;
- as part of the instruction, the bank had to complete the transfer "by using, where necessary, the amount available on the savings account in Euro" (unless s/he is not aware of the exact amount in the account, the fraudster requests "the entire amount available");

- the "comment" of the transfer order consisted of a long sequence of figures, apparently meaningless, whereas the customer usually very clearly indicated the purpose of the transfer;
- for three years, the complainant had not requested his/her bank to transfer an amount similar to that of the disputed transfer;
- the signature on the forged transfer order was obviously a signature copied or pixelised from another document.

The CSSF concluded that the bank employee, who had received the order, should have been alarmed by this series of clues and should have carried out basic checks, before the execution of any transfer, notably by contacting the customer by telephone or by secured messaging.

In a second case where the dispute opposing the customer and his/her bank resulted from a transfer order given by telephone by a person pretending to be the customer, the CSSF did not conclude to the bank's misconduct as it took enough precautions before completing the transfer.

Thus, the account executive who was instructed by telephone to complete the transfer, requested his/her interlocutor to send a complete instruction by fax including his/her signature as well as a copy of an ID document. On the same day, the account executive received the required instruction and a copy of the customer's passport.

The bank employee then applied the following verification measures:

- identification of the customer on the basis of the date and place of birth;
- identification of the customer as the account holder on the basis of the last transactions, as the information in question is usually included in an account statement or an estimate;
- identification on the basis of a copy of the customer's ID document;
- verification of the signature on the transfer order as well as on the ID document on the basis of the specimen signature given by the customer when opening the account;
- verification of the single signing authority of the customer.

After execution of the transfer order, the customer being the holder of the debited account denied having given the order in question and accused the bank of negligence. In particular, s/he blamed the bank for not having carried out checks before executing the disputed transfer order. The bank argued that it was obliged to execute the transfer order as soon as possible because it was given by a person who had a single signing authority and it had no reason to question the authenticity of the given order.

Moreover, the bank explained that it would not record telephone conversation with customers, in order to respect their privacy, so that it had no record of the telephone conversation during which the execution of the disputed transfer order was requested.

In addition, the complainant blamed the bank because the employee having executed the disputed transfer order was not his/her contact person with the bank. The complainant was of the view that this contact person knew him/her perfectly and could thus not have been misled by the voice of an identity thief. The bank responded that it was impossible that the contact person, who knows the customer's voice, is always present when the customer places an order with the bank. If another bank employee receives the order, the authenticity check is carried out on the basis of ID documents, data relating to the customer who is the holder of the account and transactions on his/her account.

### 2.2.2. Asset management by the customer

The CSSF regularly notices that the customers who prefer to make their own investment decisions and do not sign any advisory management or discretionary management contract with their bank often find it difficult to accept responsibility for their actions when they incur losses as a result of the investments made. In these situations, the customers frequently seek to put the blame on the bank.

In a case dealt with in 2011, the complainant blamed his/her bank for having provided him/her with improper investment advice.

The CSSF noted that the customer wanted to keep control over his/her assets and that s/he did not sign either an investment advice contract or a discretionary management mandate with the bank.

The bank argued that the customer made his/her own decisions at his/her own risk and it had duly informed him/her about this. It thus ensured that the customer would sign an agreement relating to derivatives and futures before carrying out any transaction on these products/contracts. Pursuant to this agreement, the customer acknowledged having taken due note of the specific and speculative characteristics of the products/contracts in question. The customer also signed a master agreement relating to derivative transactions and financial futures. In this agreement, s/he confirmed that s/he would give instructions to execute transactions only if s/he was familiar with the rules relating thereto. Moreover, the complainant confirmed that s/he had full knowledge of the specific mechanisms and risks which may arise from transactions covered by the master agreement. In addition, the bank took care to make the customer sign the transaction confirmations according to which s/he acknowledged that s/he had the required knowledge and experience to assess the benefits and risks incurred.

Moreover, the bank opposed the complainant its general conditions which s/he had expressly accepted and according to which the bank is only responsible for its gross misconduct in its relations with customers.

The CSSF settled the dispute by holding that the bank had duly drawn the complainant's attention on the risks incurred by the investments in futures and structured products.

### 2.2.3. Obligation of the bank to inform the customer

The CSSF also dealt with complaints where it was found that the bank had given wrong or even misleading information to its customer.

Thus, in a case where the CSSF finally resolved the dispute against a bank, the customer asked his/her account executive, outside any advisory management contract, whether s/he could suggest a product offering slightly higher yield and risks than the products in which s/he usually invested. Consequently, the advisor proposed him/her a bond of a company, providing him/her with some information which was not only vague and incomplete, but also misleading.

The account executive referred, *inter alia*, to an excellent credit rating of the company issuing the bond by rating agencies. By doing so, s/he kept quiet about the fact that the bond itself was not granted very good credit rating by these agencies.

When the customer asked whether the bonds were liquid, the account executive responded that they were not "very liquid" but that there was some liquidity. However, the examination of the prospectus of the bond allowed the CSSF to notice that it expressly warned the investor of possible liquidity problems. Moreover, the prospectus stated that investors should not acquire the relevant securities if they were not aware of the liquidity and credit problems relating to these bonds. The prospectus also highlighted the complex nature of the bonds.

These elements enabled the CSSF to conclude that the advisor at the bank did not properly inform the customer about the security in question by providing him/her with vague information.

### 2.2.4. Clause providing for compensation in the event of an early repayment of a mortgage



Many customers are concerned about the validity of the clauses providing for compensation for the credit institution in the event of an early repayment of a mortgage.

As there is currently no specific regulation in this regard[1], general law on securities is applicable and the aforementioned clause is enforceable against the customer if s/he accepted it when concluding the mortgage agreement.

In 2011, the CSSF dealt with one dispute where the customer, who signed a mortgage agreement providing for compensation in the event of an early repayment, considered that s/he had been deceived by his/her advisor at the bank. According to him/her, the advisor intentionally neglected to mention the existence of the clause which provided for compensation. The complainant argued that, under these circumstances, the clause was not binding on him/her. The CSSF disagreed and concluded that the clause was binding on the complainant as s/he had signed the agreement in which this clause was expressly provided for.

[1] It should be noted that compensation due to the lender by reason of an early repayment as regards consumer credits is subject to a statutory regime pursuant to Article L 224-17 of the Consumer Code.

In another case, the borrower claimed that the compensation amount fixed by the credit institution in the event of an early repayment of the loan was too high. The CSSF requested all necessary information for a verification of the compensation amount from the credit institution.

Based on this information, the CSSF could verify that the disputed amount was justified. Indeed, as the market interest rate had significantly decreased in the context of the economic and financial crisis, the bank could no longer replace the amounts repaid before its maturity date at an attractive rate for it in the market. This is especially the reason why the compensation amount due in the event of an early repayment of the loan appeared high to the complainant.

When reviewing the documents provided by the bank, the CSSF nevertheless noted that the credit institution had only supplied little information on the calculation method of the compensation amount under its general and specific conditions. However, no legal provision requires the bank to describe in detail its calculation method of the compensation amount due in the event of an early repayment of a mortgage.

In this context, reference should be made to the directive proposal dated 31 March 2011 on credit agreements relating to residential property, Chapter 8 of which includes provisions for early repayment of mortgage.

This proposed directive provides that Member States shall ensure that the consumer has the legal or contractual right to meet his/her obligations under a loan agreement before it expires. Article 18 also provides that Member States may impose certain conditions on the exercise of the right to early repayment. Thus, Member States may provide that the creditor is entitled to fair compensation, objectively justified, for the costs directly incurred as a result of the early loan repayment. If the Member State plans to impose certain conditions on the exercise of the right to early repayment, these conditions should not make it excessively difficult or costly for the consumer to exercise the right to early repayment.

The proposed directive thus provides for some safeguards to prevent any excess on the part of the creditors in the determination of the compensation amount claimed for early repayment.

### 2.2.5. Inadmissibility of complaints within the meaning of Article 58 of the law of 5 April 1993 on the financial sector

#### • Inadmissibility of complaints due to duplication of proceedings

The CSSF constantly reminds complainants that it has no jurisdiction in the case where the dispute has already been referred to a court or an out-of-court settlement body other than the CSSF. This position is set out in point 1.4. of the document entitled "FAQ-Complaints" published on the CSSF's website (www.cssf.lu, section "Investor protection", sub-section "Customer complaints").

Similarly, Circular IML 95/118 on customer complaint handling states that: "If one of the parties to a complaint has referred the matter to a court, the CSSF will cease its intervention pursuant to Article 58.".

In 2011, the CSSF confirmed its position in the event of duplication of proceedings in connection with a dispute arisen from the application of a mortgage agreement. In its position, the bank stressed, *inter alia*, with supporting documents, that the complainant referred his/her complaint to the *juge de paix* (justice of the peace) and that the case had to be argued a few months later.

The CSSF explained to the complainant that s/he had to choose between the judicial settlement and the out-of-court settlement of his/her dispute as the simultaneous use of the two remedies was illogical.

The customer replied to the CSSF that it was obliged to resolve his/her dispute pursuant to Article L 224-26 of the Consumer Code relating to the out-of-court settlement of disputes in the area of consumer credit contracts. The first paragraph of this article provides, *inter alia*, that the CSSF is the relevant authority for dealing with complaints from customers of lenders under its supervision with the aim of settling these complaints amicably. The second paragraph provides that the procedures laid down in this article shall be exercised without prejudice to the right to take legal action before ordinary courts.

Whereas the text thus guarantees access to the courts after out-of-court settlement proceedings, the complainant stated that, pursuant to the second paragraph of Article L 224-26 of the Consumer Code, the filing of an application with the *juge de paix* (justice of the peace) would not deprive the complainant of his/her right to lodge a complaint for the same facts with the CSSF.

The CSSF dismissed the complaint lodged by the customer not only because the customer misinterpreted the law, but also because the legal provisions which s/he invoked apply to consumer credit agreements and therefore did not apply to his/her dispute which related to a mortgage agreement. The customer finally chose the judicial route and the CSSF declared that it had no jurisdiction to settle the complaint.

In another case, the customer asked the CSSF to rule on an attachment (*saisie-arrêt*) which the bank exercised on the funds transferred to his/her account after the sale of his/her flat. When examining the file, the CSSF noted that the bank obtained an enforceable order from the President of the District Court entitling it to issue an attachment on all amounts belonging to it or due to it up to its claim. The CSSF also noted that the customer had been served, by means of a bailiff's writ, a notice of the attachment to establish the validity of the case. This notice included the reasons for this attachment.

The CSSF decided not to intervene in this dispute because it does not lie in its purview to decide on a matter which was referred to the *juge civil* (civil court): indeed, it relied on the provisions of Circular IML 95/118 which provides that the CSSF will cease its intervention in the case where either party to the dispute referred the matter to a court.

**• Inadmissibility of a complaint due to lack of capacity**

In 2011, the CSSF clarified the rules regarding the inadmissibility of the complaints lodged by persons who are not customers of a supervised entity.

Thus, a complaint was referred to the CSSF by the beneficial owner of a company which had an account with a bank. The complainant wished to obtain documents on the company's accounts from the bank, especially in order to be able to track the transactions undertaken on behalf of the company. The bank opposed disclosure of the documents on the ground that the complainant was not a body of the company.

The CSSF had to decide whether it assumes jurisdiction within the meaning of Article 58 of the law of 5 April 1993 on the financial sector which provides that it is competent to deal with complaints by customers of entities under its supervision while the beneficial owner was obviously not a customer of the bank. Similarly to the bank, the CSSF had to deal with the problem of the lack of connection between the beneficial owner and the bank.

The CSSF finally declared the complaint lodged by the beneficial owner inadmissible pursuant to Article 58. In this context, it took into account a decision of the Court of Appeal of 19 October 2011 (roll No. 35715) rendered in a case relating, *inter alia*, to the bank's duty to provide information *vis-à-vis* the beneficial owner of a life insurance contract, and more specifically the following passage: "The first instance judges are to be confirmed as they said that there was no contractual link between the person designated as beneficial owner by the holder of the account opened with the financial institution and this financial institution which has to invoke the banking secret against the beneficial owner in respect of information on the account statements and transactions undertaken on the account.".

# FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING



# 1. AMENDMENTS TO THE REGULATORY FRAMEWORK REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

The beginning of 2011 was marked by turmoil in different Northern African countries, namely Tunisia, Egypt and Libya, as well as in Syria, and by the international measures taken in this respect. Considering this specific situation, the CSSF took the initiative of addressing the professionals of the financial sector through a press release as it deemed appropriate to remind the professionals of their enhanced due diligence requirements, notably with respect to customers who are "politically exposed persons" (PEPs), their families and close relations. As specified in that press release, this "permanent framework" shall be in place without waiting for these politicians to be subject to international measures.

Besides the specific context of the international financial sanctions taken during the Arab Spring, the CSSF pursued its efforts to strengthen the anti-money laundering and terrorist financing framework in a broad sense and to adapt its prudential supervision in this field. The different measures also reflect the CSSF's commitment to remedy the deficiencies identified by the Financial Action Task Force (FATF) in its mutual evaluation report on Luxembourg released in February 2010 and to take its recommendations into account.

Firstly, the specific regulatory framework for anti-money laundering and terrorist financing ("AML/CFT") was completed by the publication of several circulars aiming in particular at ensuring a risk-based approach for money laundering and terrorist financing. In addition, the CSSF initiated other actions to complete and adapt its general supervisory framework, leading for instance to the adoption of the law of 28 April 2011, the provisions of which have an indirect impact with regard to the prevention of the use of the financial sector for criminal purposes, such as money laundering or terrorist financing. The law of 20 May 2011 on electronic money institutions which extended the scope of the law of 12 November 2004 relating to AML/CFT by including the new electronic money institutions should also be mentioned. Indeed, compliance with AML/CFT requirements is particularly important in this business sector given its exposure to money-laundering and terrorist-financing risks in the context of new technologies and remote business relationships or transactions.

The CSSF has also drawn up a proposal for a draft CSSF regulation relating to AML/CFT which was submitted to the competent bodies in view of its adoption in 2012. This regulation will be in line with financial sector practices and will take into account the requirements already laid down in Circular CSSF 08/387.

Measures taken within the scope of specific supervisory missions such as the analysis of applications for authorisation, on-site inspections or other specific files, are dealt with in the chapters of this report relating to these financial sector activities. In general, it should be stressed that the CSSF will respect its commitment in the field of AML/CFT and will continue along the path it has taken. By way of on-site inspections focusing on the anti-money laundering and terrorist financing regimes, the CSSF verifies the correct implementation of applicable rules by the professionals under its supervision, while adopting a risked-based approach.

## 1.1. Grand-ducal regulation of 3 August 2011 amending Grand-ducal regulation of 29 October 2010 enforcing the law of 27 October 2010 implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing

The purpose of this regulation is to adapt Grand-ducal regulation of 29 October 2010 in order to take into account the new allocation of competences to establish the lists by two different UN committees according to Resolutions 1988 (2011) (Taliban) and 1989 (2011) (Al-Qaida) of 17 June 2011. It should be noted that the European regulations also take into account these changes.

Moreover, following this regulation, the follow-up committee established by the Grand-ducal regulation of 29 October 2010 was extended by the admission of a new member, namely a representative of the *Service de Renseignement Luxembourgeois* (SREL, Luxembourg Intelligence Service).

## 1.2. Ministerial regulations

In 2011, the Ministry of Finance issued 12 ministerial regulations, implementing UN Resolutions 1988 (2011) (Taliban) and 1989 (2011) (Al-Qaida).

## 1.3. Circulars CSSF 11/519 and CSSF 11/529

Circulars CSSF 11/519 (for credit institutions) and 11/529 (for the other professionals of the financial sector) specify the CSSF's requirements with respect to Article 3(3) of the law of 12 November 2004 on the application and implementation of the risk-based approach to combating money laundering and terrorist financing. Credit institutions, in particular, were required to submit information on the practical application of the principles of the risk-based approach by means of a questionnaire appended to Circular CSSF 11/519. It is planned that the other professionals of the financial sector will be required to do the same at a later stage.

## 1.4. Circular CSSF 11/525

Circular CSSF 11/525 follows Circulars CSSF 11/516 and 11/502 and draws the attention of the professionals on FATF's statements concerning:

- jurisdictions with substantial and strategic deficiencies in their AML/CFT regimes;
- jurisdictions not making sufficient progress;
- jurisdictions whose anti-money laundering and combating the financing of terrorism regimes are not satisfactory.

## 1.5. Circular CSSF 11/528

Circular CSSF 11/528 repeals point 137 of Circular CSSF 08/387 on the mandatory parallel transmission of suspicious transaction reports to the Financial Intelligence Unit (FIU) and to the CSSF. This administrative simplification is justified by the strengthening of the cooperation and exchange of information with the FIU in this respect, notably pursuant to Article 9-1 of the law of 12 November 2004 and the cooperation agreement signed between both parties.

# 2. PARTICIPATION OF THE CSSF IN MEETINGS REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

## 2.1. International AML/CFT working groups

The year 2011 was intense in terms of work within the international groups in which the CSSF participates. Efforts were mainly focused on the review of FATF's recommendations.

### 2.1.1 Financial Action Task Force (FATF) and its working groups



One year following the adoption of the mutual evaluation report on Luxembourg in February 2010, Luxembourg was required to submit its third follow-up report at the FATF's Plenary in February 2011. This report sets out the efforts undertaken to adapt the Luxembourg framework to the requirements of the FATF by following a specific action plan. This Plenary was an important milestone to assess Luxembourg's progress as regards AML/CFT. The FATF Plenary meeting recognised the efforts undertaken and has decided to lighten the monitoring mechanism of Luxembourg by requiring the submission of the fourth follow-up report only for February 2012.

Based on the conclusions of the International Cooperation Review Group (ICRG), the different lists of high-risk and non-cooperative countries and territories have been updated during the FATF meetings in February, June and October 2011. The CSSF informed the supervised professionals thereof by means of three circulars published in March, June and November 2011, respectively.

The Plenary Meeting agreed on the mutual evaluation report on Kuwait in October 2011 and the final reports on France and on the Netherlands, adopted at the Plenary of February 2011, were released in April 2011. A fourth round of mutual assessment is planned to start in 2013, following the adoption of the new recommendations in February 2012 and the updating of the corresponding methodology.

As far as the works on the review and adaptation of the 40+9 Recommendations of the FATF are concerned, draft recommendations were submitted for consultation to the private sector in December 2011. The recommendations should be formally adopted by the FATF Plenary meeting in February 2012.

Between March 2011 and January 2012, the FATF released three new reports describing the methods or new trends used for the purpose of money laundering or the financing of terrorism, i.e. the report on Money Laundering Risks Arising from Trafficking in Human Beings and Smuggling of Migrants, the report on Organised Maritime Piracy and Related Kidnapping for Ransom and the report on Laundering the Proceeds of Corruption. The latter report identifies key vulnerabilities within the current AML/CFT framework and discusses some of the obstacles to the recovery of the proceeds of corruption.

### 2.1.2 Committee for the Prevention of Money Laundering and Terrorist Financing (CPMLTF)

This committee, instituted within the European Commission, was established pursuant to Article 41 of 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 committee assists the European Commission in its work related to this subject.

The CPMLTF met three times in 2011. These meetings dealt with, among others, the preparation of the FATF Plenary meetings and the coordination of the positions between Member States.

### 2.1.3 Anti-Money Laundering Committee (AMLC)

This European working group is a sub-committee of the Joint committee of the three European supervisory authorities (ESMA, EBA and EIOPA) and continues the works of the former Anti-Money Laundering Task Force of the predecessors CESR, CEBS and CEIOPS.

In 2011, this cross-sectoral committee met five times. It conducted different analyses concerning AML/CFT notably on the identification and determination of the beneficial owner, on the simplified due diligence measures as well as on the cooperation between authorities with regard to the fight against money laundering and terrorist financing applied by payment institutions, their branches and agents. These analyses allowed identifying certain differences in the implementation and application of AML/CFT European directives by Member States.

The committee also discussed the changes in the architecture of the European supervisory authorities, the risk-based approach in AML/CFT supervision, nominee accounts, the recast of the third European directive on AML/CFT and the 40+9 Recommendations of the FATF.

Moreover, a new working group was created with the purpose to examine the implementation of the fight against money laundering and terrorist financing in electronic money institutions.

### 2.1.4 AML/CTF Expert Group (AMLEG)

The Basel Committee on banking supervision started to review the Core Principles for Effective Banking Supervision and its methodology in order to take into account the developments in this area, and in particular the financial crisis, since the last update in 2006. In this context, AMLEG had the opportunity to make a statement on the Review of Principle No. 18 on the prevention of the abusive use of financial services. In this respect, AMLEG reiterated that the objectives pursued by the rules resulting from this principle did not exclude the fight against money laundering and terrorist financing.

In 2011, AMLEG also continued its work regarding the sound cooperation between banking supervisory authorities in the field of AML/CFT. It also submitted comments on the review of the 40+9 Recommendations to the FATF.

### 2.1.5 The Wolfsberg Group

As every year, the Wolfsberg Group, composed of eleven banks operating at international level, invited private and public market participants to its annual Plenary meeting in May 2011. The participants discussed new subjects such as the US FATCA (Foreign Asset Tax Compliance Act), the issues surrounding insurance wrapping, international financial sanctions and restrictive measures following the Arab Spring, the review of the 40+9 Recommendations of the FATF, as well as more general subjects such as transparency and the fight against corruption (politically exposed persons), the risk-based approach and risk management at group level.

## 2.2. National AML/CFT working groups

At national level, the CSSF took part in the various coordination meetings held in 2011 by the respective Ministries with respect to the preparation of the international and European meetings such as the FATF and the European Commission.

The CSSF also took part in a meeting of the technical committee "Fight against money laundering and the financing of terrorism" of the *Commissariat aux Assurances*.

As a member of the follow-up Committee on international restrictive measures established pursuant to Grand-ducal regulation of 29 October 2010 enforcing the law of 27 October 2010, the CSSF took part in three meetings of the follow-up Committee in 2011. Members exchanged their views extensively as regards the fight against terrorism and its financing, the fight against the proliferation of weapons of mass destruction and its financing and the national risks related to these subjects. The implementation of international financial sanctions, notably against the regimes in Iran, the Democratic People's Republic of Korea and in the countries of the Arab Spring (Tunisia, Libya, Egypt, Syria, etc.), as well as the European jurisprudence relating to these files were subjects that dominated the discussions.

Introduced in accordance with the requirements of the FATF, Article 9-1 of the law of 12 November 2004 relating to AML/CFT gave a legal base aimed at improving the general efficiency of the Luxembourg framework to the up-to-then informal cooperation between the supervisory authorities and the Financial Intelligence Unit (FIU).

In 2011, the CSSF and the FIU met four times. These meetings allowed more specifically to focus on the organisation of this close cooperation and sharing of information and resulted in the signature of a "Cooperation and exchange of information agreement" between both parties in December 2011. This cooperation agreement allowed the CSSF to opt out of receiving copies of the suspicious transaction reports referred to in Article 5 of the AML/CFT Law, except for exceptional cases, and to publish Circular CSSF 11/528 of 15 December 2011.

In this context, it should also be noted that with respect to three files (concerning two credit institutions and one investment firm), the CSSF referred to Article 9-1 of the AML/CFT Law to inform the FIU of noticed facts, leading to a new criminal investigation or adding to current investigations at the FIU.

In addition to the contacts with the FIU, the CSSF sought the assistance of the judiciary police (*police judiciaire*), the intelligence service (*Service de Renseignement*, SREL) or the State Prosecutor (*Parquet général*), notably in the context of applications for authorisation for natural or legal persons.

Moreover, the CSSF is in close contact with the *Institut de Formation bancaire* (IFBL) to set up continuous training in the field of AML/CFT resulting in a certification of knowledge examinations.

The CSSF's internal Risk Based Approach Committee (RBAC), in charge of preparing and following-up on the implementation of a risk-based approach in the CSSF's AML/CFT supervision, established a questionnaire concerning risk analysis in 2011. As a first step, this questionnaire was submitted to credit institutions. The responses received allow the CSSF to assess the risks identified by credit institutions and the risk mitigation measures they have taken. The information collected is an important element for the CSSF to implement its risk-based approach in AML/CFT supervision.

# 3. REPORTS REGARDING THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

## 3.1. Reports by the professionals subject to the supervision of the CSSF

As in the previous years, the number of AML/CFT reports continued to rise, reaching a total of 1,214 as at 15 December 2011, date on which Circular 11/528 repealed the principle of parallel communication of suspicious transaction reports to the CSSF. In addition to the money laundering or terrorist financing suspicious transaction reports made pursuant to Article 5(1) of the law of 12 November 2004, this number also includes the reports received by the CSSF based on national, UN or European texts which provide for the freezing of assets and economic resources with respect to certain persons, groups or entities. This figure does not take into account the reports made by one particular bank.

The total number of reports received break down as follows between the various categories of professionals:

- banks: 1,004 reports;
- PFS: 181 reports, including 142 by specialised PFS, 38 by investment firms and one by support PFS;
- management companies: 17 reports;
- payment institutions: 12 reports.

The analysis of the number of reports received from professionals reveals that 78% of the reports made in 2011 were issued by around twenty professionals of which each submitted at least ten reports during the reference year. It should thus be noted that even if the total number of reports continued to rise, it is mostly the same professionals that issue the reports.

A total of 119 professionals of the financial sector transmitted at least one report to the CSSF in 2011. This number confirms the stabilisation in the number of reporting professionals (115 in 2010), even though the number of professionals authorised to exercise a financial sector activity varies from one year to another, owing to the withdrawal of authorisation or taking-up of new activities such as payment institutions or electronic money institutions.

The breakdown of the 119 professionals concerned is as follows:

- 80 banks out of 143 banks registered on the official list as at 31 December 2011;
- 33 PFS, among which 12 investment firms, out of a total of 322 PFS registered on the official list as at 31 December 2011;
- 5 management companies out of 179 management companies subject to Chapter 15 of the law of 17 December 2010 and registered on the official list as at 31 December 2011.
- one payment institution out of four payment institutions registered on the official list as at 31 December 2011.

It should be noted that given the numerous financial restrictive measures decided by the competent European authorities in the context of the Arab Spring, the number of reports relating to a freezing of assets or economic resources of certain persons, groups and entities rose considerably compared to the previous years. In this context, the efforts to cooperate made by the professionals of the financial sector should be stressed, even if most cases turned out to be mere homonyms.

## 3.2. Reports made by the CSSF

In 2011, the CSSF made 16 reports to the State Prosecutor's office to the Luxembourg District Court, half of which concerning suspicions of money laundering and financing of terrorism in accordance with its obligations laid down in Articles 23(2) and 23(3) of the Code of Criminal Procedure.

# BANKING AND FINANCIAL LAWS AND REGULATIONS

1. Directives and regulations under discussion at EU Council level
2. Directives adopted by the Council and the European Parliament to be transposed under national law
3. Luxembourg laws and regulations adopted in 2011
4. Questions on the practical application of regulations and judgements

# 1. DIRECTIVES AND REGULATIONS UNDER DISCUSSION AT EU COUNCIL LEVEL

The CSSF participates in the groups examining the following proposals for directives or regulations.

## 1.1. Proposal for a regulation on over-the-counter (OTC) derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR)

This proposal for a regulation was discussed in detail in the CSSF's Annual Report 2010.

## 1.2. Proposal for a regulation amending Regulation (EC) No. 1060/2009 on credit rating agencies (CRA III Regulation)

This new proposal for a regulation, published on 15 November 2011, amends for the second time Regulation (EC) No. 1060/2009 on credit rating agencies (CRAs). The text aims to reinforce a certain number of existing requirements and to deal with outstanding weaknesses identified in current legislation. The European Commission targets four objectives through this proposal: (1) ensure that financial sector players do not rely mechanistically and solely on external credit ratings, (2) have more frequent and more transparent sovereign debt ratings, (3) increase diversity and independence of CRAs to eliminate conflicts of interests, and (4) make CRAs more accountable for the credit ratings issued by them.

The EU Council started negotiating on the text at the beginning of January 2012.

## 1.3. Proposal for a directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Funds Managers in respect of the excessive reliance on credit ratings

This proposal for a directive falls within the context of the CRA III proposal for a regulation (cf. item 1.2.) and amends purposefully Directives 2009/65/EC and 2011/61/EU. It completes the provisions of regulation CRA III which provide for the transsectoral introduction of a requirement aiming to reduce the financial market players' reliance on credit ratings issued by CRAs.

## 1.4. Proposal for a directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV)

## Proposal for a regulation on prudential requirements for credit institutions and investment firms (CRR)

On 20 July 2011, the European Commission published proposals for a regulation and a directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Both texts form a legislative package and will replace Directives 2006/48/EC and 2006/49/EC as amended (CRD, CRD II and CRD III). They represent the future basis of the supervision of credit institutions and investment firms within the EU.

The proposals' aim is twofold. First, the Basel III regulatory framework will be translated into European law. Second, these texts aim at implementing a set of unique and harmonised rules for institutions within the EU (single rulebook). Most rules are hence included in the future CRR, which will be directly applicable to institutions without prior implementation into the national law of each EU Member State.

In general, the proposal for a CRR includes rules directly addressed to institutions, in particular provisions on the solvency ratio calculation and large exposures. The current rules have been adapted in order to remove as many national discretions as possible; they have been amended and completed in order to reflect the Basel III regulatory framework. The new elements include thus a completely recast definition of prudential own funds, characterised by an increased amount of own funds institutions need to hold, an increased quality of those own funds and stricter deductions to be performed on the amount of own funds. Drawing the lessons from the past years' financial crisis, the CRR proposal also introduces, for the first time, harmonised liquidity ratios in European legislation. Moreover, a leverage ratio is foreseen in order to prevent an excessive build-up of leverage on institutions' balance sheets.

The CRD IV proposal covers provisions of the current directives on the access to banking activity and on the institutions' supervision. The proposal notably strengthens the internal governance rules and the sanctions regime. In order to harmonise the sanctions applicable in case of CRD IV and CRR provision breaches, the proposal for a directive includes provisions on the nature and extent of the sanctions which apply, in this context, in all EU Member States.

The CRD IV proposal also contains provisions relating to Pillar 2 and introduces a requirement for institutions to hold capital buffers on top of the minimum capital requirements deriving from the solvency ratio. If needed, credit institutions may use these capital buffers, but they will be subject to restrictions, notably on the distribution of dividends, until the own funds target is reached again.

Finally, in line with the third regulation on credit rating agencies (CRAs, cf. item 1.2.), the CRD IV proposal provides for rules aiming to limit complete and mechanistical reliance on external ratings issued by CRAs.

Negotiations on both texts started in September 2011 in Brussels and continue at a sustained pace. The objective is to come up with a final text early enough before the entry into force, scheduled on 1 January 2013, a quite ambitious date given the project's size.

### 1.5. Proposal for a directive amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority (Omnibus Directive II)

The proposal for a directive was discussed in detail in the CSSF's Annual Report 2010.

### 1.6. Proposal for a directive on deposit-guarantee schemes (recast)

The proposal for a directive was discussed in detail in the CSSF's Annual Report 2010.

### 1.7. Proposal for a directive amending Directive 97/9/EC on investor-compensation schemes

The proposal for a directive was discussed in detail in the CSSF's Annual Report 2010.

### 1.8. Proposal for a regulation on short selling and certain aspects of credit default swaps (Short Selling Regulation)

The proposal for a regulation was discussed in detail in the CSSF's Annual Report 2010.

### 1.9. Proposal for a directive on markets in financial instruments repealing Directive 2004/39/EC



### Proposal for a regulation on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories

The European Commission tabled proposals to revise the MiFID consisting of a proposal for a directive and a proposal for a regulation.

These proposals aim to improve the transparency and oversight of financial markets, including derivatives markets, and to strengthen investor protection. At the same time, supervisory powers of regulators have been increased. The proposal for a directive also provides clear operating rules for all trading activities, including those activities which do not fall within the scope of current regulation.

The proposal amending the MiFID covers, among others, the following elements:

- introduction of a new type of trading venue: the Organised Trading Facility (OTF). These are organised platforms which are not regulated but playing an increasingly important role. For example, standardised derivatives contracts are increasingly traded on these platforms;
- compliance of OTFs with the MiFID provisions, as is the case for multilateral trading facilities and regulated markets;
- extension of MiFID rules to like products and services;
- enhanced organisational requirements to safeguard the efficient functioning and integrity of markets;
- enhancement of the investor protection framework: the proposals strengthen the existing requirements for portfolio management, investment advice and complex finance products, as for example structured products; moreover, independent investment advisers and portfolio managers will no longer be entitled to receive payments (or other economic incentives) from third parties, nor to provide any such payments to third parties;
- heightened protections in the provision of investment services to non-retail clients;
- new requirements for trading venues, including the introduction of a new transparency regime for non-equities markets (i.e. bond markets and derivative and structured finance product markets);
- an improved regime for SME markets in order to facilitate access to capital markets for smaller and medium-sized enterprises; the proposals provide for the creation of a specific subcategory for markets aimed at SMEs;
- third-country regime;
- improvements to corporate governance;
- increased and more efficient data consolidation, implying new requirements for the aggregation in one place of all market data in order for users to be able to obtain an overview of all trading activities across the EU, which will facilitate taking decisions on an informed basis;
- heightened powers over derivative positions for competent authorities and effective sanctions. The proposal implies that competent authorities may, in coordination with ESMA, and in well-defined circumstances, prohibit certain products, services or practices when these adversely affect investor protection, financial stability or the proper functioning of markets.

## 1.10. Proposal for a regulation on insider dealing and market manipulation (market abuse) and proposal for a directive on criminal sanctions for insider dealing and market manipulation

The proposal for a regulation mainly aims to update and strengthen the existing framework to ensure market integrity and investor protection provided by the Market Abuse Directive (2003/6/EC).

The proposal for a regulation takes into account new technology and new market reality, notably by extending its scope to financial instruments only traded on new platforms (MTFs and OTFs) and to all OTC derivatives. The proposal clarifies that market abuse occurring across both commodity and related derivative markets is prohibited, and reinforces cooperation between financial and commodity regulators.

Moreover, the proposal reduces administrative burdens on SME issuers.

The proposal also reinforces the financial markets regulators' powers in order for them to obtain all information required in the context of market abuse investigations. In order to put in place more efficient and dissuasive administrative sanctions, it provides that at least certain administrative measures and pecuniary administrative sanctions, for which the proposal sets out minimum thresholds, be addressed by the administrative authorities. ESMA shall perform a facilitation and coordination role in relation to cooperation and exchange of information between competent authorities and regulatory authorities of Member States and third countries.

The proposal for a directive includes minimum criminal sanctions for insider dealing and market manipulation committed intentionally, as well as for inciting, aiding and abetting, and attempting to commit market abuses. The criminal sanctions must be effective, proportionate and dissuasive. This is the first case where the European Commission uses the new powers conferred on it by the Lisbon Treaty to ensure the application of an EU policy by means of criminal sanctions.

### 1.11. Proposal for a directive amending 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 and Directive 2007/14/EC

As provided for in Article 33 of the Transparency Directive, the European Commission prepared a report on the operation of this directive in 2010. This report showed that several areas of the Transparency Directive could be improved, the main purpose being to make regulated markets more attractive for small and medium-sized issuers, by simplifying certain obligations and increasing the legal clarity and effectiveness of the existing regime.

In this context, the European Commission published a proposal for an amendment of the Transparency Directive on 25 October 2011, the main points of which are listed hereunder.

In relation to periodical information, the obligation to publish interim management statements and/or quarterly financial reports for all issuers subject to the Transparency Directive would be abolished. This amendment should reduce the administrative burden, which seems particularly high for small and medium-sized issuers, as well as short-term pressure on issuers. In order to ensure that all issuers are subject to the same obligations and the administrative burden is reduced, Member States shall no longer be allowed to require the publication of this type of financial reports. Indeed, the European Commission considers that investor information is sufficiently guaranteed through other legal provisions, deriving in particular from the Market Abuse Directive; abolishing this obligation would thus not have a negative impact on investor protection.

In order to reduce costs linked to the publication of financial reports and to improve their comparability, ESMA shall be required to draw up standard forms or templates which may be used by issuers for the preparation of the financial reports' narrative content.

The European Commission also suggested to introduce for issuers which have activities in the extractive or logging of primary forest industries an obligation to publish an annual report on the payments made to governments of the countries in which they operate. The publication of such payments aims at making governments of resource-rich countries accountable for the use which is made of their natural resources.

In relation to the requirements for notification concerning major shareholdings, amendments have been proposed, on the one hand, on financial instruments covered by these provisions and, on the other hand, on the harmonisation of the applicable rules.

First, the definition of financial instruments to be considered for notifications concerning major shareholdings has been extended in order to include all instruments having an economic effect similar to holding of shares and entitlements to acquire shares. Certain instruments, which are currently not impacted by notifications concerning major shareholdings, have been included in order to discourage secret stock building in listed companies by the holders of such instruments.

Moreover, as Member States adopted different approaches for notifications concerning major holdings, harmonisation seems necessary for a more consistent approach allowing reducing costs for investors. The European Commission's proposal requires the aggregation of voting rights attached to shares with those relating to specific financial instruments and the application of existing exemptions in order to achieve optimal harmonisation of the different Member States' regimes. It provides that Member States may set lower and additional thresholds for notification.

Additional simplifications and clarifications concerning the definition of “home Member State” have also been included. By establishing a default home Member State for issuers who have not notified their choice during a period of three months, the proposed amendments aim to ensure that issuers falling within the scope of application of the Transparency Directive do not operate without being supervised by any Member State.

As regards the definition of “issuer” for the purpose of the Transparency Directive, the amendments proposed by the European Commission aim at introducing clarifications for certain specific cases, in particular for trusts.

Moreover, additional powers should be granted to the European Commission in relation to the dissemination of regulated information and pan-European access to regulated information, with, in particular, the development of a central access point for regulated information.

Finally, the sanctions regime should be strengthened and harmonised at European level.

## 1.12. Proposal for a directive on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings

On 25 October 2011, the European Commission tabled a proposal for a directive repealing and replacing the Fourth Directive (Directive 78/660/EEC on the annual accounts of certain types of companies) and the Seventh Directive (Directive 83/349/EEC on consolidated accounts), hereafter the “Accounting Directives”. This proposal for a directive follows up on several public consultations of the European Commission which confirmed that a simplification of the European accounting framework is necessary, mainly for small companies. All amendments to the Accounting Directives that have been made in the last 30 years did not contribute to improving comparability of financial statements of EU companies as the options available to Member States have been increasing over the years.

The proposal for a directive essentially focusses on two major aspects:

- reduction of the administrative burden for small companies in the EU, which total more than five million entities, and
- a greater social responsibility for companies.

The new text of the proposal for a directive groups hence in a single directive the complete legislation relating to annual financial statements and consolidated financial statements. It should be noted that this proposal completes the proposal for a directive of 2009 on financial statements of micro-entities adopted by the European Parliament on 13 December 2011, the final text of which will be included in the current proposal for a directive.

To simplify reading especially for small companies, the proposal for a directive adopts a bottom-up approach for the provision of information in the notes to the accounts, which implies that information applicable to all companies, including small companies, have to be mentioned first. Moreover, by proposing a reduction of the options, mainly on accounting layouts and information to be provided in the notes, the new text seeks to improve the clarity and comparability of financial statements.

Finally, in order to promote governments’ accountability and good governance, the proposal for a directive introduces new provisions for large companies and public interest entities active in the extractive industry or in the logging of primary forests. These companies will thus have to disclose, on an annual basis and in a separate report, the payments they make to governments in each country where they operate and for each project, where the payment has been attributed to a certain project and when material to the recipient government.

The proposal for a directive will be submitted for adoption to the European Parliament and to the Council in May 2012.

### 1.13. Proposal for a regulation on European Venture Capital Funds

The EU Council initiated in 2011 the discussions on the proposal for a regulation on European Venture Capital Funds. This proposal follows up on the commitments taken by the EU within the framework of the Single Market Act to enable venture capital funds established in one Member State to invest and raise capital in any other Member State, without additional obstacles or requirements. The aim is thus to allow innovative SMEs to have access to venture capital, in particular by removing the obstacles hindering cross-border investments.

The proposal also includes uniform requirements for UCI managers operating under the designation of "European Venture Capital Fund". These requirements notably concern the composition of the investment portfolio, the investment techniques, the eligible target undertakings, the eligible investor categories and the internal organisation of these fund managers. The proposal also provides for managers of European Venture Capital Funds, subject to uniform European legislation, to benefit from a European passport to market these venture capital funds across the EU.

### 1.14. Proposal for a regulation on European Social Entrepreneurship Funds

In the second half of 2011, the EU Council initiated the negotiations on a proposal for a regulation on the implementation of a "European Social Entrepreneurship Fund" label (EuSEF). This proposal for a regulation, discussed at the same time as the proposal for a regulation on a label for European Venture Capital Funds, but independent from it, should allow alternative investment fund managers following a social impact investment policy to have better access to capital raising with mainly professional investors, through the implementation of a European passport for the marketing of alternative investment funds bearing this label. The proposal forms part of a larger initiative by the European Commission which aims to foster social business.

Under this proposal for a regulation, the label, available as an option, is allocated on condition that at least 70% of the EuSEF's assets are invested in qualifying investments, i.e. in entities that comply with the definition of social investment within the meaning of the proposal for a regulation. The proposed rules also provide for a defined framework on reporting obligations and requirements on the targeted social impact assessment.

## 2. DIRECTIVES ADOPTED BY THE COUNCIL AND THE EUROPEAN PARLIAMENT TO BE TRANSPOSED UNDER NATIONAL LAW

### 2.1. Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010 (AIFM Directive)

The AIFM Directive aims at providing a harmonised regulatory and supervisory framework which alternative investment fund managers (AIFMs) have to comply with within the EU. AIFMs are legal persons whose regular professional business is managing alternative investment funds (AIFs). This directive applies to all AIFMs established in the EU and to all AIFMs established outside the EU for which at least part of the activities are exercised within the EU (either through the management of European AIFs or through the marketing of AIFs in the EU).

The AIFM Directive sets out the rules on the organisation and conduct of the business for the management of alternative funds. In return, the managers of these funds are offered new opportunities through a European passport which allows them to provide management services and to offer their funds to well-informed investors in all the EU Member States. The provisions of the directive cover, among others, the authorisation conditions for AIFMs, the capital requirements, the requirements as regards liquidity and risk management, the requirements in relation to valuation, depositaries, delegation arrangements, the disclosure of information, the restrictions on the use of leverage and the clauses for non-EU countries.

On 16 November 2011, ESMA published its technical advice to the European Commission on the implementing measures of the AIFM Directive. The final implementing measures (Level 2 measures) will be published by the European Commission by July 2012.

The AIFM Directive entered into force on 1 July 2011. It must be transposed into national law by 22 July 2013. The CSSF has been tasked with preparing a draft law for this purpose, which is currently being discussed in technical committees.

### 2.2. Directive 2011/89/EU of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate

This directive was discussed in detail in the CSSF's Annual Report 2010. Most of its articles shall be transposed into national law by 10 June 2013.

### 2.3. Directive 2010/73/EU of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive) and 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 directive was discussed in detail in the CSSF's Annual Report 2009. It will be transposed into national legislation through the adoption of draft law No. 6319.

### 2.4. Directive 2010/78/EU of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (Omnibus Directive)

This directive was discussed in detail in the CSSF's Annual Report 2009. It will be transposed into national legislation through the adoption of draft law No. 6397.

## 3. LUXEMBOURG LAWS AND REGULATIONS ADOPTED IN 2011

### 3.1. Law of 28 April 2011:

- **transposing Directive 2009/111/EC of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management;**
- **transposing for credit institutions Directive 2009/49/EC of 18 June 2009 amending Directives 78/660/EEC and 83/349/EEC as regards certain disclosure requirements for medium-sized companies and the obligation to draw up consolidated accounts;**
- **completing the transposition of Directive 2009/14/EC of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes and the payout delay.**

The law transposes several European directives and amends a set of laws relating to the financial sector. The amendments introduced by the transposition of the aforementioned European directives mainly concern the CSSF's obligations in its capacity as consolidating supervisory authority and in the field of crisis management. The law also completes the transposition of Directive 2009/14/EC on deposit-guarantee schemes notably by extending the credit institutions' information obligation towards their customers.

A detailed description of the major amendments introduced by the law is provided in Circular CSSF 11/515.

### 3.2. Law of 20 May 2011 transposing:

- **Directive 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC;**
- **Directive 2009/44/EC of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims**

The main objective of the law is to transpose the provisions of Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions, by amending the law of 10 November 2009 on payment services. The purpose of the new rules is to promote the creation of innovative and secure electronic money services, to facilitate market entry of new players, to promote a level playing field for all market players, to ensure public confidence in electronic money and to guarantee a high level of consumer protection.

A detailed description of the major amendments introduced by the law is provided in Circular CSSF 11/517.

### 3.3. Law of 28 October 2011 implementing Regulation (EC) No. 1060/2009 of 16 September 2009 on credit rating agencies and amending:

- **the law of 5 April 1993 on the financial sector, as amended;**
- **the law of 8 December 1994 relating to annual and consolidated annual accounts of Luxembourg insurance and reinsurance companies and relating to the duties of branches of third country insurance companies in respect of the right of establishment and of the publicity of accounting documents, as amended**

As far as rating agencies are concerned, the law provides that the CSSF has been granted the powers set out in Articles 59 and 63 of the law of 5 April 1993 on the financial sector towards the persons which are subject to its supervision, and referred to in Article 4(1)(1) and (2) of Regulation (EC) No. 1060/2009 on credit rating agencies.

As far as remuneration policy is concerned, the law provides that each credit institution and each investment firm referred to in Articles 24-2 to 24-6, 24-7(3) or 24-9 of the law of 5 April 1993 shall implement remuneration policies and practices allowing to promote a sound and efficient risk management. The powers of the CSSF in this area have also been strengthened: it may require the credit institution and investment firm to limit the variable remuneration as a percentage of the total net revenues where this remuneration is not in line with the keeping up of a sound financial basis and to use the net profit to strengthen its financial basis.

### 3.4. Regulation (EU) No. 513/2011 of 11 May 2011 amending Regulation (EC) No. 1060/2009 on credit rating agencies

This regulation was discussed in detail in the CSSF's Annual Report 2010.

### 3.5. CSSF Regulation N° 11-01 relating to:

- **the adoption of audit standards in the field of statutory audit under the law of 18 December 2009 concerning the audit profession;**
- **the adoption of standards in the field of the other missions reserved by the law exclusively to *réviseurs d'entreprises agréés* under the law of 18 December 2009 concerning the audit profession;**
- **the adoption of standards on professional ethics and internal quality control under the law of 18 December 2009 concerning the audit profession**

**CSSF Regulation N° 11-02 relating to the establishment of a list of Master's degrees or diplomas corresponding to equivalent training which satisfy the requirements referred to in Article 2(1) and (2) of Grand-ducal regulation of 15 February 2010 determining the requirements for the professional qualification of *réviseurs d'entreprises* (statutory auditors)**

**CSSF Regulation N° 11-03 relating to the establishment of a list of approvals referred to in Article 1, Section B of Grand-ducal regulation of 15 February 2010 determining the requirements for the professional qualification of *réviseurs d'entreprises***

The regulations are further detailed under item 1.1. of Chapter XI "Public oversight of the audit profession".

### 3.6. CSSF Regulation N° 11-04 amending CSSF Regulation N° 10-05 transposing Commission Directive 2010/44/EU of 1 July 2010 implementing Directive 2009/65/EC as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure

The regulation is further detailed under item 3.1. of Chapter V "Supervision of undertakings for collective investment".

# 4. QUESTIONS ON THE PRACTICAL APPLICATION OF REGULATIONS AND JUDGEMENTS

## 4.1. Guidelines on the CSSF's assessment of professional standing condition

The law of 5 April 1993 on the financial sector (hereafter "LFS") and some sectoral laws provide that obtaining an authorisation is subject to the condition that members of administrative, management and supervisory bodies, as well as shareholders or members with a qualifying holding must produce evidence of their professional standing.

According to the LFS, such standing shall be assessed on the basis of police records and of any evidence tending to show that the persons concerned are of good repute and offering every guarantee of irreproachable conduct. Similar or identical wordings are also used in certain sectoral laws. Preparatory work that introduced the concept of "professional standing" in the legislation on the supervision of the financial sector indicates that the text on the professional standing of persons directing a credit institution has been influenced by the new wording used in the establishment law of 28 December 1988; this wording has been completed and strengthened through a reference taken from the Swiss banking law. The chosen wording clearly shows that professional standing is subject to a different and more rigorous assessment in the financial sector than under common law[1]. This being said, even in the financial sector, directors with criminal records or previous convictions shall not be excluded *ipso facto*, on the grounds that they do not have the professional standing required by texts such as the LFS. Indeed, the Communication dated 21 February 2006 from the European Commission to the Council and the European Parliament on disqualifications arising from criminal convictions in the European Union explains[2]: "under the Banking Directive, a credit institution cannot be authorised to perform its duties if the persons concerned are not of sufficiently good repute. It is therefore likely that their criminal records will be checked and that they will not be authorised if they have been convicted of offences such as money laundering or corruption. The interpretation of "good repute" is however left to the Member States and there is no systematic disqualification flowing from the commission of specific offences. The same applies to the legislation relating to investment firms (...)".

Just as convictions registered on criminal records do not allow to exclude *ipso facto* a person, the absence of conviction does not mean that a person is irrefutably deemed to be of good repute. The CSSF carries out a case-by-case analysis of the professional standing based on three main guidelines which derive from doctrine and case law.

### 1. The facts on which convictions are based and which took place more than 10 years ago shall not constitute the only elements on which a decision denying professional standing should be based.

There is no systematic disqualification flowing from the commission of specific offences. Also, the older the convictions, the more difficult it is to take them into consideration to deny professional standing to a person, above all if these convictions are the only elements on which an authority may base its decision.

For example, in its decision dated 18 November 2002[3], the *Tribunal administratif* (administrative court) considered that facts on which a conviction is based and which took place more than 10 years ago may not alone be considered as decisive. The 10-year time limit was moreover explicitly laid down in the law of 2 September 2011 regulating the access to the professions of craftsman, salesman, industrial as well as to some liberal professions[4]. Article 6(2) of this law provides that professional standing is assessed based on the police records of the manager and on all elements provided during the administrative instruction provided that they relate to facts that occurred not more than 10 years ago. A similar temporal approach is also applied in other jurisdictions and by other competent authorities.



[1] Draft law n° 3344, page 15.

[2] Communication from the Commission to the Council and the European Parliament of 21 February 2006 on disqualifications arising from criminal convictions in the European Union (COM(2006) 73 final).

[3] *T.adm.* 18 November 2002, n° 15025.

[4] Law of 2 September 2011, Mémorial A - No. 198 of 22 September 2011, page 3601.

Thus, in order to allow the CSSF to assess whether or not certain convictions need to be taken into account, the person concerned must inform it of any previous conviction, even if the latter dates back to more than 10 years and even if the conviction is not or no longer mentioned in his/her extract from police records submitted to the CSSF.

### 2. The facts that are likely to affect the professional standing must have a direct link with the type of activity for which an authorisation is requested.

The professional standing analysis also consists in assessing whether the alleged facts attributed to the person whose professional standing is analysed are linked to the activities performed by the entity for which the authorisation is requested. This analysis is in line with the aim pursued by the professional standing condition. Indeed, this condition mainly aims to ensure the integrity of the profession and the protection of future cocontractors and clients[5]. In Switzerland, for example, "The principal criterion used in assessing a person's suitability is their past and present business activity as well as their professional plans"[6].

In Luxembourg, the *Tribunal administratif* (administrative court of first instance) repealed a decision of the Minister of Finance refusing to grant an authorisation to an insurance agent, on the grounds that the facts for which the applicant was convicted by judgement (...) of 9 June 2009 do not have a direct link with the type of activity for which the authorisation was requested and are not of sufficient gravity to deny professional standing and morality required to exercise the profession of insurance agent[7].

The aforementioned decision of 15 November 2010 was confirmed by the *Cour administrative* (higher administrative court) on 7 April 2011. The *Cour administrative* added that in the context of its assessment for the exercise of a professional activity, it is important to focus on the moral behaviour towards the persons with whom the applicant will be in contact in the context of this activity and the trust those persons may and should give this person concerning their professional relationship[8].

### 3. The reasons for refusal indicated by the authority must be based on accurately established factual circumstances and must be verifiable in consideration of all of the supporting documents of the file.

The third guideline results from the obligation incumbent on any public authority to provide reasons for its decisions. Hence, when the nature of an administrative act is such that it might adversely affect rights, freedoms or interests of the interested party, it is essential - particularly in view of a possible recourse - that the act states the reasons on which it is based, otherwise the interested party is not in a position to decide on the opportunity to dispute this act[9]. An administrative act must be based on reasons taken from accurately established facts and from legally admissible general considerations and in relation with the public interest it must serve[10].

This guideline is in line with case law of the *Cour administrative* which held that professional standing, assessed under the law of 5 April 1993, as amended, on the basis of police records and of any evidence tending to show that a person is of good repute and offering every guarantee of irreproachable conduct, may not be granted to a person towards whom the CSSF representative may issue the fears described above, if the reasons given are upheld by supporting documents of the file[11].

Therefore, on the one hand, the factual circumstances must be accurately established and, on the other hand, the reasons given must be upheld by the supporting documents of the file.

In order to allow the CSSF to assess the professional standing of the persons concerned, the applicant to the authorisation must submit all the necessary information and supporting documents and provide exhaustive answers to the questions raised by the CSSF agents.

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[5] Article 6(1) of the law of 2 September 2011 regulating the access to the professions of craftsman, salesman, industrial as well as to some liberal professions.

[6] FINMA, FAQs - Institutions - Assurance of proper business conduct (last modification: 13 September 2010).

[7] *T.adm.* 15 November 2010, n° 26730.

[8] *C.adm.* 7 April 2011, n° 27591C.

[9] R. Nothar, S. Helminger, La procédure administrative non contentieuse, Service Central de Législation 2002, page 10.

[10] G. Ravarani, La responsabilité civile des personnes privées et publiques, 2nd edition, Pasicrisie luxembourgeoise 2006, n° 188, page 175.

[11] *C. adm.* 13 November 2006, rôle n° 22917C.

## 4.2. Judgement of the *Cour administrative* (higher administrative court) of 29 November 2011 confirming a decision by the CSSF to withdraw a specialised investment fund from the official list

The CSSF withdrew a SICAV-SIF from the official list of specialised investment funds as severe irregularities had been identified in the compliance with its legal requirements. The investment fund lodged an appeal before the *Tribunal administratif* (administrative court of first instance) against the CSSF's decision. In first instance, the investment fund's appeal was dismissed by a judgement of the *Tribunal administratif* dated 4 April 2011.

The judgement of the *Cour administrative* on 29 November 2011 confirmed the line of reasoning of the judgement rendered on 4 April 2011 by the *Tribunal administratif*. It is important to note that the *Cour administrative* explained, in its judgement, certain fundamental aspects concerning the mission exercised by the CSSF. The *Cour administrative* thus underlined that the CSSF exercises its powers exclusively in the public interest, i.e. its supervision does not primarily aim to safeguard the interests of investors only, but also to safekeep the public's general confidence in the financial centre by ensuring that the management of assets entrusted by investors to specialised undertakings complies with legislation and prudential rules. The *Cour administrative* further specified that this mission may only be usefully exercised through a strict control and sanctioning of applicable rules and not through *ad hoc* arrangements allowing some investors, by circumventing the law, to temporarily protect their interests. The *Cour administrative* drew its conclusions from Article 41(2) of the law of 13 February 2007 relating to specialised investment funds which provides that "The CSSF carries out its duties exclusively in the public interest", as well as from the preparatory works of this law. By doing so, the *Tribunal administratif* had already retained in its decision that the legal mission conferred on the CSSF exclusively aims to defend public interest. Indeed, the CSSF's mission is clearly stated in Article 41(2) of the law of 13 February 2007. The CSSF does not exercise a role which would aim to protect only investors of these investment funds, as this would rest with private interest. In other words, the CSSF must take care of public interest and not only opposed private interests of investors. The *Cour administrative* thus also considered that these elements (which had been identified) were largely sufficient to allow the CSSF to intervene in the interest of current investors and future possible investors. The CSSF was exercising its role as general protector by intervening to stop these transactions and initiate a liquidation procedure which would take into account equality of the investment fund's creditors.

## 4.3. Judgement of the *Cour constitutionnelle* (constitutional court) of 1 April 2011 on the conformity of the derogatory regime of civil liability under common law of Article 10a(1) of the Constitution on equality

Following a preliminary question by the *Cour d'appel* (court of appeal), the *Cour constitutionnelle* (constitutional court) decided by a judgement of 1 April 2011[12] on the conformity of Article 20(2) of the law of 23 December 1998 establishing a financial sector supervisory commission ("CSSF organic law") creating a regime for civil liability of the CSSF which derogates from common law, with Article 10a(1) of the Luxembourg Constitution on the equality principle.

Pursuant to Article 20(2) of the CSSF organic law: "For the CSSF to assume civil liability for individual damage incurred by the companies or professionals subject to its supervision, their clients or third parties, it must be demonstrated that the damage was caused through gross negligence in the choice and application of the means implemented to carry out the CSSF's public service remit".



[12] *Cour constitutionnelle*, 1 April 2011, B./CSSF, judgement n°63/11, Mémorial A, n° 65, of 11 April 2011, p. 1104.

The *Cour constitutionnelle* considers that the limitation in civil liability set out in Article 20(2) of the CSSF organic law is not inconsistent with Article 10a(1) of the Constitution. In its judgement, the *Cour constitutionnelle* recognises that the legislator may, without infringing the constitutional principle of equality, submit certain categories of persons to different legal regimes on condition that the difference so established proceeds from objective disparities, that it is rationally justified, adequate and proportionate to its aim. The *Cour constitutionnelle* thus indicates, in particular, that the civil liability of the CSSF may be assumed for a tort, but that the difference in regimes concerning the civil liability of the CSSF, on the one hand, and of the State and legal persons governed by public law, as regards their administrative and legal services, and of private individuals, on the other hand, results from the prudential supervision of the financial sector conferred on the CSSF, this mission constituting an objective criteria of disparity. In this respect, the *Cour constitutionnelle* takes into account the international context in which this particular prudential supervisory mission is exercised and notes that foreign supervisory institutions have progressively been subject to total or partial non-liability or liability attenuation. The *Cour constitutionnelle* considers also that the different liability regime of the CSSF aims to impede systematic search for liability of the financial sector supervisory authority, i.e. the control authority, instead of the civil liability of the supervised professionals of the financial sector, i.e. the controlled entities, and to avoid, as a consequence, that the liability of the latter be absorbed by the liability of the CSSF. Finally, it considers that the derogatory regime of the CSSF organic law is adapted to the objectives to be achieved and, taking into account that the CSSF remains liable for severe neglect in the choice and application of the means implemented for accomplishing its mission, that the relation between attenuation of its liability and objectives aimed is reasonably proportionate.

In the context of the judgement, the *Cour constitutionnelle* also considers that the CSSF exercises a general policing mission designed to ensure the financial system's efficient functioning as a whole in the public interest[13].

[13] Parl. doc. Draft law n° 3600.3, Governmental amendment, page 2.

# INTERNAL ORGANISATION OF THE CSSF



# 1. GOVERNANCE AND FUNCTIONING OF THE CSSF

Established by the law of 23 December 1998, the CSSF is a public institution with legal personality and financial autonomy. It operates under the authority of the Minister responsible for the financial centre, i.e. the Minister of Finance Mr Luc Frieden.

In this capacity, Mr Frieden met the CSSF's executive board and heads of departments on 9 November 2011. This visit allowed the CSSF to present its day-to-day work and the challenges it faces. While reiterating the importance of the financial centre for Luxembourg as the first pillar of the national economy, Mr Frieden congratulated the CSSF for its achievements and encouraged the agents to continue along this path.

## 1.1. CSSF bodies

The board of directors comprises seven members appointed by the Grand-Duke on the proposal of the Government in Council for a period of five years. The powers conferred upon the board of directors include notably the annual adoption of the CSSF's budget and the approval of the financial statements and of the report of the executive board, which are submitted to the board of directors before their presentation to the Government for approval. The board of directors also sets the general policy as well as the annual and long-term investment programmes which are submitted to it by the executive board before being submitted for approval to the Minister of Finance. The internal rules set out the meeting and decision-making processes of the board of directors. The board of directors is not competent to intervene in the CSSF's prudential supervisory matters.

The senior executive authority of the CSSF is the executive board, composed of a director general and between two and four directors, appointed by the Grand-Duke on the proposal of the Government in Council for a period of five years. The executive board prepares measures and takes the decisions it deems useful and necessary for the fulfilment of the CSSF's mission and for its organisation. Moreover, it sets up a five-year "targets contract" with the Minister of Finance. The executive board is responsible for the reports and proposals it is required, as part of its remit, to address to the board of directors and the Government.

## 1.2. The decision-making process

According to its internal rules, the executive board must meet collectively at least once a week to take the decisions required to accomplish the mission of the CSSF. The executive board is responsible collectively even if each individual member runs one or several departments.

The decisions taken in the context of the CSSF's mission may be referred to the Administrative Court, which decides on the merits of the case. These recourses must be instituted, under penalty of foreclosure, within one month from the notification of the decision.

## 1.3. Drawing-up of regulations

The legislative framework applicable to the financial sector is complemented by circulars issued by the CSSF with a view to specifying how the legal provisions should be applied, publishing prudential regulations specific to certain areas of activity and issuing recommendations on conducting activities in the financial sector. Furthermore, the CSSF has the power to make regulations within the limits of its competence and missions, in accordance with Article 9(2) of the law of 23 December 1998. These regulations shall be published in the *Mémorial*.

Following the example of international forums and counterpart authorities, the CSSF has established a broad consultation procedure, which involves, during the stage of drawing-up of regulations, the professionals of the financial sector, as well as any other person concerned, notably *via ad hoc* expert groups and working groups. The draft texts are also submitted to the Consultative committee for prudential regulation and the Consultative committee for the audit profession.

## 1.4. Financing of the CSSF and account auditing

The CSSF is authorised to levy taxes on supervised persons and undertakings to cover its staff, financial and operating costs. The Grand-ducal regulation of 18 December 2009 lays down the amounts applicable and guarantees full financing of the operating costs.

The Government appoints a *réviseur d'entreprises agréé* (approved statutory auditor) on a proposal from the CSSF's board of directors. The *réviseur d'entreprises agréé* shall be appointed for a term of three years and his mission shall be to verify and certify the CSSF's accounts. He draws up a detailed report on the CSSF's accounts at the end of the financial year for the board of directors and the Government. The board may request him to carry out specific verifications.

The CSSF is subject to the control of the *Cour des comptes* (Court of Auditors) for the compliant use of the public financial participation it receives.

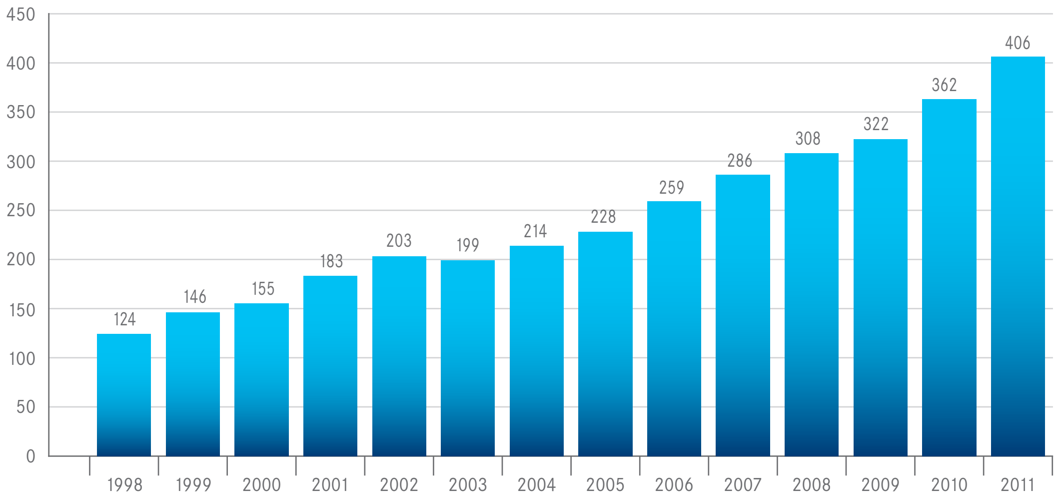
Further details on the organisation of the CSSF's administration and management are available on the CSSF's website (www.cssf.lu), section "About the CSSF", sub-section "Governance and functioning".

# 2. HUMAN RESOURCES

## 2.1. CSSF staff

As far as human resources are concerned, the year 2011 was marked by substantial recruitment of new staff members. Thus, 53 agents were recruited, including 4 under the regime of *fonctionnaire* and 49 under the regime of *employé de l'État*. Following the resignation of 9 agents during that period, total employment reached 406 units as at 31 December 2011, representing a 12.15% increase compared to 2010. This is the equivalent of 369.95 full-time jobs, i.e. a 12.91% increase compared to 2010.

**Movements in staff numbers (at the end of the year)**




The average age of CSSF staff members was 37.74 years as at 31 December 2011. Women made up 48.5% of total staff and men 51.5%.

## 2.2. Staff training

CSSF staff followed 266 training seminars in 2011.

These seminars concerned, on the one hand, the *stage* (training) and the adaptation to the new staff members' workplace, i.e. the internal training programme aiming to facilitate integration of these new hires into the CSSF's structure and to make them acquainted with the CSSF's activities (16.4%) and, on the other hand, lifelong learning for CSSF agents (83.6%). 40.8% of this lifelong learning focused on economics, finance and law, 18.4% on IT/office automation, 21.0% on management and human resources management and 13.1% on languages. The remaining 15.4% covered subjects such as the adaptation to the workplace, security and professional techniques.

1,257 participations in training sessions were recorded in 2011. The CSSF staff attended a total of 1,347 training days, representing an average of 3.5 days of training per agent.

# 3. INFORMATION SYSTEMS

The CSSF's IT department is a division of the department "IT systems and supervision of support PFS". This division is in charge of installing, maintaining and developing the CSSF's internal IT infrastructure as well as managing the electronic reporting of supervised entities.

## 3.1. COREP and FINREP reporting

In June 2011, the CSSF published an update of tables B1.4 and B6.4 in order to make the tables on capital adequacy compliant with Directives CRD II and CRD III. This update which concerned tables CA-SRO (capital adequacy - solvency overview) and MKR IM (market risk: internal model), came into effect on 31 December 2011.

Work to define tables relating to capital adequacy (COREP) in line with the future regulatory framework CRD IV is in progress at European level. In December 2011, EBA launched a public consultation on this subject ending 20 March 2012. The documents concerned are available on EBA's website (www.eba.europa.eu). Following their adoption by the European Commission, the new tables COREP CRD IV will be applicable throughout the EU. The technical reference implementation will be in XBRL and will have a new architecture which will support the validation of the reports through the formula linkbase and the tabular representation of the reports through the table linkbase.

As far as organisational aspects are concerned, it should be noted that the XBRL working groups that operated in the past as coordinating and cooperating groups among national authorities, are henceforth directly under the aegis of EBA.

### 3.2. Development of the CSSF's internal IT systems

The implementation of the new electronic document management system (EDMS), initiated in 2010, was pursued in 2011. The first implementation results are expected for the fourth quarter 2012. During the past year, the project team defined the technical framework for the EDMS tool, i.e. the man-machine interface and its application libraries. Capitalising on the experience gained through the use of the existing EDMS during the past ten years, the ergonomics of the new EDMS are being totally reviewed so as to integrate the facilities expected by the users.

In addition to document classification and indexing, the new EDMS integrates flow management, thereby improving the follow-up of inbound processing, in particular of the documents submitted to the CSSF for approval, such as UCI prospectuses or prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market. These "business" functions, which concern large volumes of documents from external players, are to be distinguished from the "support" functions of the EDMS as internal document management tool. Flow management is a priority for "business" functions as these are at the heart of the responsiveness that is to be expected from a public authority and cover ever increasing volumes.

With the introduction of the notification process inherent in the UCITS IV Directive, the CSSF implemented a tool to collect the documents to be submitted within the context of this notification procedure (notably KIID). It adapted its chains of applications allowing to process, store and transmit these documents to the other European authorities concerned. A web interface has been developed allowing the filing of KIID documents for filing entities that do not have access to the authorised channels that transfer and process substantial volumes.

In this context and given the market demand for a technical and commercial alternative, the CSSF decided to open up the access to certain filing procedures that were restricted to the E-File channel so far. To this end, it started reviewing the exchange protocol with the channels for documents linked to prospectuses and proposes a catalogue of SAO web services (Service-Oriented Architecture). A catalogue of exchange functions, which are likely to evolve, will be proposed. It will rely on XML for data structuring and will allow the authorised channels to develop value-added applications adapted to the expectations of the filing entities. The use of web services, rather than an exchange of files through filing in a secure file transfer protocol (sFTP), also improves interactivity of exchanges.

Within the framework of the public oversight of the audit profession, the CSSF is required to publish the list of *réviseurs d'entreprises agréés* (approved statutory auditors). The teams of the department "Information systems and supervision of support PFS" developed a web application allowing to search this register based on the name, even partial, of the *réviseur d'entreprises* or the *cabinet de révision* (audit firm).

Overall, the year 2011 was thus marked by the implementation of interactive web applications, and which go beyond static information, which will allow improving data flows between the CSSF and the public.

## 4. STAFF MEMBERS

### Executive board

| | |
|---|---|
| Director General | Jean Guill |
| Directors | Andrée Billon, Simone Delcourt, Claude Simon |

### Internal audit

Marie-Anne Voltaire
Valérie Lecointe

### Executive board secretariat

| | |
|---|---|
| Head of department | Danielle Mander<br>Francis Fridrici, Iwona Mastalska |
| Executive secretaries | Joëlle Deloos, Elisabeth Demuth, Karin Frantz, Carole Hessler, Marcelle Michels, Monique Reisdorffer |

### General secretariat

| | |
|---|---|
| Head of department | Danièle Berna-Ost |
| | Yamina Agouni, Carmela Anobile, Carine Conté, Patrick Hommel, Danielle Meyrer, Danijela Stojkovic |

### Legal department

| | |
|---|---|
| Heads of department | Jean-Marc Goy, Jean-François Hein, Marc Limpach, Geneviève Pescatore |
| | Vanessa Gabriel, Yasmin Gabriel, Simone Gloesener, François Goergen, Nadine Holtzmer, Nora Humbert, Stéphanie Jamotte, Isabelle Jaspart, Benoît Juncker, Michèle Muller, Elisabeth Omes, Anne Wagener, Carole Winandy |

### Department General supervision

| | |
|---|---|
| Head of department | Romain Strock |
| Deputy heads of department | Danièle Goedert, Nadia Manzari, Joëlle Martiny, Patrick Wagner |

#### *Division 1 - International matters*

| | |
|---|---|
| Head of division | Joëlle Martiny |
| | Ngoc Dinh Luu, Sophie Schiltz, Isabelle Schmit, Vincent Thurmes, Karin Weirich |

#### *Division 2 - Accounting, reporting and audit*

| | |
|---|---|
| Head of division | Danièle Goedert |
| | Annick Bové, Maryse Duarte, Ana Bela Ferreira, Marguy Mehling, Christina Pinto, Martine Wagner |

### *Division 3 - Governance rules, electronic payments and crisis management*

Head of division — Nadia Manzari

Natasha Deloge, Gilles Jank, Charles Krier, Nicole Lahire, Sylvie Nicolay-Hoffmann

### *Division 4 - On-site inspections*

Head of division — Patrick Wagner

Valérie Alezine, Françoise Bergmans, Magali De Dijcker, Joan De Ron, Sonja Kinn, Guido Kruse, Carole Philippe, Christian Schaack, Nicolas Van Laar

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## Department Supervision of undertakings for collective investment

Head of department — Irmine Greischer

Deputy heads of department — Jean-Paul Heger, Alain Hoscheid, André Schroeder, Claude Steinbach

### *International regulations regarding UCIs and analysis of specific legal aspects*

Mireia Camarasa, Rudi Dickhoff, François Hentgen, Siobhan Ronan, Laurent van Burik

### *Enquiries and review of pre-contentious files*

Heads of division — Serge Eicher, Christiane Streef

Laurence Dujic, Marisa Garcia Fernandes, Ariane Guignard, Laurent Mayer, Sébastien Traversa

### *General organisation, database management and use, coordination and development of IT systems, Visa and notifications, secretariat*

Deputy head of department — Claude Steinbach

#### *Coordination and development of IT systems*

Head of division — Nico Barthels

Marie-Louise Baritussio

#### *Database management and use*

Head of division — Jolanda Bos

Serge Besché, Christiane Cazzaro, Nicole Grosbusch, Dominique Herr, Claude Krier, Danielle Neumann, Evelyne Pierrard-Holzem, Marc Schwalen, Claudine Thielen, Nadia Trausch, Suzanne Wagner

#### *Desk Visa and notifications*

Head of division — Danièle Christophory

Adrienne André-Zimmer, Patrick Bariviera, Giuseppe Daloia, Isabelle Wagner

*Secretaries* — Sandy Bettinelli, Joy Flick, Angelica Formica, Sandra Ghirelli, Simone Kuehler, Sandra Preis

### Analysis of specific economic aspects

Deputy head of department André Schroeder

Jacqueline Arend, Géraldine Bouvy, Angela De Cillia, Gisèle Detaille, Fabio Ontano

### Instructions and supervision of UCIs

Deputy head of department Jean-Paul Heger

#### *Supervision of UCIs activity*

Head of division Francis Gasché

Michael Baust, Patrick Da Silva, Julien Gageonnet, Nicole Gengler, Pierre Hilbert, Amandine Hordebise, Sophie Leboulanger, Géraldine Olivera, Sabine Schiavo, Rudy Stranen, Michèle Wilhelm

#### *Group 1*

Instruction of UCIs

Head of division Charles Thilges

Yolanda Alonso, Nathalie De Brabandere, Jérôme Mousny, Gilles Oth, Quentin Parisse, Nathalie Reisdorff, Marc Runau, Daniel Schmitz, Christel Tana, Sarah Villain

Supervision of UCIs

Head of division Francis Lippert

Leonardo Brachtenbach, Marie-Rose Colombo, Melania Dinescu, Joël Goffinet, Martine Kerger, Thierry Quaring, Daniel Wadlé

#### *Group 2*

Instruction of UCIs

Head of division Ralph Gillen

Anne-Christine Depienne, Marc Dondlinger, Yves Fischbach, Urbain Hever, Tom Muller, Carine Peller, Yannick Rouby, Roberta Tumiotto, Florence Winandy

Supervision of UCIs

Head of division Paul Hansen

Géraldine Appenzeller, Isabelle Dosbourg, Patricia Jost, David Phillips, Philippe Polfer, Marc Racké, Pierre Reding, Marc Siebenaler

#### *Group 3*

Instruction of UCIs

Head of division Michel Friob

Claude Detampel, Anne Diederich, Christophe Faé, Joëlle Hertges, Robert Köller, Sonia Miloche, Laurent Reuter, Pascale Schmit, Isah Skrijelj, Julien Warrant

Supervision of UCIs

Head of division Guy Morlak

Nathalie Cubric, Marc Decker, Jean-Claude Fraiture, Damien Houel, Jean-Marc Lehnert

### *Risk management and macroprudential supervision of UCIs*

| | |
|---|---|
| Deputy head of department | Alain Hoscheid |
| | Alain Bressaglia, Bruno Dawance, Agnès Gury, François Petit, Mireille Reisen, Tom Ungeheuer |

## Department Supervision of management companies

| | |
|---|---|
| Head of department | Sonny Bisdorff-Letsch |
| Deputy head of department | Pascal Berchem |
| | Anne Boxho-Conrath, Pascale Felten-Enders, Anica Giel-Markovinovic, Anne-Marie Hoffeld, Roberto Montebrusco, Eric Tanson |
| Secretary | Sandra Preis |

## Department Supervision of securities markets

| | |
|---|---|
| Head of department | Françoise Kauthen |
| Deputy heads of department | Annick Zimmer, Maggy Wampach |

### *Division 1 - Approval of prospectuses*

| | |
|---|---|
| Head of division | Jean-Christian Meyer |
| Group 1 | Frédéric Dehalu, Patrick Fricke, Yves Hansen, William Lebec, Paul Lepage, Jim Neven, Jerry Oswald, Stefan Weyand |
| Group 2 | Carine Merkes, Joëlle Paulus, David Schmitz |

### *Division 2 - Approval of prospectuses*

| | |
|---|---|
| Head of division | Gilles Hauben |
| Group 1 | Antonio Colino, Olivier Ferry, Daniel Jeitz, Julien May, Jacqueline Picard, Marc Reuter, Cyrille Uwukuli, Olivier Weins |
| Group 2 | Carine Brandenburger, Michèle Debouché, Estelle Gütlein-Bottemer |

### *Division 3 - Transparency*

| | |
|---|---|
| Head of division | Maureen Wiwinius |
| Enforcement | Jérôme Tourscher |
| Group 1 | David Deltgen, Nicolas Hinterscheid, Hanna Klattenhoff, Robert Nossek, Max Raths, Brice Robreteau, Manuel Roda, Stéphanie Weber |
| Group 2 | Giang Dang, Christine Jung |

### *Division 4 - Supervision of markets and market operators*

| | |
|---|---|
| Head of division | Maggy Wampach |
| | Stéphanie Bonifas, Eric Fritz, Mylène Hengen, Hary Suttor |

### *Division 5 - Enquiries and legal issues*

| | |
|---|---|
| Head of division | Mendaly Ries |
| | Laurent Charnaut, Anne Lutgen |

| | |
|---|---|
| ***Secretaries*** | Sarah Morosi, Marie-Josée Pulcini |

## Department Personnel, administration and finance

| | |
|---|---|
| Head of department | Alain Oestreicher |
| Deputy head of department | Georges Bechtold |

### *Division 1 - Human resources*

| | |
|---|---|
| Head of division | Georges Bechtold |
| | Tanja Helten, Manon Hoffmann, Vic Marbach, Vanessa Marinier |

### *Division 2 - Financial management*

| | |
|---|---|
| Head of division | Jean-Paul Weber |
| | Tom Ewen, Guy Frantzen |

### *Division 3 - Administration and facility management*

| | |
|---|---|
| Head of division | Marc Feiereisen |
| | Sergio De Almeida, Raul Domingues, Daniel Hames, Patrick Klein, Ricardo Oliveira, Marco Valente |

| | |
|---|---|
| ***Secretaries*** | Milena Calzettoni, Ylenia Gambuto, Nicole Thinnes |

## Department Information systems and supervision of support PFS

| | |
|---|---|
| Head of department | David Hagen |
| Deputy heads of department | Constant Backes, Pascal Ducarn |

### *Transversal function Supervision of IT Systems and International coordination of IT Systems*

#### *Supervision of information systems*

| | |
|---|---|
| Head of division | Cécile Gellenoncourt |

#### *International coordination*

| | |
|---|---|
| Head of division | Paul Herling |

### *Support function*

#### *Administration and finance, budget and contracts*

| | |
|---|---|
| Administration and secretariat | Jill Roden |
| Finance, budget and contracts | Carine Schiltz |

#### *Coordination and user relations*

| | |
|---|---|
| Head of division | Emile Bartolé |
| | Pascale Damschen |

| | |
|---|---|
| *Strategic adviser* | Jean-Luc Franck |

### *Area 1 - Information systems*

| | |
|---|---|
| In charge | Constant Backes |

| | |
|---|---|
| *IT Monitoring Function* | Marco Fardellini |

#### *Division I - Production IT Systems*

| | |
|---|---|
| In charge | Edouard Lauer |
| Section GFD | Yves Bartringer, Christelle Hutmacher |

Section Systems, networks and applications

| | |
|---|---|
| Unit Systems and networks | Frank Brickler, Jean-Jacques Duhr, Steve Kettmann |
| Unit Applications | Cédric Brandenbourger, Luc Prommenschenkel |

Section Helpdesk

| | |
|---|---|
| In charge | Thierry Stoffel |
| | Jean-François Burnotte, Nadine Eschette |

#### *Division II – Supervision of information systems*

| | |
|---|---|
| | Claude Bernard |

#### *Division III - Developments*

| | |
|---|---|
| Section I (Repository) | Marc Kohl, Guy Wagener |
| Section II (EDMS) | Joao Almeida, Nicolas Lefeuvre |
| Section III (DB & Analyses) | Romain De Bortoli, Sandra Wagner |
| Section IV (Web, MiFID) | Denise Arnaud |

### *Area 2 - Supervision of support PFS*

| | |
|---|---|
| In charge | Pascal Ducarn |
| Head of division | Marc Bordet |
| | Laurent Dohn, Isabelle Gil, Julie Lagrange, Josiane Laux, Martine Simon |

## Department Public oversight of the audit profession

| | |
|---|---|
| Head of department | Frédéric Tabak |
| | Mathieu Antoine, Dimitra Arend, Cédric Marchal, Isabelle Michalak, François Mousel, Agathe Pignon, Hugues Wangen, Anne Wirard |
| Secretary | Claude Fridrici |

## Department Supervision of specialised PFS

| | |
|---|---|
| Head of department | Carlo Felicetti |
| Deputy head of department | Denise Losch |
| | Lucinda Azevedo Pereira, Gérard Brimeyer, Jean-Louis Duarte, Annick Heintz, Isabelle Lahr, Sylvie Mamer, Claudia Miotto, Christian Schroeder |
| Secretary | Emilie Lauterbour |

## Department Supervision of banks

| | |
|---|---|
| Head of department | Frank Bisdorff |
| Deputy heads of department | Ed. Englaro, Nico Gaspard, Claude Moes, Davy Reinard, Jean-Paul Steffen, Jacques Streweler, Claude Wampach |

### *Division 1 - Supervision of credit institutions 1*

| | |
|---|---|
| Head of division | Ed. Englaro |
| | Anouk Dondelinger, Anne-Marie Fiorello, Françoise Jaminet, Jean Ley, Laurent Petry, Claude Wagner |

### *Division 2 - Supervision of credit institutions 2*

| | |
|---|---|
| Head of division | Jean-Paul Steffen |
| | Alain Clemens, Marina Sarmento, Claudine Tock, Michèle Trierweiler, Andy Züst |

### *Division 3 - Supervision of credit institutions 3*

| | |
|---|---|
| Head of division | Nico Gaspard |
| | Marco Bausch, Françoise Daleiden, Claude Ley, Livia Moretti, Yves Simon |

### *Division 4 - Supervision of credit institutions 4*

| | |
|---|---|
| Head of division | Claude Moes |
| | Carlos Azevedo Pereira, Monica Ceccarelli, Gilles Karels, Jean Mersch, Alain Weis, Christoph Winnefeld |

### *Division 5 - Supervision of credit institutions 5*

| | |
|---|---|
| Head of division | Jacques Streweler |
| | David Aranda, Felipe Araya, Stéphanie Nothum, Diane Seil, Thomas Weber |

### *Division 6 - Risk management functions*

| | |
|---|---|
| Heads of division | Davy Reinard, Claude Wampach |
| | Didier Bergamo, Blandine Caeiro, Bettina Eisele, Laurent Goergen, Timo Litzenberger, Paul-Marie Majerus, Nele Mayer, Pierrot Rasqué, Joé Schumacher |

| | |
|---|---|
| ***Statistics and IT issues*** | Claude Reiser |
| ***Legal issues*** | Gabrielle Fatone |
| ***Surveys and general issues*** | Marc Wilhelmus |
| ***Secretaries*** | Michèle Delagardelle, Steve Humbert, Claudine Wanderscheid |

## Department Supervision of investment firms

| | |
|---|---|
| Head of department | Marc Weitzel |
| Deputy heads of department | Luc Pletschette, Steve Polfer |

### *Division 1*

| | |
|---|---|
| Head of division | Steve Polfer |
| | Marc Birchen, Céline Gamot, Andrea Haris, Filipa Mendes, Carola Nilsson, Mariette Thilges |

### *Division 2*

| | |
|---|---|
| Head of division | Luc Pletschette |
| | Annick Hucker, Michel Kohn, Patrice Mack, Anne Marson, Carole Ney, Diane Reuter, Christiane Trausch, Pierre van de Berg |

***Secretary*** Sally Habscheid

## Department Supervision of pension funds, SICARs and securitisation undertakings

| | |
|---|---|
| Head of department | Christiane Campill |

### *Authorisation and supervision of pension funds*

Arthur Backes, Tom Becker, Nathalie Wald

### *Authorisation and supervision of SICARs*

Tom Becker, Nicolas Beckrich, Daniel Ciccarelli, Raffaela Fiorentino, Aurore Fonfreide, Kristel Gilissen, Carole Lis, Laurent Neyen, Pierre Oestreicher, Catherine Phillips, Michael Rademacher, Isabelle Maryline Schmit, Paul Scholtes, René Schott, Alex Weber, Martine Weber

### *Authorisation and supervision of securitisation undertakings*

Cliff Buchholtz, Anouk Dumont, Nathalie Wald

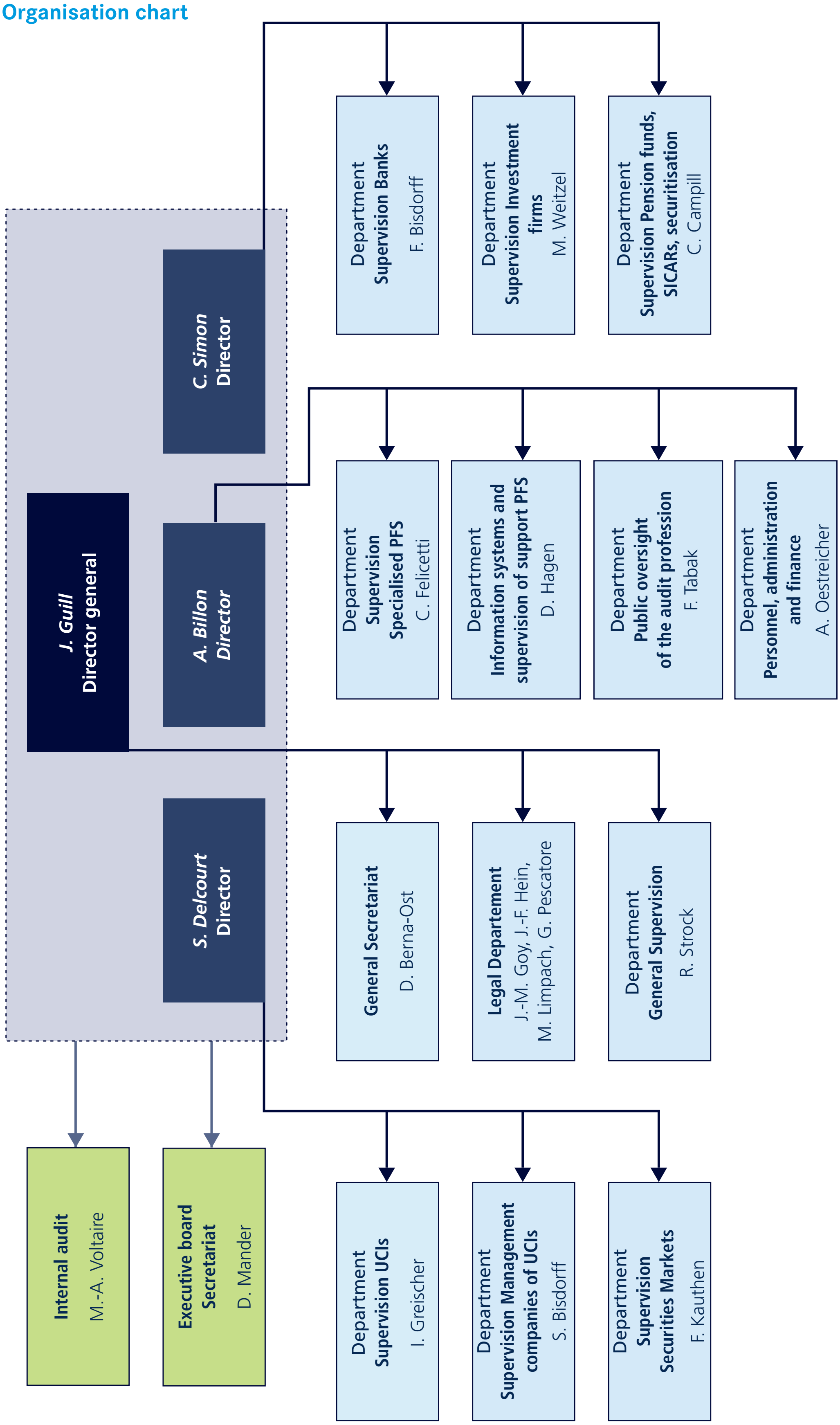
***Administration*** Joëlle Hommel

***Secretary*** Carla Dos Santos

## Financial controller

Deloitte S.A.

## Organisation chart



# 5. COMMITTEES

## 5.1. Consultative committees

### 5.1.1. Consultative committee for prudential regulation

The Government may seek the advice of the committee, constituted by the law of 23 December 1998 establishing a financial sector supervisory commission (*Commission de surveillance du secteur financier*), on any draft law or Grand-ducal regulation in the field of the financial sector regulation falling within the remit of the CSSF. The CSSF's executive board shall seek an opinion of this consultative committee on any draft regulation of the CSSF other than related to statutory audits and the audit profession. A member of the consultative committee may also seek its advice concerning the implementation or application of the prudential regulation overall or for specific issues. The external members of the committee are appointed by the Minister of Finance.

Committee composition:

Executive board of the CSSF: Jean Guill (Chairman), Andrée Billon, Simone Delcourt, Claude Simon

Members: Nicolas Buck, Alain Feis, Georges Heinrich, Michel Maquil, Jean-Jacques Rommes, Carlo Thill, Camille Thommes

Secretary: Danielle Mander

### 5.1.2. Consultative committee for the audit profession

The Government may seek the advice of the Committee, established by the law of 18 December 2009 concerning the audit profession, on any draft law or Grand-ducal regulation related to statutory audits and the audit profession falling within the remit of the CSSF. The CSSF's executive board shall seek an opinion of this consultative committee on any draft regulation of the CSSF related to statutory audits and the audit profession. A member of the committee may also seek its advice concerning the setting-up or application of the regulation of public oversight of the audit profession overall or for specific issues. The external members of the committee are appointed in accordance with Article 15-1 of the law of 23 December 1998 establishing a financial sector supervisory commission.

Committee composition:

Executive board of the CSSF: Jean Guill (Chairman), Andrée Billon, Simone Delcourt, Claude Simon

Members: Serge de Cillia, Pierre Krier, Philippe Meyer, Victor Rod, Daniel Ruppert, Marny Schmitz, Anne-Sophie Theissen, Camille Thommes, Eric van de Kerkhove

Secretary: Danielle Mander

## 5.2. Permanent and *ad hoc* expert committees

The expert committees assist the CSSF in analysing the development of the different areas of the financial sector, give their advice on any issue relating to their activities and contribute to the drawing-up and interpretation of regulations relating to areas covered by the respective committees. In addition to the permanent committees listed below, *ad hoc* committees are formed to examine specific subjects.

The permanent expert committees are the following:

- Anti-Money Laundering Committee;
- Banks and Investment Firms Committee;
- Bank and Investment Firm Accounting Committee;

- Pension Funds Committee;
- Corporate Governance Committee;
- Laws and Regulations Committee;
- Securities Markets Committee;
- Undertakings for Collective Investment Committee;
- Consumer Protection Committee;
- Professionals of the Financial Sector Committee;
- SICAR Committee;
- Audit Technical Committee;
- Securitisation Committee.

In 2011, the following persons participated in the work of the various expert committees and *ad hoc* committees of the CSSF:

| | |
|---|---|
| ACHILLES Matthias | Hypo Pfandbrief Bank International S.A. |
| BAIS Gérard Jan | Erste Europäische Pfandbrief- und Kommunalkreditbank AG In Luxemburg |
| BARBIER Jean-Louis | Banque Raiffeisen |
| BAUER Maurice | Société de la *Bourse de Luxembourg* S.A. |
| BAUMERT Martin | UBS (Luxembourg) S.A. |
| BECHET Marc-André | Banque Degroof Luxembourg S.A. |
| BEYTHAN Hermann | Linklaters LLP |
| BIRASCHI Sonia | State Street Bank Luxembourg S.A. |
| BIVER Janine | Linklaters LLP |
| BOSI Stéphane | Banque de Patrimoines Privés |
| BRAUSCH Freddy | Linklaters LLP |
| BRUCHER Jean | Brucher Thieltgen & Partners |
| BURBI David | PricewaterhouseCoopers |
| BURG Werner | Deutsche Bank Luxembourg S.A. |
| CACCLIN Yves | Société Générale LDG |
| CARRE Olivier | PricewaterhouseCoopers |
| CHAN YIN Victor | KPMG Luxembourg |
| CHRISTIAENS Evelyne | Association of the Luxembourg fund industry |
| COEKELBERGS Olivier | Ernst & Young |
| COLBERT Cheryl | Ministry of Higher Education and Research |
| CONAC Pierre-Henri | University of Luxembourg |
| CONTER Marie-Jeanne | Ministry of Finance |
| CONTZEN Ernst Wilhelm | The Luxembourg Bankers' Association |
| COOK Geoffrey | Brown Brothers Harriman (Luxembourg) S.C.A. |
| DE CILLIA Serge | The Luxembourg Bankers' Association |
| DE CROUY-CHANEL Henri | Aurea Finance Company |
| DELVAUX Jacques | Notary |
| DENAYER Laurent | Ernst & Young |

| | |
|---|---|
| DIBUS Reinolf | EUROHYPO Europäische Hypothekenbank S.A. |
| DOGNIEZ Nathalie | KPMG Luxembourg |
| DONDELINGER Germain | Ministry of Higher Education and Research |
| DUPONT Philippe | Arendt & Medernach |
| DUREN Philippe | PricewaterhouseCoopers |
| DUSEMON Gilles | Arendt & Medernach |
| ELVINGER Jacques | Elvinger, Hoss & Prussen |
| ENGEL Doris | Banque et Caisse d'Épargne de l'État Luxembourg |
| EVRARD Amaury | PricewaterhouseCoopers |
| FALTZ Christiane | State Street Bank Luxembourg S.A. |
| FEIS Alain | Interinvest S.A. |
| FELD Thomas | KPMG Luxembourg |
| FISCHER Rafik | KBL European Private Bankers S.A. |
| FUCHS Jean | Association Luxembourgeoise des Professionnels du Patrimoine |
| GENET Frédéric | Société Générale Bank & Trust |
| GEORTAY Patrick | Linklaters LLP |
| GODFRAIND Michel | KBL European Private Bankers S.A. |
| GOUBIN Isabelle | Ministry of Finance |
| GOUDEN Patrick | The Luxembourg Bankers' Association |
| GRIGNON DUMOULIN Hubert | Société de la *Bourse de Luxembourg* S.A. |
| GUAY Michel | Institut des réviseurs d'entreprises |
| HAUSER Joëlle | Clifford Chance |
| HEINRICH Georges | Ministry of Finance |
| HENRION Emmanuel-Frédéric | Linklaters LLP |
| HENRY Marc | Dexia LdG Banque S.A. |
| HOFFMANN Robert | Loyens & Loeff |
| HOG-JENSEN Isabel | Association of the Luxembourg fund industry |
| HOSS Philippe | Elvinger, Hoss & Prussen |
| IEK Kenneth | PricewaterhouseCoopers |
| JORDANT Olivier | Ernst & Young |
| JUNG Rüdiger | The Luxembourg Bankers' Association |
| KAMPHAUS Jean-Luc | Ministry of Finance |
| KAYSER Nicki | Linklaters LLP |
| KHABIRPOUR Sarah | Ministry of Finance |
| KIESCH Lou | Deloitte |
| KINSCH Alain | Ernst & Young |
| KREMER Christian | Clifford Chance |
| KREMER Claude | Arendt & Medernach |
| KRIER Pierre | PricewaterhouseCoopers |
| KUZUHARA Anne-George | Allen & Overy |
| LACROIX Yves | Arendt & Medernach |
| LAGUESSE Sophie | Elvinger, Hoss & Prussen |

| | |
|---|---|
| LAM Benjamin | Deloitte |
| LAMORLETTE Cyril | PricewaterhouseCoopers |
| LANZ Christoph | Banque Privée Edmond de Rothschild Europe |
| LEBBE Isabelle | Arendt & Medernach |
| LEBBE Virginie | Association of the Luxembourg fund industry |
| LEQUEUE Jean-Noël | ICE S.A. |
| LHOEST Bernard | Ernst & Young |
| LIBERMANN Daniel | Ministry of the Economy and Foreign Trade |
| LICHTFOUS Marco | Luxembourg Central Bank |
| LIFRANGE Frédérique | Elvinger, Hoss & Prussen |
| LOEHR Jean-Michel | RBC Dexia Investor Services Bank S.A. |
| LOESCH Tom | Linklaters LLP |
| LONGREE José-Benjamin | Citibank International Plc, Luxembourg branch |
| MAQUIL Michel | Société de la *Bourse de Luxembourg* S.A. |
| MARGUE Pierre | SES S.A. |
| MAUSEN Frank | Allen & Overy |
| McMAHON Brian | Citibank International Plc, Luxembourg branch |
| MENGAL Michel | Elvinger, Hoss & Prussen |
| MEYER Philippe | KPMG Luxembourg |
| MOAYED Vafa | Deloitte |
| MOUSEL Paul | Arendt & Medernach |
| NEUGEBAUER Andreas | DZ PRIVATBANK S.A. |
| NIEDNER Claude | Arendt & Medernach |
| NOSBUSCH Danièle | Ministry of Finance |
| OLY Carlo | Société de la *Bourse de Luxembourg* S.A. |
| PACAUD Jean-Michel | Ernst & Young |
| PARKHOUSE John | PricewaterhouseCoopers |
| PICONE Alan | Deloitte |
| POSTAL Philippe | Banque Privée Edmond de Rothschild Europe |
| PRUM André | University of Luxembourg |
| PRUSSEN Yves | Elvinger, Hoss & Prussen |
| QUEUDEVILLE Guy | Institute of Internal Auditors - ILA |
| REINESCH Gaston | Ministry of Finance |
| REITER Guy | Crédit Suisse Fund Management S.A. |
| REUTER Etienne | Ministry of Finance |
| RIEHL Karin | KPMG Luxembourg |
| ROD Victor | Commissariat aux Assurances |
| ROMMES Jean-Jacques | The Luxembourg Bankers' Association |
| RUPPERT Daniel | Ministry of Justice |
| SALUZZI Marc | Association of the Luxembourg fund industry |
| SAUVAGE Benoît | The Luxembourg Bankers' Association |
| SCHADECK Raymond | Ernst & Young |

| | |
|---|---|
| SCHIFFLER Thomas | PricewaterhouseCoopers |
| SCHINTGEN Gilbert | UBS Fund Services (Luxembourg) S.A. |
| SCHLEIMER Pierre | Allen & Overy |
| SCHMITT Alex | Bonn & Schmitt |
| SCHMITZ Hans-Jürgen | Mangrove Capital Partners S.A. |
| SCHOTT Marcel | DZ PRIVATBANK S.A. |
| SCHUMAN Thierry | BGL BNP Paribas |
| SCHWABE Henning | Arendt & Medernach |
| SEALE Thomas | European Fund Administration S.A. |
| SIMON Günter | PricewaterhouseCoopers |
| SIX Jean-Christian | Allen & Overy |
| SPÉDENER Stéphane | Fiduciaire Probitas |
| TANCRÉ Bernard | BNP Paribas Securities Services, succursale de Luxembourg |
| THEISSEN Anne-Sophie | Chamber of Commerce |
| THESEN Markus | Nord/LB Covered Finance Bank S.A. |
| THIELTGEN Nicolas | Brucher Thieltgen & Partners |
| THILL Carlo | BGL BNP Paribas |
| THOMMES Camille | Association of the Luxembourg fund industry |
| TIXIER Valérie | PricewaterhouseCoopers |
| UEBERECKEN Jean-Marc | Arendt & Medernach |
| VALSCHAERTS Dominique | Société de la *Bourse de Luxembourg* S.A. / Finesti |
| VAN DE KERKHOVE Eric | Deloitte |
| VAZQUEZ Ana | CACEIS Bank Luxembourg |
| VINCIARELLI Paolo | Banque et Caisse d'Épargne de l'État Luxembourg |
| WAGNER Henri | Allen & Overy |
| WARKEN François | Arendt & Medernach |
| WEBER Alain | Banque LBLux S.A. |
| WIRION Claude | Commissariat aux Assurances |
| YIP Johnny | Deloitte |
| ZAEGEL Xavier | Deloitte |
| ZEEB Christophe | Chamber of Commerce |
| ZIMMER Julien | DZ PRIVATBANK S.A. |
| ZURSTRASSEN Patrick | MDO Services S.A. |
| ZWICK Marco | PRiM - Risk Management Professionals |

# ANNUAL ACCOUNTS OF THE CSSF - 2011

## BALANCE SHEET AS AT 31 DECEMBER 2011

| *Assets* | *EUR* | *EUR* |
|---|---|---|
| Fixed assets | | 18,950,726 |
| - Intangible assets | 138,135 | |
| - Tangible assets | 18,809,591 | |
| - Financial assets | 3,000 | |
| Current assets | | 28,448,981 |
| - Trade debtors | 1,227,004 | |
| - Other debtors | 475,614 | |
| - Cash at bank | 26,746,363 | |
| Prepayments and accrued income | | 2,023,926 |
| **Total assets** | | **49,423,633** |
| *Liabilities* | | |
| Capital and reserves | | 19,656,829 |
| - Profit brought forward | 22,928,386 | |
| - Result for the financial year | (3,271,557) | |
| Provisions | | 350,000 |
| - Provisions for risks and charges | 350,000 | |
| Creditors | | 28,844,470 |
| - Amounts owed to credit institutions | 24,266,667 | |
| - Trade creditors | 1,408,873 | |
| - Other creditors | 3,168,930 | |
| Accruals and deferred income | | 572,334 |
| **Total liabilities** | | **49,423,633** |

## PROFIT AND LOSS ACCOUNT AS AT 31 DECEMBER 2011

| *Charges* | *EUR* |
|---|---|
| Other external charges | 9,538,045 |
| Staff costs | 35,125,049 |
| Value adjustments in respect of tangible fixed assets | 66,052 |
| Interest payable and similar charges | 1,423,547 |
| Extraordinary charges | 173,034 |
| **Total charges** | **46,325,727** |
| *Income* | |
| Taxes and fines charged | 42,114,124 |
| Other operating income | 87,290 |
| Interest receivable and similar income | 631,642 |
| Extraordinary income | 221,114 |
| Loss for the financial year | 3,271,557 |
| **Total income** | **46,325,727** |

# LIST OF ABBREVIATIONS

| | |
|---|---|
| AGDL | Association pour la garantie des dépôts, Luxembourg - Deposit Guarantee Association Luxembourg |
| AIF | Alternative Investment Fund |
| AIFM | Alternative Investment Fund Managers |
| AML/CFT | Anti-Money Laundering and Counter-Terrorist Financing |
| BCL | Banque centrale du Luxembourg - Luxembourg Central Bank |
| CEBS | Committee of European Banking Supervisors |
| CEIOPS | Committee of European Insurance and Occupational Pensions Supervisors |
| CESR | Committee of European Securities Regulators |
| COREP | Common Reporting |
| CRD | Capital Requirements Directives |
| CRF | Cellule de Renseignement Financier - Financial Intelligence Unit |
| CRR/CRD IV | Draft directive on the taking up of the business of credit institutions and prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV) and draft regulation on the prudential requirements applicable to credit institutions and investment firms (CRR Regulation) |
| CSSF | Commission de Surveillance du Secteur Financier – Financial sector supervisory authority |
| EBA | European Banking Authority |
| EC | European Community |
| ECB | European Central Bank |
| EEA | European Economic Area |
| EFRAG | European Financial Reporting Advisory Group |
| EGAOB | European Group of Auditors' Oversight Bodies |
| EIOPA | European Insurance and Occupational Pensions Authority |
| EMI | Electronic Money Institution |
| EMIR | European Market Infrastructure Regulation |
| ESFS | European System of Financial Supervision |
| ESMA | European Securities and Markets Authority |
| ESRB | European Systemic Risk Board |
| EU | European Union |
| EUR | Euro |
| FATF | Financial Action Task Force |
| FCP | Fonds commun de placement - common fund |
| FINREP | Financial Reporting |
| IAS | International Accounting Standards |
| IASB | International Accounting Standards Board |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFAC | International Federation of Accountants |

| | |
|---|---|
| IFRS | International Financial Reporting Standards |
| IMF | International Monetary Fund |
| IML | Institut Monétaire Luxembourgeois - Luxembourg Monetary Institute (1983-1998) |
| IORP | Institution for occupational retirement provision |
| IOSCO | International Organization of Securities Commissions |
| ISA | International Standards on Audit |
| ISQC | International Standard on Quality Control |
| MiFID | Markets in Financial Instruments Directive |
| MiFIR | Markets in Financial Instruments Regulation |
| MTF | Multilateral Trading Facility |
| NAV | Net asset value |
| OAM | Officially Appointed Mechanism |
| OECD | Organisation for Economic Cooperation and Development |
| OPA | Offre publique d'acquisition - takeover bid |
| OTF | Organized Trading Facility |
| PFS | Professional of the financial sector |
| PIE | Public Interest Entity |
| SBL | Société de la *Bourse de Luxembourg* S.A. - Luxembourg Stock Exchange |
| SICAF | Société d'investissement à capital fixe - Investment company with fixed capital |
| SICAR | Société d'investissement en capital à risque - Investment company in risk capital |
| SICAV | Société d'investissement à capital variable - Investment company with variable capital |
| SIF | Specialised investment fund |
| SME | Small and medium enterprises |
| SRP | Supervisory Review Process |
| TREM | Transaction Reporting Exchange Mechanism |
| UCI | Undertaking for collective investment |
| UCITS | Undertaking for collective investment in transferable securities |
| VaR | Value-at-Risk |
| XBRL | eXtensible Business Reporting Language |