Commission de Surveillance du Secteur Financier

110, route d'Arlon
L - 2991 LUXEMBOURG

Tel.: (+352) 26 251-1
Fax: (+352) 26 251-601
E-mail: direction@cssf.lu
Website: http://www.cssf.lu

Cut-off date: 1 March 2010.
The reproduction of the annual report is authorised, provided the source is acknowledged.

Design: metaph
Printed by: Imprimerie Centrale
After the shock of the financial crisis in autumn 2008 which affected the Luxembourg financial centre, 2009 started in an atmosphere of suspense. Ultimately, that year finished with results which seem, at first glance, to suggest a return to a normal situation. The depositors’ and investors’ trust gradually returned and the actors of the financial sector started to spread again their activities. The financial markets in particular were revived, which generally allowed the different types of undertakings for collective investment, including specialised funds, SICARs, pension funds and securitisation vehicles to rake in new money and to observe a growth of their investment.

However, the profits which the banks registered again give a deceptive image of good health which cannot sustain when carrying out a more in-depth analysis. The profits mainly result from unusually high interest rate margins at the beginning of the year, from a slight decrease in operating costs and from the purely accounting effect registered following the partial offset of capital loss which had been incurred during the peak of the crisis.

Thus, if the 2009 results justify in themselves a certain feeling of relief given the prevailing fears at the beginning of the year, they still do not offer a solid basis for a sustainable growth in 2010 and after. Since, due to lack of growth in other areas, the financial sector remains predominant for the Luxembourg economy, the latter shall accommodate with the drawbacks which a direct or indirect drop in employment and consequently a decrease in tax revenues will induce.

The financial crisis left not only a banking landscape which changed in many respects. It also caused a profound change in the climate of the financial world and of the international financial centres in particular. The crisis exasperated the competition between centres and actors. This competition is not only in the prices, product and service quality any more. The economic and budget situations were so unbearable that many countries seek now to get back within their territory the financial activity and capital which benefited from advantages offered by professional and open financial centres such as Luxembourg when borders were removed and freedom of capital movement was allowed.

The challenge is to regain the trust of the clients who not only got more aware of the risks inherent to any activity, but also worry about the criticism against investment abroad. The actors of the Luxembourg financial sector took up this challenge. Undertakings for collective investment or bankers active in private banking focused more on sophisticated clients and offered them up-market products and services with high added value. The results of those who took on this path are promising and they can contemplate now to spread geographically to enlarge their clientele. These positive prospects come with a welcome diversification by the financial centre’s actors under the various statutes of professionals of the financial sector. Even though these initiatives cannot all succeed, the potential of the support PFS, for example, particularly in IT, may be underlined.

Although the crisis is mainly a consequence of irresponsible behaviour of many economic actors rather than of a lack of regulations, the result is that regulatory and supervisory authorities have to master henceforth a delicate task. On the one hand, the depositors and investors request a guarantee for any kind of risk which is not feasible. On the other hand, the professionals of the financial sector assert that additional regulation and supervision would be a quality factor for business, but they fear, at the same time, to be over-regulated and are against the ensuing administrative costs and burden.
Furthermore, regulation and supervision is increasingly becoming a key element in the competition between the financial centres. A financial centre cannot afford having financial regulation and supervision which are not up to the standards imposed by formal and informal international institutions regularly verifying the compliance via on-site inspections. In the European Union, the harmonisation, already well-developed, will accomplish further qualitative and quantitative progress with the implementation of the European system of financial supervisors which will have three sectoral authorities.

The CSSF takes on its responsibilities by ensuring that the regulation of the Luxembourg financial sector fully observes the requirements provided for in the international and EU texts as well as the requirements resulting from the implementation of new international structures for the prudential supervision. The CSSF further continues to be attentive to the financial sector in order to accompany the development of new activities by drawing up an appropriate legal framework.

For its prudential supervision, the CSSF particularly focuses on efficient and strict verification of compliance with the legal conditions for the access to the financial centre. Compared to bigger countries, Luxembourg is more exposed to reputational risks and costs which would result from dubious activities exercised by actors who would not have been checked in-depth right from the start. Moreover, the supervisory authority increased its presence on the ground by carrying out more on-site inspections and setting up a team dedicated to this task. The CSSF will also strengthen the measures it uses to intervene with supervised entities and substantially improve the texts governing sanctions in case of non-compliance with financial sector regulations. These amendments shall allow, *inter alia*, a greater efficiency in the fight against money laundering and terrorist financing.

Given its broader mission in consumer protection, the CSSF contemplates contributing to a better financial education of the public and responding in an appropriate manner to customer complaints.

As of 1 May 2009, for the fulfilment of the multiple missions the CSSF is entrusted with, the Government allocated a larger executive board to the CSSF which forms a collegial and coherent team. The CSSF’s missions were again expanded and include now the oversight of the audit profession. Consequently, the executive board has increased the CSSF staff through several recruitment campaigns which will be repeated according to the needs. Finally, the executive board would like to thank all the CSSF agents who show ongoing commitment in their missions and would like to pay tribute to the previous members of the executive board and more particularly to Director General Jean-Nicolas Schaus and Director Arthur Philippe, who have built up the CSSF’s authority and identity since the beginning.

Jean GUILL
Director General
Corporate governing bodies of the Commission de Surveillance du Secteur Financier 8

Summary 10

CHAPTER I
GENERAL SUPERVISION AND INTERNATIONAL COOPERATION 13
1. General Supervision
2. Cooperation at EU level
3. Multilateral cooperation

CHAPTER II
SUPERVISION OF THE BANKING SECTOR 39
1. Developments in the banking sector in 2009
2. Prudential supervisory practice

CHAPTER III
SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT 75
1. Developments in the UCI sector in 2009
2. Developments of UCI entities in 2009
3. The Madoff Case
4. Performance analysis of the major Luxembourg UCI categories in 2009
5. Management companies set up under Chapter 13 of the law of 20 December 2002
6. Developments in the regulatory framework
7. Prudential supervisory practice

CHAPTER IV
SUPERVISION OF PENSION FUNDS 123
1. Developments in the pension funds sector in 2009
2. Liability managers

CHAPTER V
PRUDENTIAL SUPERVISION OF SICARS 127
1. Developments in the SICAR sector in 2009
2. Prudential practice

CHAPTER VI
SUPERVISION OF SECURITISATION UNDERTAKINGS 133
1. Developments in the sector of authorised securitisation undertakings
2. Prudential supervisory practice

CHAPTER VII
SUPERVISION OF PFS 137
1. Developments of PFS in 2009
2. Prudential supervisory practice
3. Support PFS

CHAPTER VIII
SUPERVISION OF SECURITIES MARKETS 157
1. Reporting of transactions in financial instruments
2. Supervisory practice
3. Developments in the regulatory framework
CHAPTER IX
SUPERVISION OF INFORMATION SYSTEMS
1. Activities in 2009
2. Supervisory practice

CHAPTER X
PUBLIC OVERSIGHT OF THE AUDIT PROFESSION
1. Legal and regulatory aspects
2. Quality assurance
3. Human and financial means
4. International standards on auditing
5. Ethics and independence
6. Third-country auditors and audit entities

CHAPTER XI
MEANS OF SANCTION AVAILABLE TO THE CSSF
1. Means of intervention available to the CSSF
2. Sanctions imposed in 2009

CHAPTER XII
CUSTOMER PROTECTION
1. Consumer protection
2. Customer complaints

CHAPTER XIII
FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING
1. Amendments to the legislation regarding the fight against money laundering and terrorist financing
2. Participation of the CSSF in meetings regarding the fight against money laundering and terrorist financing
3. Reports regarding the fight against money laundering and terrorist financing

CHAPTER XIV
BANKING AND FINANCIAL LAWS AND REGULATIONS
1. Directives and regulations under discussion at EU Council level
2. Directives and regulations adopted by the Council and the European Parliament but not yet implemented under national law
3. Luxembourg laws and regulations adopted in 2009

CHAPTER XV
INTERNAL ORGANISATION OF THE CSSF
1. Functioning of the CSSF
2. Human resources
3. IT systems
4. Staff members
5. Committees

ANNEXE
List of abbreviations
CORPORATE GOVERNING BODIES OF THE CSSF

Board of Directors

Chairman
Etienne REUTER
Premier Conseiller de Gouvernement, Ministry of Finance

Vice-chairman
Gaston REINESCH
General administrator, Ministry of Finance

Members
Rafik FISCHER
Member of the Board of Directors of the Association Luxembourgeoise des Fonds d’Investissement
Jean FUCHS
Chairman of the Association Luxembourgeoise des Professionnels du Patrimoine
Sarah KHABIRPOUR
Attaché de Gouvernement 1er en rang, Ministry of Finance
Jean MEYER
Chairman of the Association des Banques et Banquiers, Luxembourg
Claude WIRION
Member of the Executive Committee of the Commissariat aux Assurances

Secretary
Danielle MANDER

Executive Board

Director General
Jean GUILL (from 1 May 2009)
Jean-Nicolas SCHAUSS (until 30 April 2009)

Directors
Simone DELCOURT
Andrée BILLON (from 1 May 2009)
Claude SIMON (from 1 May 2009)
Arthur PHILIPPE (until 31 March 2009)
Executive Board of the CSSF
Left to right: Andrée BILLON, Jean GUILL, Simone DELCOURT, Claude SIMON
SUMMARY

Overall, the Luxembourg financial centre ended the financial year 2009 with satisfactory results despite the direct and indirect effects of the financial and economic crisis which did not spare Luxembourg. However, this revival does not mean that the difficult times are over. Now, the lessons learned from the crisis must be implemented, the knowledge consolidated and solid and diversified bases put in place in order to have a lasting financial centre.

438 international meetings

The preparation of new prudential rules which take into account the acquired experience, mainly in relation to the financial crisis and the standardisation of the existing regulations remain the main objectives of the international meetings in the framework of European (CEBS, CESR, CEIOPS, etc.) and international (Basel Committee on banking supervision, IOSCO, etc.) forums. Greater emphasis is also given to enhanced cooperation between competent authorities with the implementation of colleges of supervisors.

Therefore, the supervisory work on the international level requires more and more resources which is proved, among others, by the increasing number of meetings in which the CSSF participates.

149 credit institutions
Balance sheet total: EUR 792.6 billion
Net profit: EUR 2,740 million

The number of banks decreased by three entities to 149 as at 31 December 2009. During the year, five banks started their activities while two banks merged with other banks of the financial centre and six banks terminated their activities.

As a consequence of the financial crisis, the banks adapted and consolidated the structure of their balance sheet and reduced the risk-weighted assets which resulted in a 17.9% drop in the aggregated balance sheet total of the financial centre. Net profit of the Luxembourg banking sector reached EUR 2,740 million in 2009. This remarkable improvement compared to the historically low results of the previous year is mainly explained by the substantial decline in the creation of provisions. However, it should be borne in mind that there are great differences between the banks, 47% of which suffered a decrease in their net profit at the end of their financial year compared to 2008.

3,463 UCIs
12,232 economic entities
Total net assets: EUR 1,841.0 billion

In 2009, the UCI sector registered an 18.04% growth in net assets managed originating for 30% from net issues and for 70% from the increase in stock exchanges. The net capital investments in Luxembourg UCIs which amounted to EUR 84.4 billion in 2009 reflect the return of investors’ confidence in the markets.

The number of UCIs grew by 2.73% during the year. This growth mainly results from the continuing boom of the specialised investment funds which represent 28.0% of the total number of UCIs (as regards assets managed, they represent 8.4%). When considering umbrella funds, a total of 12,232 economic entities were active on 31 December 2009, i.e. a 0.8% decrease compared to the end of 2008 due to a consolidation trend.

192 management companies

The number of management companies authorised in accordance with Chapter 13 of the law of 20 December 2002 relating to undertakings for collective investment increased from 189 as at 31 December 2008 to 192 at the end of 2009. The management companies focus more on the activity of collective management and abandon slowly the ancillary activities set out in the law.
The pension funds sector registered a slight improvement after several years of stagnation, following the authorisation of two new pension funds in 2009. However, the cross-border activities of Luxembourg pension funds did not develop further yet.

The number of investment companies in risk capital (SICAR) continued to increase, but there was, nevertheless, a downturn in the growth in 2009. As regards the investment policy, the SICARs were slightly more inclined towards private equity.

The slow but ongoing development of the securitisation activity continued with four new securitisation undertakings authorised in 2009. Since the role of securitisation techniques was put forward several times in the context of the financial crisis, the CSSF will include the lessons learned from the crisis for the authorisation and supervision of securitisation undertakings.

With 42 new entities and 22 withdrawals in 2009, the PFS sector continued attracting new promoters. The positive development in the number is mainly attributable to PFS other than investment firms and, to a lesser extent, to support PFS.

The balance sheet total of PFS reached EUR 22,456 million as at 31 December 2009 against EUR 62,676 million at the end of 2008, i.e. an annual decrease of 64.17%. This important fall mainly results from the withdrawal, in 2009, of a professional performing securities lending which had a significant balance sheet total.

However, the net profit of PFS substantially rose by 77.07% over a year. The recovery of the financial markets is one element which allowed investment firms to register an overall increase in net results. This positive development in the difficult context of 2009 was also influenced by a significant rise in the results of an entity active as a professional performing credit offering. Support PFS suffered more and registered a decrease in net results compared to 2008.

The employment fell by 2.3%, i.e. by 983 people due to the crisis. However, depending on the category of actors of the financial centre, the situation diverges.

Almost 80% of the decrease is attributable to banking employment which fell to 26,420 people (-785 jobs or -2.9%) following the economic restructuring and the measures to reduce the costs generated by the financial crisis. Nevertheless, 61.1% of the banks maintained or even increased their staff in 2009. Indeed, the current market state offers opportunities to fill vacancies needed internally which was difficult to do during the previous months.

The number of staff for PFS also suffered a slight decrease (-120 jobs or -0.9%). These job losses concerned some support PFS and could not be compensated by the creation of employment in the PFS newly authorised during the year.

Employment in management companies remained, however, stable in 2009.
In 2009, the CSSF received, among others, 1.2 million transaction reports in the context of the supervision of securities markets.

Moreover, under the law on market abuse, the CSSF received eight suspicious transaction reports and dealt with eleven suspicious transaction reports transmitted by foreign authorities.

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 decreased by 40.6% in 2009 due, among others, to the financial crisis. However, in the light of the increasing complexity of the transaction structures and of the relevant deposited documents and due to the increasing number of files relating to structured products, the amount of work did not lessen.

The CSSF exercises the supervision of 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 law. Their number reached 750, of which 233 Luxembourg issuers.

The law of 18 December 2009 confers to the CSSF the mission of public oversight of the audit profession. This mission includes the implementation of a quality assurance system which shall apply to all réviseurs d’entreprises agréés (approved statutory auditors) and approved audit firms for the statutory audit of accounts and for all other missions which are exclusively conferred to them by the law.

By virtue of its specific task of mediating as regards handling of customer complaints, the CSSF received 284 complaints during 2009, i.e. a substantial increase of 22.4% compared to 2008. A great part of these complaints concerned transactions relating to transferable securities resulting from the crisis which affected investors.

2009 was marked by a substantial increase in the CSSF human resources in order to face the growing work volume which results from the introduction of new prudential requirements, from the great importance of multilateral cooperation between supervisory authorities and, in general, from the increase in volume and complexity of the financial products. The total number of letters sent by the CSSF, of which almost 60% relate to UCIs, as well as meetings at national level indicate the volume of work at the CSSF. In addition, there are over 100 on-site inspections, the participation in international meetings (cf. above) and the work in different internal committees.