COMMISSION de SURVEILLANCE du SECTEUR FINANCIER

Annual Report 2005

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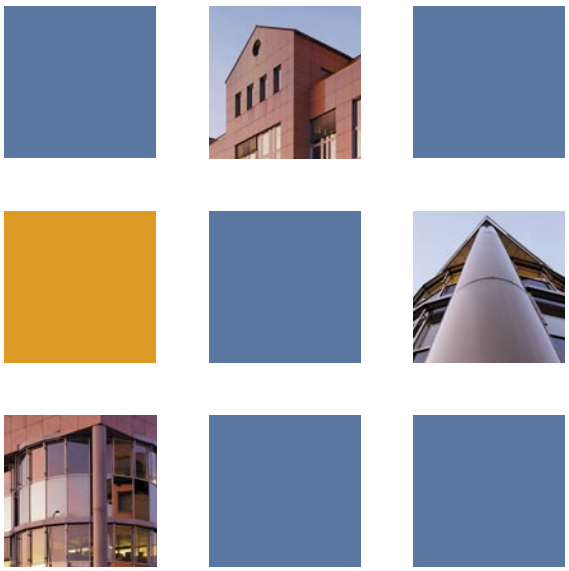

Annual Report 2005

Commission de Surveillance du Secteur Financier

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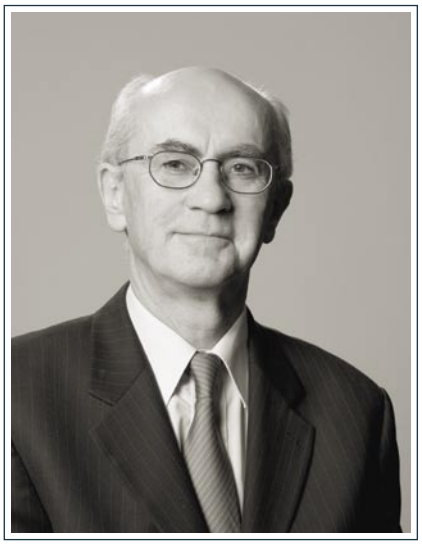

The year 2005 has been a good year for the financial centre in the sense that the results in every field were on the rise. The positive evolution already experienced in 2003 and 2004 thus kept up, thereby assuring a growing stability of this development.

The boom in the investment fund industry, at a time where Luxembourg has become the main European centre in this field, should be noted in particular. There are good reasons for this, as the financial centre has not been created by accident. It is indeed the combination of the know-how of the financial professionals and the open-mindedness of the authorities that allowed to achieve this result. If we wish to perpetuate this development, we need to continue with this approach, for nothing is final in the area of finance, and unceasing commitment is needed.

Quality combined with creativity will also ensure in the future the development of the financial centre, which is still an essential element of the Luxembourg economy with 32% of GDP, 17% of employment and 27% of tax revenue as at 31 December 2004. More than ever, all the national authorities should bear in mind that care should be taken of Luxembourg's financial activities. Otherwise, negative effects may be felt. Wishing to shape the financial centre so that it is sufficiently large, but not too large, is an illusion, as there are not many national means available to intervene to that effect.

One of the worries that has often been voiced relates to an over-regulation by the national authorities. If such were the case, the texts concerned ought to be amended, as it is in nobody's interest to do unnecessary work. That is why it has been decided in the *Comité pour le développement de la place financière de Luxembourg* (CODEPLAFI - Committee for the development of the Luxembourg financial centre) to set up a working group in charge of analysing the arguments that speak in favour of an amendment of certain regulations. Both authorities concerned, namely the CSSF and the *Commissariat aux Assurances*, agreed to fulfil this task while committing themselves to total objectivity. It will be interesting to see the results of these discussions.

The CSSF for its part continued to being entrusted with new responsibilities, including notably the approval of prospectuses for offers to the public or trading on a regulated market, which made it necessary to recruit new agents.

This report describes, just like the ones of the previous years, the different activities of the financial centre and depicts the vast variety of problems that have been dealt with during the year.

Finally, I would like to pay tribute to the employees of the CSSF who have, once again, managed to do excellent work while being aware of the importance of their mission for Luxembourg.

Jean-Nicolas SCHAUS

Director General

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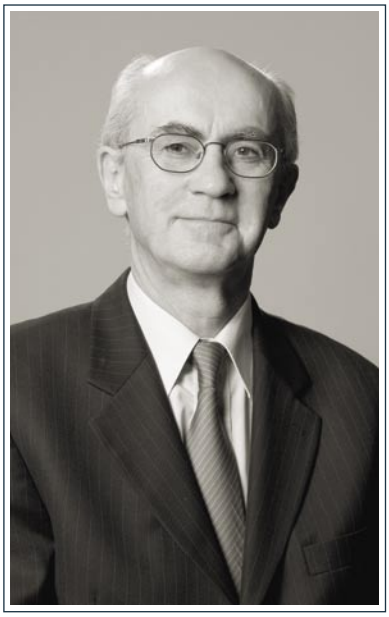
EXECUTIVE BOARD

Arthur PHILIPPE

Director



Jean-Nicolas SCHAUS

Director General

Simone DELCOURT

Director

CORPORATE GOVERNING BODIES OF THE COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

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EXECUTIVE BOARD

Director General	Jean-Nicolas Schaus
Directors	Arthur Philippe, Simone Delcourt

CHAPTER I

SUPERVISION OF THE BANKING SECTOR

1. Developments in the banking sector in 2005
2. Developments in the regulatory framework
3. Prudential supervisory practice

1. DEVELOPMENTS IN THE BANKING SECTOR IN 2005

1.1. Characteristics of the Luxembourg banking sector

The Luxembourg banking legislation provides for three types of banking licences, namely licences governing the activities of universal banks (152 institutions had this status on 31 December 2005), those governing the activities of banks issuing mortgage bonds (3 institutions had this status on 31 December 2005) and those governing the activities of banks issuing electronic means of payment (no institution had this status on 31 December 2005).

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

- banks incorporated under Luxembourg law (112 on 31 December 2005);
- branches of banks originating from a Member State of the European Union (35 on 31 December 2005);
- branches of banks originating from non-Member States of the European Union (8 on 31 December 2005).

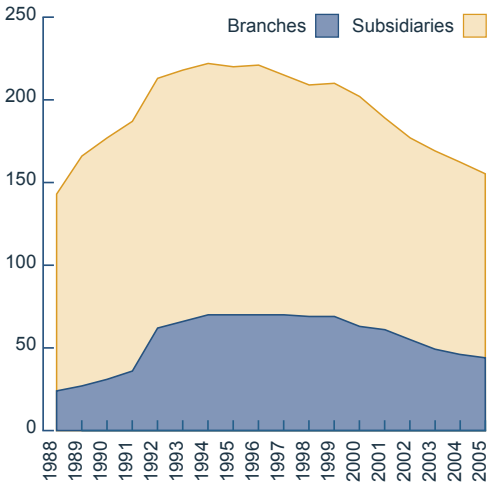
The *caisses rurales* (16 on 31 December 2005) and their central establishment, Banque Raiffeisen, which, according to the law on the financial sector, are to be considered as a single credit institution, constitute a special case.

1.2. Development in the number of credit institutions

The downward trend of the number of credit institutions established in Luxembourg continued at the same rate as in the previous year. The number of banks only totals 155 at the end of the year 2005 against 162 as at 31 December 2004. Among these 155 entities, 112 are banks incorporated under Luxembourg law (2004: 116) and 43 are branches (2004: 46).

Development in the total number of banks established in Luxembourg

Year	Number of branches	Number of subsidiaries	Total number
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



The development in the number of credit institutions notably depends on the following phenomena.

- Mergers, generally originating in the restructuring of parent companies abroad, unavoidably affect the Luxembourg presences. Following a constant decrease in the number of mergers over three years, their rate has again accelerated in 2005: four banks disappeared in 2005 due to a merger (against one in 2004, three in 2003 and seven in 2002).
- Four banks decided to cease their activities. Three branches transferred their activities to a bank incorporated under Luxembourg law of the same group and one bank gave up its banking license to become a Luxembourg PFS.

Thus, the following twelve credit institutions have been withdrawn from the official list during the year:

• Banque Continentale du Luxembourg S.A.	Merger with avec Kredietbank S.A. Luxembourgeoise on 01.01.2005
• Cortal Consors Luxembourg	Merger with avec BNP Paribas Luxembourg on 01.01.2005
• Kaupthing Bunadarbanki, Luxembourg Branch	Transfer of activities to Kaupthing Bank Luxembourg S.A. on 24.01.2005
• Allgemeine Deutsche Direktbank International S.A.	Withdrawal on 22.04.2005
• Banca Sella S.p.A., succursale de Luxembourg	Transfer of activities to Sella Bank Luxembourg S.A. on 24.06.2005
• American Express Bank (Luxembourg) S.A.	Change of status to PFS on 17.06.2005
• Crédit Lyonnais Luxembourg S.A.	Merger with Crédit Agricole Luxembourg on 01.07.2005
• Crédit Lyonnais S.A., succursale de Luxembourg	Withdrawal on 12.08.2005
• Lampebank International S.A.	Withdrawal on 23.08.2005
• Banque Corluy Luxembourg S.A.	Merger with ABN Amro Bank (Luxembourg) S.A. on 14.11.2005
• Islandsbanki hf, Luxembourg Branch	Transfer of activities to ISB (Luxembourg) S.A. on 19.12.2005
• DZ Bank AG, Niederlassung Luxemburg	Withdrawal on 31.12.2005

Five new banks started their activities in 2005:

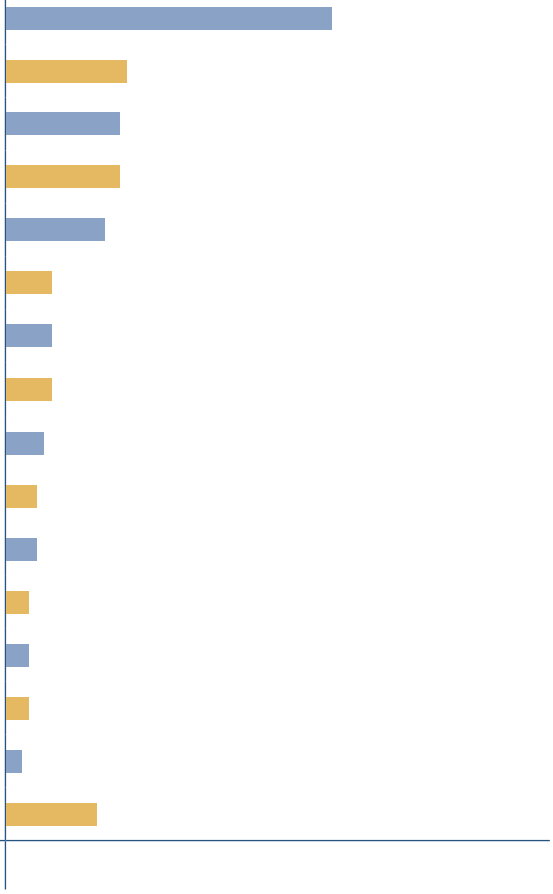
• Nord Europe Private Bank S.A.	1 January 2005
• CREDIT SUISSE, Zurich (Switzerland), Luxembourg branch	1 January 2005
• ISB (Luxembourg) S.A.	4 March 2005
• ABN AMRO Mellon Global Securities Services, Amsterdam (Netherlands), Luxembourg Branch	1 August 2005
• MEDIOBANCA INTERNATIONAL (LUXEMBOURG) S.A.	21 December 2005

Besides the changes recorded during 2005, the following changes have to be noted at the beginning of 2006: the withdrawal from the official list of Banque Nagelmackers 1747 (Luxembourg) S.A., which has been taken over by Banque Degroof Luxembourg S.A. on 1 January 2006, the withdrawal of Banque Colbert (Luxembourg) S.A. on 16 January 2006, as well as the setting up of three new banks, i.e. RBC Dexia Investor Services Bank S.A. on 2 January 2006, EFG Bank (Luxembourg) S.A. on 10 January 2006 and Advanzia Bank S.A. on 11 January 2006.

The breakdown of the credit institutions according to geographical origin has changed as follows (2004 figures between brackets). Banks of German origin remain the highest in number with 43 (46) entities, followed by Belgian and Luxembourg banks with 16 (18) entities. 15 (17) banks originate from France, 15 (15) from Italy, 13 (12) from Switzerland, 6 (6) from Sweden and 6 (6) from the United Kingdom.

Geographical origin of banks

Country	Number
Germany	43
Belgium / Luxembourg	16
France	15
Italy	15
Switzerland	13
United Kingdom	6
Sweden	6
United States	5
Japan	5
Netherlands	4
Portugal	4
Brazil	3
China	3
Israel	3
Denmark	2
Others	12
Total	**155**



1.3. Development in the local branch network in Luxembourg

The downward trend in the branch networks since the 1990s continued in 2005.

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

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

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

1.4. Development in banking employment

The total number of employees of Luxembourg credit institutions as at 31 December 2005 reached 23,227, which represents an increase of 673 employees (+3%) over a year.

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

The growth in banking employment in 2005 is particularly strong within recently incorporated credit institutions as well as within banks that are especially involved in the investment fund business. Among the credit institutions registered on the official list as at 31 December 2005, 63% have maintained, or even increased, their staff. This percentage was, for the same sample, 61% and 46% respectively in 2004 and 2003.

The breakdown of total employment shows that the share of executives within total employment continues to grow, rising from 21.8% to 22.1% during 2005. The female employment rate remains almost unchanged (45.7%).

Situation of employment in credit institutions

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

Breakdown of the number of employees per bank

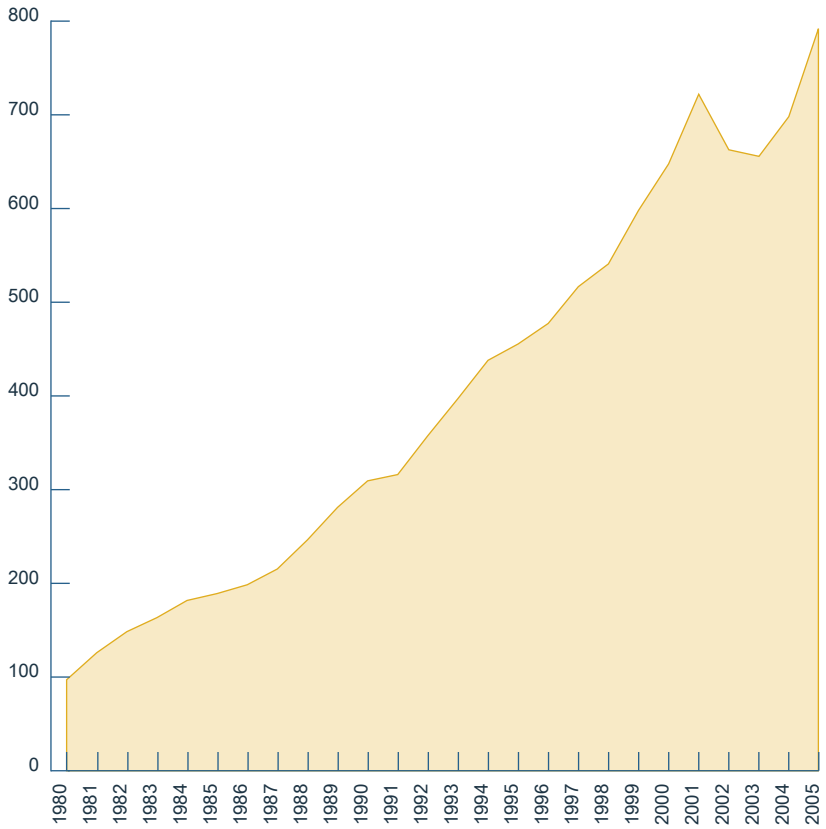
Number of employees	Number of banks					
	2000	2001	2002	2003	2004	2005
> 1,000	4	4	4	4	4	4
500 to 1,000	3	5	6	4	2	6
400 to 500	5	4	3	4	6	4
300 to 400	3	4	7	6	8	7
200 to 300	11	12	9	11	8	7
100 to 200	19	16	18	19	19	20
50 to 100	30	26	23	21	21	18
< 50	127	118	105	100	94	89
TOTAL	**202**	**189**	**175**	**169**	**162**	**155**

1.5. Development in the balance sheets

The balance sheet total of credit institutions rose to EUR 792,422 million at the end of 2005 against EUR 695,363 million at the end of 2004, which represents an increase of 14% during 2005.

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	**792.42**



Aggregated balance sheet total – in million EUR

ASSETS	2004	2005[1]	Variation	LIABILITIES	2004	2005[1]	Variation
Loans and advances to credit institutions	372,548	398,582	7.0%	Amounts owed to credit institutions	328,647	384,367	17.0%
Loans and advances to customers	121,690	146,490	20.4%	Amounts owed to customers	229,068	253,022	10.5%
Fixed-income securities	146,069	191,327	31.0%	Amounts owed represented by securities	72,330	84,932	17.4%
Variable-yield securities	4,385	5,121	16.8%	Various items	4,840	6,786	40.2%
Participating interests and shares in affiliated undertakings	6,928	8,795	26.9%	Permanent means (*)	60,477	63,315	4.7%
Fixed assets and other assets	43,742	42,108	-3.7%	*of which profit for the year*	*2,866*	*3,548*	*23.8%*
Total	**695,363**	**792,422**	**14.0%**	**Total**	**695,363**	**792,422**	**14.0%**

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

Assets

As far as assets are concerned, the growth in the banks' balance sheet total mainly results from a significant increase in the portfolio of fixed-income securities (+31% year-on-year) and loans and advances to customers (+20.4% year-on-year). Loans and advances to credit institutions, variable-yield securities and participations and shares in affiliated undertakings have also grown. The other items of the banks' total assets (fixed assets and other assets) slightly dropped compared to the end of 2004.

Loans and advances to credit institutions increased by 7.0% in 2005 to EUR 398,582 million. The growth of this item in 2005 goes together with a strengthening of the refinancing of banks on the liability side. The share of amounts owed to credit institutions slightly fell to 50.3% of the balance sheet total. This figure bears witness to the lasting importance of interbank positions for the Luxembourg financial centre. The importance of the interbank activities can be mainly explained by a group cash management logic and by the structure of the legal entities that take part in this management (notably the double presence of credit institutions in Luxembourg). Thus, 69% of the interbank assets and 60% of the interbank liabilities constitute transactions with banks of the group.

Qualitative breakdown of interbank assets

	2003	2004	2005
Central and multilateral banks	0.13%	0.14%	0.08%
Banks zone A[2]	98.27%	98.39%	98.18%
Banks zone B[3]	1.60%	1.46%	1.74%

[1] Preliminary figures for the end of 2005.

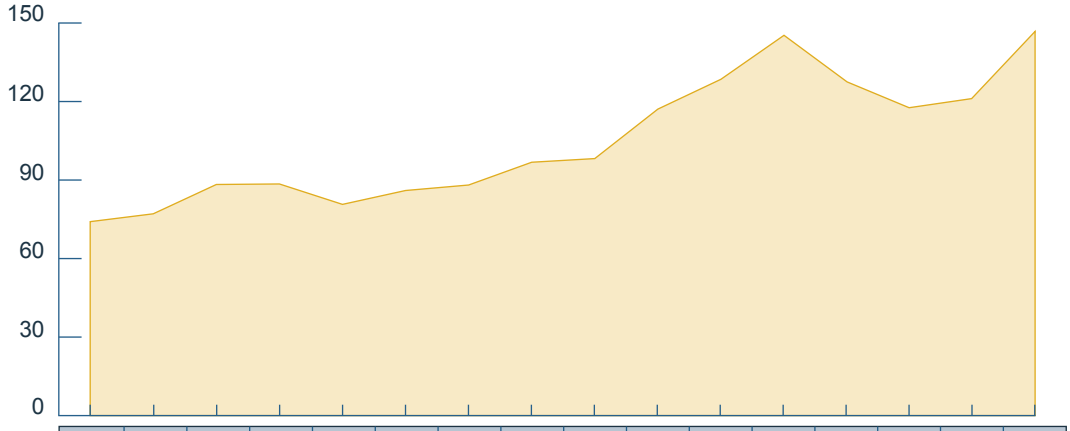
[2] Countries zone A: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Saudi Arabia, Slovakia, South Korea, Spain, Sweden, Switzerland,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

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

This breakdown shows that the vast majority of loans and advances to credit institutions consist of commitments on zone A banks, i.e. banks of industrialised countries. The breakdown in relative terms remained relatively stable over the last three years. Loans and advances to central and multilateral banks, which had been weak already, have however recorded a substantial fall.

The item **loans and advances to customers** grew by 20.4% to EUR 146,490 million or 18.5% of the balance sheet total at the end of 2005, compared to EUR 121,690 million in 2004.

Development in loans and advances to customers – in billion EUR



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

Breakdown of loans and advances to customers

	2003	2004	2005
Public authorities zone A	6.77%	8.63%	6.99%
Public authorities zone B	0.19%	0.09%	0.03%
Private customers & Financial institutions	92.98%	91.28%	92.97%
of which: legal persons	*52.44%*	*50.68%*	*49.43%*
of which: natural persons	*23.84%*	*24.18%*	*20.78%*
of which: financial institutions	*23.66%*	*25.08%*	*29.73%*
Leasing	0.06%	0.06%	0.05%

Loans and advances to legal entities grew by 20% in 2005. This development marks the beginning of a new trend after four consecutive years of a more restrictive credit policy of the banks as regards their non-financial corporate customers. The volume of loans and advances to financial institutions has recorded an even stronger increase with 45.9%. This growth, which is mainly imputable to some major players, essentially results from an intensification of their intragroup transactions. Loans and advances to natural persons have however only grown by 5.8%. Overall, these trends led to an increase in relative terms of loans and advances to financial institutions and to a decrease in loans and advances to legal and natural persons. Loans and advances to public authorities, which represent a rather unimportant asset category with slightly more that 7% of the total loans and advances to customers, have fallen in 2005 after four years of growth in absolute and relative terms. Overall, it seems that in 2005, banks have favoured higher-risk asset classes to the detriment of lower-risk asset classes. Nevertheless, almost all high-risk exposures continued to fall in 2005 across all asset classes[4].

[4] Please also refer to Chapter I, point 1.11. on exposure to high-risk sectors.

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

	2003	2004	2005
Secured by public authorities	3.31%	2.98%	2.50%
Secured by credit institutions	16.64%	16.80%	14.81%
Secured by real estate mortgage	13.53%	15.04%	9.06%
Secured by other tangible guarantees	32.53%	31.50%	27.98%
Unsecured	33.99%	33.67%	45.66%

The secured part of loans and advances continues to drop, the downward trend having even accelerated in 2005. However, this development is not considered worrying as the banks' solvency remains positive and, as noted above, loans and advances to almost all high-risk sectors are falling.

The portfolio of the **fixed-income securities** recorded a substantial increase (+31%) in 2005. This item reached EUR 191,327 million and represents 24.1% of the total balance sheet of 2005. The relative importance of this item thus continues to grow. In addition to the overall increase of this item which can be observed for a large number of banks, this improvement can be explained by the positive development of the banks issuing mortgage bonds and by the decision of one banking group to concentrate its securities activities within its Luxembourg subsidiary.

Qualitative breakdown of fixe income securities

	2003	2004	2005
Public sector zone A	23.63%	25.41%	30.11%
Public sector zone B	0.69%	0.31%	0.40%
Credit institutions zone A	51.32%	51.82%	43.45%
Credit institutions zone B	0.80%	0.83%	0.62%
Other issuers zone A	19.38%	17.76%	21.76%
Other issuers zone B	4.18%	3.87%	3.66%

The volume of the portfolio of **variable-yield securities**, i.e. shares, remains marginal for Luxembourg banks, even though this item recorded a substantial increase by 16.8% in 2005 to EUR 5,121 million at the end of the year. This development reflects the improvement of stock exchanges over the year.

The item **participating interests and shares in affiliated undertakings** has also grown to reach EUR 8,795 million in 2005 (+26.9%). A substantial part of this improvement can be explained by the decision of one banking group to regroup its subsidiaries active in leasing under its Luxembourg entity.

The only item of assets that has fallen considerably in 2005 is the item **fixed assets and other assets** which dropped by 3.7% to reach EUR 42,108 million at the end of the year.

Liabilities

As far as liabilities are concerned, all major items have increased.

Amounts owed to credit institutions increased by 17% to EUR 384,367 million. The interbank market remains the main item as regards refinancing with 48.5% of liabilities.

Amounts owed to customers, representing 31.9% of total liabilities, increased by 10.5% to EUR 253,022 million at the end of 2005. Amounts owed to the public sector decreased (-4.7%), as well as amounts owed to natural persons (-3.5%), while amounts owed to legal entities grew substantially (+14.5%). This improvement is to be read in the context of a more positive economic situation at national and international level.

Breakdown of amounts owed to customers

	2003	2004	2005
Amounts owed to the public sector	3.92%	3.46%	3.01%
Amounts owed to legal persons	68.29%	71.86%	75.23%
Amounts owed to natural persons	27.79%	24.68%	21.76%

Amounts owed represented by securities grew by 17.4% in absolute terms as compared to 2004. With 10.7% of the balance sheet total, this refinancing mode remains interesting, notably for the banks issuing mortgage bonds.

The **permanent means**, which mainly encompass subscribed capital, reserves, provisions, subordinated debts and accruals, rose by 4.7% in 2005 to EUR 63,315 million at the end of the year. This rise is mainly attributable to an increase in the accruals and reserves.

1.6. Development in the profit and loss account

The profitability of the banking sector developed very favourably in 2005. Thanks to the positive stock exchange situation and the sustained development of the UCI industry, the main indicators have reached new highs. Thus, both the gross production of wealth, reflected by the banking income, and the operating income have reached historical peaks, exceeding even the year 2002 where income was boosted by substantial capital gains realised on the disposal of participating interests in Clearstream.

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

	1999	2000	2001	2002	2003	2004	2005[5]
Interest and dividends received	35,943	47,996	51,942	41,257	34,071	29,218	35,318
Interest paid	32,664	44,467	47,560	37,116	29,991	25,306	31,404
Interest-rate margin	**3,279**	**3,529**	**4,382**	**4,141**	**4,080**	**3,913**	**3,914**
Commission income	2,338	3,035	2,792	2,615	2,533	2,771	3,203
Income from financial operations	563	488	355	261	481	582	626
Other income	255	465	410	1,044	496	184	526
Banking income	**6,435**	**7,517**	**7,939**	**8,061**	**7,590**	**7,450**	**8,269**
General administrative expenses	2,627	3,016	3,227	3,182	3,095	3,174	3,409
of which: staff costs	*1,444*	*1,588*	*1,758*	*1,809*	*1,752*	*1,798*	*1,941*
of which: other administrative expenses	*1,183*	*1,393*	*1,470*	*1,373*	*1,342*	*1,375*	*1,468*
Depreciation	283	306	396	308	290	288	268
Result before provisions	**3,525**	**4,195**	**4,316**	**4,571**	**4,206**	**3,989**	**4,592**
Creation of provisions	1,095	1,520	1,261	1,824	1,389	1,098	1,100
Write-back of provisions	577	767	725	658	751	754	860
Taxes	977	1,013	920	685	694	778	804
Result for the financial year	**2,030**	**2,429**	**2,861**	**2,720**	**2,874**	**2,866**	**3,548**

[5] Preliminary figures for the end of 2005.

Net profits of the Luxembourg banking sector in 2005 reached EUR 3,548 million, which represents a 23.8% growth as compared to the previous year.

Analysis of the development of profit and loss accounts over two years – in million EUR

	2004	Relative share	2005	Relative share	Variation
Interest and dividends received	29,218		35,318		20.9%
Interest paid	25,306		31,404		24.1%
Interest-rate margin	**3,913**	**53%**	**3,914**	**47%**	**0.0%**
Commission income	2,771	37%	3,203	39%	15.6%
Income from financial operations	582	8%	626	8%	7.5%
Other income	184	2%	526	6%	186.2%
Banking income	**7,450**	**100%**	**8,269**	**100%**	**11.0%**
General administrative expenses	3,174	43%	3,409	41%	7.4%
of which: staff costs	*1,798*	*24%*	*1,941*	*23%*	*7.9%*
of which: other administrative expenses	*1,375*	*18%*	*1,468*	*18%*	*6.8%*
Depreciation	288	4%	268	3%	-7.1%
Result before provisions	**3,989**	**54%**	**4,592**	**56%**	**15.1%**
Creation of provisions	1,098	15%	1,100	13%	0.2%
Write-back of provisions	754	10%	860	10%	14.2%
Taxes	778	10%	804	10%	3.3%
Result for the financial year	**2,866**	**38%**	**3,548**	**43%**	**23.8%**

In a business environment favourable for asset management, the banks have improved their gross **profits** to EUR 8,269 million. This 11% improvement over a year stems equally from commission income, remunerating asset management activities, as well as from other income dominated by extraordinary factors. The increase in general expenses (+6.2%), including depreciation on tangible assets, remains, despite the strong growth in staff costs, quite weaker than that of income, resulting in a 15.1% increase in profit before provisions and taxes.

The growth in stock valuation and the vigour of stock exchange operations are above all beneficial to commission income which increases by an average of 15.6%. The increase is particularly strong for exchange commissions (+15.9%), as well as for commissions for holding and managing assets (+19.3%), which follow the upward trend of third-party assets (+23.7%). In 2005, banks in the financial centre thus earned EUR 3,203 million in commission income. As far as market activities are concerned, net results total EUR 626 million as at 31 December 2005. This figure reflects a growth in income from financial operations of 7.5% year-on-year.

The interest-rate margin, reaching EUR 3,914 million, remains unchanged as compared to the previous year. This stagnation results from two contrasting developments. While the pure interest-rate margin, excluding income from dividends, increases by 1.8% in a context of recovering intermediation activities, dividends received on participating interests[6] fell by 9.6%. This decrease can be mainly explained by a substantial extraordinary dividend of a single credit institution that boosted the figures relating to the year 2004.

(in million EUR)	2003	2004	2005[7]
Dividends received on participating interests	628	643	581

[6] Dividends related to participating interest and shares in affiliated undertakings.

[7] Preliminary figures for the end of 2005.

A third of the growth in banking income (+11%) results from non-recurring factors, posted under the item "other income". The rise in other income stems from some extraordinary revenue (capital gains), but also from a decrease in extraordinary costs as compared to 2004. These non-recurring factors concern, as in the previous years, only a handful of banks.

As far as **expenses** are concerned, general administrative expenses have increased substantially. This growth both concerns administrative expenses (+4.4%) and staff costs (+7.9%), which increased under the effect of wage adjustments and the rise in banking employment.

The sharper growth of income as compared to costs entailed a strong increase of 15% in gross result before provisions and taxes. Disregarding extraordinary elements of "other income", profit before provisions still rose by 8%. This figure bears witness to the ability of the banks of the financial centre to generate solid ordinary results.

While provisioning remains at its 2004 level, write-back of provisions, whose increase is due to a single credit institution of the financial centre, grow by 14.2%. After taking into account tax costs, which rose by 3.3% as against 2004, net profit records a 23.8% growth as against the previous year.

Structural ratios	2003	2004	2005
Cost / income ratio	44.6%	46.5%	44.5%
Profit before taxes / assets	0.54%	0.52%	0.55%
Profit before taxes / risk-weighted assets	22.4%	22.8%	25.3%
Profit before taxes / tier 1 capital	15.1%	15.4%	16.1%
Income excluding interest / banking income	46.2%	47.5%	52.7%
Creation of provisions for loans and advances to customers[8]	0.92%	0.73%	0.54%
Creation of provisions for participations and shares in affiliated undertakings[9]	9.13%	16.94%	12.83%

Luxembourg credit institutions used the year 2005 to consolidate their profitability. Thus, the cost / income ratio fell back below the 45% mark, after having been close to 46.5% in December 2004. Moreover, all the indicators of net unit profitability, whether they measure return on assets, weighted assets or tier 1 capital, are increasing. This development takes place in a context of an expanding tax base as average assets increased by 9.5%, weighted assets by 12.2% and tier 1 capital by 5.9%.

Creation of provisions for loans and advances decreases by 11.2% year-on-year. Taking account of a 20% growth in volume of loans and advances to customers, the unit creation of provisions thus decreases to 0.54% of the gross amount. The development is similar for participations and shares in affiliated undertakings, whose volume grew by 26.9% against a decrease of 3.8% for the relevant creation of provisions.

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

(in million EUR)	2003	2004	2005
Banking income / employee	0.337	0.330	0.356
Staff costs / employee	0.078	0.080	0.084

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

[8] As a % of the gross amount.

[9] As a % of the gross amount.

1.7. Off-balance sheet items and financial derivatives

The banks of the financial centre used derivatives for a nominal amount of EUR 711.1 billion in 2005 against EUR 623.3 billion in 2004. The use of derivatives thus increased by 14.1% as compared to 2004.

The greater use of derivatives concerns all the categories of derivatives: interest rate swaps (+6.7%), future and forward rate agreements (+61.4%), futures (+122.5%) and options (+103.9%). Interest rate swaps, used mainly within the scope of the management of assets/liabilities, remain the predominant derivative. They totalled EUR 609.5 billion, i.e. 85.7% of the total volume. Financial derivatives are mainly based on underlyings of interest rates (94.1% of the total volume). Exposures to exchange rates and title deeds are of minor importance (3.9% and 1.5% of the total volume).

The ratio of the volume of derivatives compared to the balance sheet total amounts to 89.7% against 89.6% in 2004.

Instruments dealt over the counter remain the most used products (92.9% of the total nominal amount in 2005 against 96.1% in 2004). They reached a volume of EUR 660.7 billion against EUR 599 billion in 2004.

Use of financial derivatives by credit institutions

	2004		2005[10]	
	in billion EUR	*as a % of balance sheet total*	*in billion EUR*	*as a % of balance sheet total*
Interest rate swaps	571.4	82.2%	609.5	76.9%
Future or forward rate agreements	17.6	2.5%	28.4	3.6%
over the counter	*14.1*	*2.0%*	*27.1*	*3.4%*
regulated market	*3.4*	*0.5%*	*1.3*	*0.2%*
Futures (currencies, interests, other rates)	17.4	2.5%	38.8	4.9%
Options (currencies, interests, other rates)	16.9	2.4%	34.5	4.4%
over the counter	*13.4*	*1.9%*	*24.2*	*3.1%*
regulated market	*3.5*	*0.5%*	*10.3*	*1.3%*

In 2003, the CSSF had refined the reporting of third-party assets held by banks[11] . While this category previously comprised all the securities deposits of professional and non-professional customers, this amount is now broken down into the following categories:

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

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

[10] Preliminary figures for the end of 2005.

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

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

(in billion EUR)	2003	2004	2005[12]
Assets deposited by UCIs	890.5	1,041.1	1,457.3
Assets deposited by clearing or settlement institutions	301.0	311.1	422.1
Assets deposited by other professionals acting in the financial markets	3,472.9	3,765.2	4,445.5
Other deposited assets	335.3	361.7	450.3

While assets deposited by other professionals remain the most important item, assets deposited by UCIs grew by 40% in 2005. The "other deposited assets", which reflect in particular the private portfolio management, increased by 24% over a year.

1.8. Development in own funds and in the solvency ratio

1.8.1. Number of banks required to meet a solvency ratio

As at 31 December 2005, the number of banks required to meet a non-consolidated solvency ratio stood at 113, including 112 banks incorporated under Luxembourg law and one branch of non-EU origin. 89 banks carry out limited trading activities, and are therefore authorised to calculate a simplified ratio. Trading activities in the true sense remain confined to a limited number of banks.

Number of banks required to meet a solvency ratio	Integrated ratio		Simplified ratio		Total	
	2004	2005	2004	2005	2004	2005
Non-consolidated	24	24	93	89	117	113
Consolidated	14	14	14	14	28	28[13]

1.8.2. Development in the solvency ratio

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

Although it has dropped compared to the previous year, the capital adequacy ratio maintained its high level in 2005. The significant increase in capital requirements has only been partly offset by the growth in the base of eligible own funds. The solvency ratio itself reached 15.2%, easily exceeding the minimum threshold of 8% required by the existing prudential regulations. Considering core equity capital (Tier 1) only, the aggregate ratio for the financial centre decreased from 12.9% as at 31 December 2004 to a provisional figure of 12.1% at year-end 2005.

Capital requirements for credit risk grew strongly in 2005 (+12.4%), reflecting a revival in lending operations. Besides, lending operations continue to make up the bulk of capital requirements. Capital requirements for the banks' trading portfolios, negligible in terms of volume, remain at an almost equal level as that in the previous years (+0.5% compared to year-end 2004). Capital requirements for foreign exchange risks remain marginal, although their downward trend that started in 2000 is broken by the figures of the year under review.

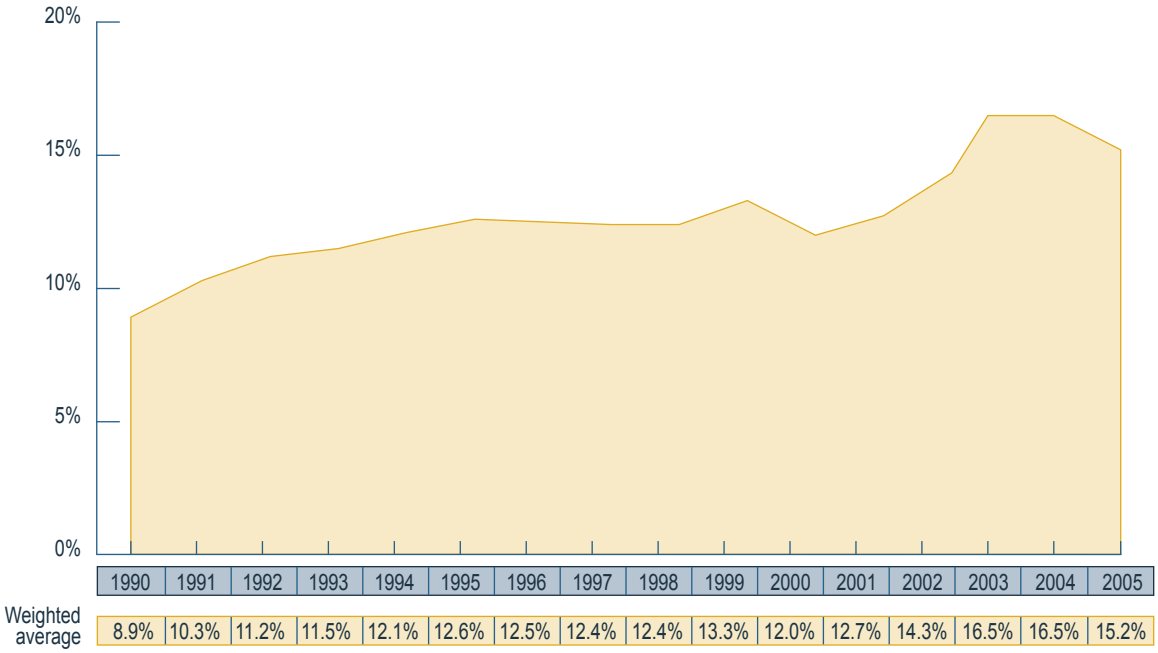
[12] Preliminary figures for the end of 2005.

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

Eligible own funds continue their positive development of the previous years. Core capital, which represents 82% of total eligible own funds, grow by 5.9% due to the rise of the item "Paid-up capital". This development is mainly attributable to the decision of one banking group to concentrate the securities activities in its Luxembourg subsidiary and to consequently provide it with the appropriate own funds. Additional own funds (after capping) confirm their downward trend of the previous years and record a provisional volume of EUR 6,683 million as at 31 December 2005, i.e. down 2.8% year-on-year. The marginal use of sub-additional own funds, as in the two previous years, also needs to be noted. Finally, items to be deducted from own funds follow an upward trend since 2003 and record a volume of EUR 1,035 million in 2005, owing to the growth in the item participating interests in other credit and financial institutions exceeding 10% of the capital of the institutions under supervision. The impact on the solvency ratio denominator is significant as the participations concerned are to be fully deducted from eligible own funds.

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

Development in the solvency ratio (base 8%)



(in million EUR)

Numerator	2004 consolidated	2005 consolidated (provisional)
Original own funds before deductions	***26,182***	***27,593***
Paid-up capital	7,783	8,936
Silent participation ("Stille Beteiligung")	2,523	2,646
Share premium account, reserves and profits brought forward	13,155	13,321
Funds for general banking risks	1,837	1,907
Profits for the financial year	494	470
Specific consolidation items	390	313
Items to be deducted from original own funds	***-712***	***-612***
Own shares	0	0
Intangible assets	-99	-96
Losses brought forward and loss for the financial year	-50	-27
Specific consolidation items	-562	-489
ORIGINAL OWN FUNDS (TIER 1)	**25,470**	**26,981**
Additional own funds before capping	***6,900***	***6,688***
Upper TIER 2	3,197	3,013
of which: cumulative preference shares with no fixed maturity	*27*	*29*
of which: subordinated upper TIER 2 debt instruments	*2,269*	*2,127*
Lower TIER 2	3,703	3,675
Lower TIER 2 subordinated debt instruments and cumulative preference shares with fixed maturity	*3,703*	*3,675*
ADDITIONAL OWN FUNDS AFTER CAPPING (TIER 2)	**6,878**	**6,683**
Sub-additional own funds before capping	***69***	***20***
SUB-ADDITIONAL OWN FUNDS AFTER CAPPING (TIER 3)	**31**	**20**
OWN FUNDS BEFORE DEDUCTIONS (T1+T2+T3)	**32,379**	**33,684**
ITEMS TO BE DEDUCTED FROM OWN FUNDS	**835**	**1,035**
Items of share capital in other credit and financial institutions in which the bank owns interests exceeding 10% of their share capital	643	917
Items of share capital in other credit and financial institutions in which the bank owns interests less or equal to 10% of their share capital	192	118
ELIGIBLE OWN FUNDS	**31,544**	**32,649**
Denominator		
TOTAL CAPITAL ADEQUACY REQUIREMENT	**15,312**	**17,183**
of which: to cover credit risk	14,945	16,794
of which: to cover foreign exchange risk	41	62
of which: to cover trading risk	326	327
Ratio		
SOLVENCY RATIO (base 8%)[14]	**16.5%**	**15.2%**
SOLVENCY RATIO (base 100%)	**206.0%**	**190.0%**

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

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

In non-consolidated terms, the high solvency ratio in the financial centre also includes a rather low number of banks whose ratio is situated within the medium capitalisation bands, i.e. below 11%. For instance, as at 31 December 2005, the percentage of banks with a solvency ratio below 10% is 8.0%. Conversely, more than two thirds of credit institutions of the financial centre record a solvency ratio exceeding 15%.

Ratio	Number of banks 2004	Number of banks 2005	as % of total 2005
<8%	0	0	0.0%
8%-9%	2	4	3.5%
9%-10%	2	5	4.4%
10%-11%	11	9	8.0%
11%-12%	7	5	4.4%
12%-13%	3	8	7.1%
13%-14%	5	5	4.4%
14%-15%	7	5	4.4%
15%-20%	26	19	16.8%
>20%	54	53	46.9%
Total	**117**	**113**	**100.0%**

1.9. International expansion of Luxembourg banks

In 2005, Luxembourg banks continued their prudent policy as regards the development of their activities abroad. External and organic growth strategies are only pursued on an isolated basis.

Eight banks have expanded their international network in 2005, either by opening branches, or by acquiring existing companies, with a total of ten presences abroad, namely:

• Dexia Banque Internationale to Luxembourg S.A.	Opening of a branch in Milan Creation of Dexia Investor Services Bank, France
• Société Générale Bank & Trust	Opening of a branch in Singapore
• Banque Degroof Luxembourg S.A.	Opening of a branch in Brussels
• Kredietbank S.A. Luxembourgeoise	Acquisition of Effectenbank Stroeve N.V. (Netherlands) Acquisition of Financière Groupe Dewaay S.A., Luxembourg
• UBS (Luxembourg) S.A.	Opening of a branch in Dublin
• SEB Private Bank S.A.	Opening of a branch in Singapore
• Kaupthing Bank Luxembourg S.A.	Acquisition of Kaupthing Asset Management (Switzerland)
• Fortis Bank Luxembourg	Setting up of Fortis Lease Group with establishments in several countries

One bank hived off a foreign entity, namely:

• Dexia Banque Internationale to Luxembourg S.A.	Sale of Dexia Bank Nederland N.V.

Number of branches established in the EU/EEA as at 31 December 2005

Country of origin	Luxembourg branches established in the EU/EEA	Branches of EU/EEA banks established in Luxembourg
Germany	1	16
Austria	1	-
Belgium	3	1
Spain	3	-
Finland	-	1
France	1	5
Greece	-	-
Ireland	4	1
Italy	1	2
Netherlands	-	1
Portugal	2	2
United Kingdom	3	5
Sweden	1	1
Total	**20**	**35**

Freedom to provide services within the EU/EEA as at 31 December 2005

Country	Luxembourg banks providing services in the EU/EEA	EU/EEA banks providing services in Luxembourg
Germany	48	39
Austria	25	18
Belgium	51	18
Cyprus	4	2
Denmark	28	7
Spain	38	5
Estonia	6	-
Finland	23	3
France	51	60
[Gibraltar]	-	1
Greece	22	1
Hungary	6	2
Ireland	21	30
Iceland	4	1
Italy	40	6
Latvia	6	-
Liechtenstein	1	1
Lithuania	6	-
Malta	4	1
Norway	10	3
Netherlands	40	24
Poland	5	1
Portugal	27	7
Czech Republic	5	-
United Kingdom	38	80
Slovakia	5	-
Slovenia	5	-
Sweden	22	3
Total number of notifications	**541**	**313**
Total number of banks concerned	**65**	**313**

1.10. Banks issuing mortgage bonds

The banks issuing mortgage bonds continued their positive development during 2005. Indeed, as at 31 December 2005, the balance sheet total of the three banks issuing mortgage bonds totalled EUR 38.9 billion and the total volume of public sector mortgage bonds issued (and in circulation) by these three banks reached EUR 23 billion against EUR 17.9 billion at the end of 2004.

Issues of mortgage bonds are guaranteed by ordinary cover assets and by substitute cover assets. As at 31 December 2005, mortgage bonds in circulation benefited from an over-collateralisation (nominal value) of EUR 2.5 billion. Over-collateralisation calculated according to the current value amounts to EUR 2.32 billion as at 31 December 2005.

The ordinary cover assets of municipal bonds for the three banks break down as follows:

- claims on or guarantees from public organisations: EUR 6.67 billion;
- bonds issued by public organisations: EUR 14.94 billion;
- public bonds of other issuers: EUR 1.24 billion;
- derivative transactions: EUR 1.0 billion.

Besides these ordinary cover assets, the banks used substitute cover assets amounting to EUR 1.75 billion as at 31 December 2005.

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

Although the law of 21 November 1997 allows the banks issuing mortgage bonds to issue public bonds as well as mortgage bonds, the Luxembourg banks continued to limit their main activities in 2005 to public bonds covered by sovereign debtors. However, Erste Europäische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg publicly announced its intention to launch a real estate financing activity in 2006. In a first stage, the bank does not intend to issue mortgage credits, but will only issue mortgage bonds, covered by other bonds that are compliant with the provisions of article 42(2) of the law of 30 March 1988 on UCIs as amended and article 43(4) of the law of 20 December 2002 on UCIs as amended. In that case, the mortgage register must comprise a second part in which the guarantees of the mortgage bonds are registered. Moreover, the specific report filed on a monthly basis with the CSSF, which allows to verify the sufficiency of collateralisation, must include a new part for mortgage bonds comprising the composition of the cover assets, as well as the geographic breakdown and the over-collateralisation according to the current value. The possibility to issue mortgage bonds against other similar securities had already been envisaged with the creation of the status of bank issuing mortgage bonds by the law of 21 November 1997.

During the last few months, some German banks expressed their interest in opening, besides their universal bank, a bank issuing mortgage bonds in Luxembourg, one of the reason being the *Wegfall der Anstaltslast und der Gewährträgerhaftung für Körperschaften des öffentlichen Rechts* in Germany, so that the debts of these institutions cannot be included anymore in the cover assets of the German banks issuing mortgage bonds. However, as the provisions of article 12-1 c) of the law of 21 November 1997 do not require any additional guarantee such as *Anstaltslast* or *Gewährträgerhaftung*, these assets may still be included in the cover assets of the Luxembourg banks issuing mortgage bonds.

1.11. Exposure to high-risk sectors

Circular letter of 29 November 2001 requested the twenty most important credit institutions of the financial centre to provide information concerning their exposures to certain sectors more particularly hit by the, at that time, unfavourable economic environment. Thus, they report, on a quarterly basis, their exposures towards the sectors of telecommunications, media and technology, transport, aviation, tourism and leisure industry, as well as the insurance sector. These twenty credit institutions cover nearly 60% of the total balance sheet of the financial centre in 2005.

In 2005, the CSSF closely monitored the development of the reported risk exposures. The following table summarises the recent development of loans, net of specific provisions, drawn by the different sectors. Overall, the risk exposures taken into consideration represent less than 1% of the total balance sheet of the banks of the financial centre at the end of 2005.

(in million EUR)	**Exposure at the end of 2004**	**Exposure at the end of 2005**	**Variation in %**
Telecommunications, media and technology	2,713	2,668	-2%
Aviation	1,501	1,386	-8%
Insurance	1,067	925	-13%
Transport	1,203	1,647	+37%
Tourism and leisure industry	770	755	-2%

Total risk sector exposures slightly increased by 1.8% during 2005. However, this growth is exclusively attributable to the transport sector, as the other high-risk sectors are falling. Risk exposures to the insurance sector recorded the most important decrease with EUR 142 million down in 2005, representing a drop of more than 13%. Exposures to the aviation sector and, to a lesser extent, to the telecommunications, media and technology sector and the tourism sector, also fell. Banks however increased their exposures to the transport sector, which moves to the second place in terms of importance among the analysed high-risk sectors. This sector now represents 22.3% of the total volume of risk exposures.

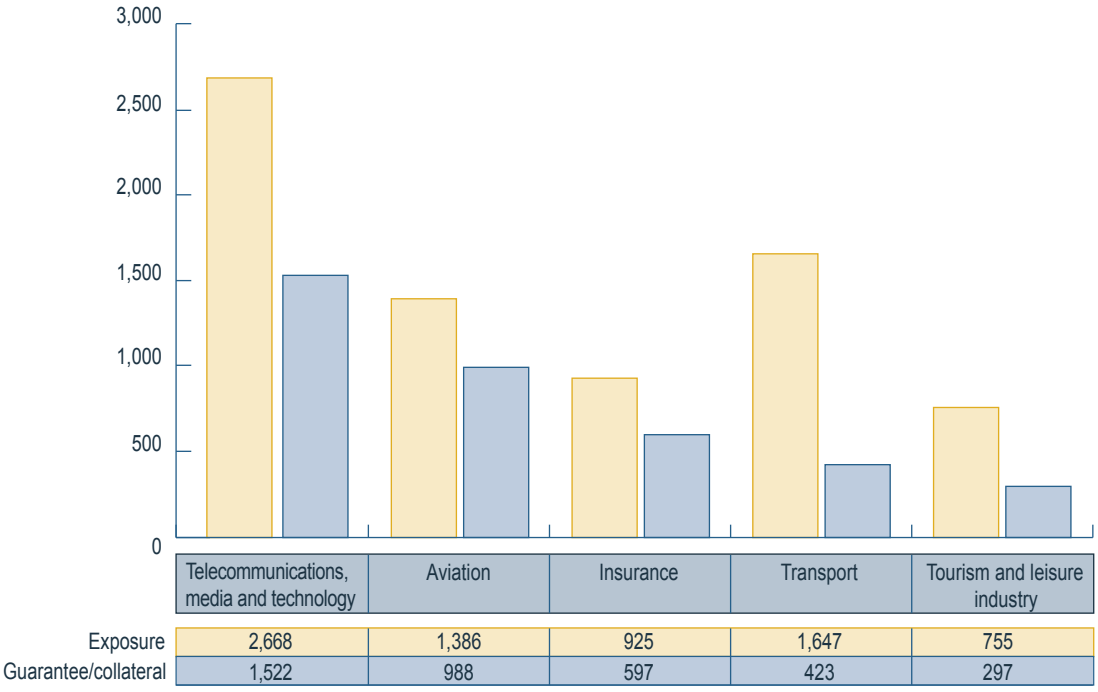
The analysis of the figures collected over the last four years of the twenty most important credit institutions in the financial centre reveals a clear improvement of the banks' situation as regards exposures to high-risk sectors. Risk exposures have thus continuously decreased. The development of the majority of high-risk exposures is in stark contrast with the development in the total volume of loans and advances to customers, which increased by 20.4% over a year. This divergent development is attributable to a more selective credit policy of banks. The banks have thus adopted a more prudent approach with respect to their exposures to certain risk sectors.

Exposure at the end of the year *(in million EUR)*	**2001**	**2002**	**2003**	**2004**	**2005**
Telecommunications, media and technology	3,986	3,855	2,829	2,713	2,668
Aviation	2,566	2,107	1,677	1,501	1,386
Insurance	1,618	1,392	1,165	1,067	925
Transport	1,492	1,071	1,247	1,203	1,647
Tourism and leisure industry	656	734	736	770	755
Total exposure to high-risk sectors	**10,318**	**9,159**	**7,654**	**7,254**	**7,381**
Variation *(in %)*		-11%	-16%	-5%	+2%
Guarantees and collateral (*as a % of risk exposures*)	44%	58%	52%	56%	52%
Aggregated balance sheet total	**721,978**	**662,700**	**655,601**	**695,363**	**792,422**
Variation (in %)		-8%	-1%	+6%	+14%

Concurrently, the degree of coverage of the risk exposures has strengthened substantially since 2001 and exceeded 50%. Overall, exposures were covered up to about 52% by guarantees and collateral in 2005.

The following graph illustrates the degree of coverage of the different risk sectors. The coverage ratio is highest for the aviation sector (71%) and the insurance sector (65%).

Risk positions at the end of 2005: exposure and guarantee/collateral – in million EUR



The CSSF applies very strict eligibility requirements as regards guarantees/collateral. Only guarantees and collateral of outstanding quality and liquidity are taken into account for internal analysis. In certain cases, haircuts that take into account the non-covered residual risk are deducted from the gross amount of guarantees.

The table below sets out own funds of banks with exposures to high-risk sectors. It also gives a fair outline of the coverage ratio by own funds of the risk exposures considered.

Sector	Own funds of banks with risk exposures *(in million EUR)*	Ratio between exposure and own funds	
		Highest ratio for systemic banks	Ratio for the three most exposed banks
Telecommunications, media and technology	22,587	23%(*)	16%(*)
Aviation	18,333	21%	13%
Insurance	19,878	10%	7%
Transport	21,956	69%	26%
Tourism and leisure industry	21,287	9%	5%

(*) Highest ratio among those calculated separately for the telecommunications, media and technology sectors.

The first ratio analysed by the CSSF relates the risk-sector exposure to the own funds of the individual banks. For each sector, the table shows the highest ratio observed among the systemic banks. A second ratio calculates the same percentage as regards the three banks with the highest risk-sector exposures. Neither of these ratios indicates an abnormal concentration. The risk concentration of banks is highest for the transport sector. The concentration of exposures to the aviation sector has been greatly reduced.

The decrease in ratios relating the sector exposure to the own funds of the banks has been particularly marked in the last three years due to the joint impact of a policy consisting in reducing risk exposures and a strengthening of the banks' own funds.

Capital buffers constituted mainly by lumpsum provisions allow most banks to absorb possible losses incurred in high-risk sectors without their own funds being directly affected.

Recent developments in certain risk sectors monitored more particularly by the CSSF are not very encouraging, despite a more positive macroeconomic environment. Certain airlines, in particular, continue to encounter serious financial problems that could jeopardise their existence. Furthermore, the financial perspectives of the large players in the telecommunication sector have not particularly improved over the last years. The CSSF thus continues to closely monitor the development of the banks' risk exposures. In 2005, the CSSF has carried out stress tests based on the risk exposures as at the end of September.

Overall, the test results were satisfactory. The resistance of banks against a shock with regard to their exposures has thus continuously strengthened since 2001. The potential impact of a shock with respect to high-risk sectors has substantially weakened under the joint effect of the improvement of own funds and the reduction in the banks' high-risk exposures. Thus, under the scenario of a shock limited to an individual high-risk sector, none of the analysed banks sustains any default. It is only in the event of a correlated shock in several risk sectors, a highly unlikely scenario, that one bank sustains a more substantial loss of capital. Even in this extreme scenario, none of the banks defaults and the average solvency ratio remains quite respectable.

New high-risk sectors have certainly been added to those monitored by the CSSF for several years. The real estate sector, for instance, is weakened due to the evolution of the non-residential national and international real estate market. This observation led the CSSF to have a closer look at the quality of mortgage credits granted by the Luxembourg banks, even if this aggregate represents overall only 2.6% of the aggregate balance sheet at the end of 2005. From these 2.6%, 1.6% are mortgage credits to natural persons and 1% mortgage credits to legal persons. It follows that the mortgage credit activity represents a limited risk for the financial centre as a whole.

As the risks may nevertheless be considerable as regards individual banks, the CSSF decided to carry out stress tests. The real estate crisis scenario leads the CSSF to simulate a noticeable increase in the default rate and a zero collection rate of the mortgage loans concerned. The tests have revealed that the banks' solvency has not been affected in a noticeable way.

The high number of bankruptcies of small and medium-sized undertakings is another concern of banks active in the financing of this sector. In the absence of major issues encountered by the banks within the scope of the management of their exposures to these sectors, the CSSF does not consider any formalised and regular monitoring of these sectors for the time being.

2. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

Circular CSSF 05/177 concerning the abolition of prior control by the CSSF of advertising material used by persons and undertakings supervised by the CSSF

In the context of the efforts made to reduce the administrative burden, the persons and undertakings under the prudential supervision of the CSSF are no longer compelled to communicate to the CSSF, to obtain its opinion, the content of their advertising messages intended for the distribution to their customers or to the public. In particular, advertising material used by persons in charge of the distribution of the units of undertakings for collective investment and by their representatives, does not need to the submitted to the CSSF for control anymore, even if this material is not subject to control by the competent authorities in countries in which it is used.

Based on the interventions of the CSSF, it appeared that it was not necessary to uphold these provisions. To this end, the circular repeals point II. of Chapter L. of circular IML 91/75, as well as the last two sentences of point IV. 5.11 of circular CSSF 2000/15.

The persons and undertakings under the supervision of the CSSF shall of course continue to comply with the rules of conduct of the financial sector both in Luxembourg and abroad, by refraining from any misleading advertisement of offered services, by stating, where applicable, the particular inherent risks in these services and by referring specifically to the customer's own responsibility.

The CSSF remains empowered to check compliance with the rules of conduct of the financial sector with respect to advertising and to order the withdrawal notably of any deceptive advertising of offered services, as well as any inappropriate communication of information on the Luxembourg legal framework.

3. PRUDENTIAL SUPERVISORY PRACTICE

3.1. Objectives of prudential supervision

Supervision of banks aims at the following:

- ensuring the security of the public's savings by monitoring the solvency and prudent management of individual banks;
- ensuring financial stability and proper functioning of the banking system as a whole;
- protecting the reputation of the financial sector by penalising ethically unacceptable conduct.

In order to fulfil these objectives of public interest, the CSSF monitors the implementation by credit institutions of the laws and regulations relating to the financial sector.

3.2. Monitoring of quantitative standards

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

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

In 2005, the CSSF had to intervene in one instance of violation of the capital ratio and in two instances of violation of the liquidity ratio. It turned out that the case of capital ratio violation was due to a technical overstepping and in both instances concerning violation of the liquidity ratio, the banks concerned have respected the liquidity ratio again within a short period of time.

On 24 occasions, the CSSF requested additional information concerning the apparent overrun of the large exposures limits and, where the overruns were not the result of difficulties in interpreting the regulations, required that the banks concerned take the appropriate measures so as to bring back the commitments in question within the regulatory limits.

3.3. Monitoring of qualitative standards

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

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

These reports are processed according to a methodology described in the CSSF's internal procedures. The response of the CSSF depends on the seriousness of the problem raised and whether it is repetitive in nature. It ranges from the simple monitoring of the problem based on reports, to the drawing-up of deficiency letters, or 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 and suspension of managers or activities.

During 2005, the CSSF sent 105 (159 in 2004) deficiency letters to banks based on shortcomings in terms of organisation.

The most frequent issues that arose were the following:

- update of the documentation of customer files and credit files;
- internal audit (hierarchical position of the internal audit, resources, frequency of controls; implementation of recommendations);
- procedure manual (degree of precision, regular updates);
- IT systems and back-up solutions for IT data;
- outsourcing agreements and data access;
- process of sending and delivering mail.

Other interventions, although less frequent, concerned for example the separation of tasks, equal powers of the approved managers, weaknesses relating to rules of conduct as laid down in circular CSSF 2000/15 (absence of a written warning on the risks concerning derivatives, ill-informed clients in case of significant losses), handling of customer disputes, IT security (control of access rights, encryption of telecommunications), incorrect reporting to the CSSF, unsatisfactory or ill-tested disaster recovery and business continuity plans, supervisory system of margin lending (frequency of assessments, consideration of all the exposures, including forward transactions and assimilated, deficiencies in the legal records, procedure to start liquidation of cover assets), as well as insufficient supervision of the internal accounts.

3.4. Analytical report

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

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

In 2005, the CSSF analysed 232 analytical reports, 23 of which were consolidated analytical reports and 77 were analytical reports of subsidiaries of Luxembourg banks.

3.5. Co-operation with external auditors

Article 54 of the law of 5 April 1993 on the financial sector as amended governs the relationship between the CSSF and the external auditors. This article confers upon the CSSF the power to establish the regulations relating to the scope of the audit mandate and the content of the audit report. The professionals supervised shall communicate all the reports issued by the external auditor within the course of the audit of the annual accounts to the CSSF.

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

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

3.6. On-site inspections

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

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

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

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

During the year under review, 46 inspections have been carried out, against 76 in 2004 and 62 in 2003. The reason for this decrease lies in the fact that the missions carried under Basel II are no longer mentioned in this chapter, but in Chapter XI on General Supervision and the involvement of the CSSF in international groups. Basel II missions taken into account, the number of on-site controls and inspections amounts to 98 in 2005.

In 2005, the controls and inspections focused on two specific topics:

- Thirteen missions concerned the functioning of the banks' bodies, notably the board of directors. During these inspections, the CSSF inspected the meeting frequency of the board of directors, the subjects mentioned, the frequency of the audits of the parent company and the decision-making process relating to the main counterparty risks and the business relationships in general. The CSSF observed that the banks inspected are in general well integrated in the decision-making process and control of the parent companies. In some cases, the frequency of the controls carried out by the group's internal audit can be qualified as insufficient.
- The objective of eight missions was to assess the quality of the internal audit function. The most frequent observations included a) a potential overload of work due, in certain cases, to the recent takeover of one or several entities, b) the distribution of the internal audit report to only part of the authorised management, c) the exclusion of certain business areas from the scope of the audit and d) insufficient exhaustiveness of the information communicated to the CSSF as regards the internal audit mission and the relevant reports.

The other inspections covered subjects as various as lending activities, private banking, asset liability management, margin lending, liquidity, supervision of subsidiaries and the control of the local branches.

As the control of compliance with the rules on money laundering was a major focus of attention during the last years, with eleven inspections in 2004 and twenty in 2003, its relative importance, in numbers of inspections, decreased in 2005.

3.7. 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 compliance with professional obligations as regards the fight against money laundering and financing of terrorism by every person subject to its supervision. However, non-compliance with the professional obligations in full knowledge falls under the penal law and relevant proceedings thus fall within the competence of the Public Prosecutor's office.

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

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

During the year under review, the CSSF sent 29 deficiency letters to banks in relation with shortcomings concerning money laundering. These letters, based on on-site inspections and external or internal audit reports, list the shortcomings identified and enquire about the corrective measures envisaged.

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

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

3.8. Management letters

Management letters drawn up by external auditors for the attention of the banks' management are an important source of information as regards the quality of the credit institutions' organisation. In these reports, the external auditors point out weaknesses they observed in the internal control system in the course of their assignment. In 2005, the CSSF analysed 84 management letters and similar documents.

3.9. Meetings

The CSSF regularly holds meetings with bank executives to discuss business and any problems. It also requires prompt notification by the banks if a serious problem arises.

In 2005, 179 meetings were held between CSSF representatives and bank executives.

3.10. Specific controls

According to article 54(2) of the law of 5 April 1993 on the financial sector as amended, the CSSF has the right to require an external auditor to conduct a specific audit in a given institution. The CSSF did not make use of this power during 2005. However, it has invited two banks to specifically appoint their external auditor to audit a specific business area.

3.11. Internal audit reports

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

3.12. Supervision on a consolidated basis

As at 31 December 2005, 31 banks under Luxembourg Law[15] (idem in 2004), as well as one Luxembourg-incorporated finance company[16] (idem in 2004) 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 Section III, chapter 3 of the law of 5 April 1993 on the financial sector as amended. These rules transpose Directive 92/30/EEC on the supervision of credit institutions on a consolidated basis. The practical application of the rules governing supervision on a consolidated basis is explained in circular IML 96/125.

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

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

- The CSSF requires a periodic reporting reflecting the financial situation and the consolidated risks of a group subject to its consolidated supervision.
- Another source of information are the reports prepared by the external auditors. Circular CSSF 01/27 defining the mission of the external auditor requires that a consolidated long form report of a group subject to the consolidated supervision of the CSSF must be drawn up. The purpose of this consolidated report is to provide the CSSF with an overview of the group's situation and to inform on the risk management and structures of the group.
- For each important subsidiary, the CSSF requires an individual long form report.
- By virtue of circular IML 98/143 on internal control, a summary report on the activities carried out by the internal audit department is to be communicated to the CSSF on an annual basis. The CSSF requires that the scope of intervention of the internal audit of the Luxembourg parent company be extended to the subsidiaries in Luxembourg and abroad. This report must mention the controls carried out within the subsidiaries and the results thereof.

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

[16] Clearstream International

- 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 Luxembourg banks subject to consolidated supervision, information on any interventions of the host country authorities with the subsidiaries, where these interventions concern non-compliance with domestic regulations and aspects regarding organisation or risks of these subsidiaries.
- As regards groups with an important network of subsidiaries, the CSSF follows the development of the financial situation and the risks of the subsidiaries included in the consolidated supervision by means of regular meetings with the management of the Luxembourg credit institution under consolidated supervision.

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

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

3.13. International co-operation on matters of banking supervision

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

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

In 2005, the CSSF held three bilateral meetings with banking supervisory authorities in order to exchange prudential information on supervised institutions having a presence in both countries.

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

In 2000, the CSSF has signed a memorandum of understanding with the Belgian and French authorities relating to supervision of the DEXIA Group. In 2001, a similar agreement, this time relating to supervision of the banking activities of the FORTIS Group, was signed between the CSSF and the Belgian and Dutch authorities.

Following the takeover of the Clearstream group by the Deutsche Boerse AG, the German and Luxembourg authorities have signed a memorandum in 2004 defining the modes of co-operation between both authorities as regards the supervision of the Clearstream group.

The authorities considered that the new structures of these groups, introducing a decentralised organisation of operational management units and centres of competence, called for an adaptation of the prudential supervisory modes of the activities of these groups. The key objective of such a co-operation between authorities is to ensure that all banking activities of these groups are adequately supervised. To this end, the authorities ensure in particular that the various sets of regulations are applied in a harmonised manner in order to avoid any unbalanced treatment within the groups.

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

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

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

Besides frequent exchanges of information between the persons directly responsible of the supervised entities in each authority, the CSSF attended thirty meetings within the framework of this co-operation. It should be noted that in 2005, a high number of these meetings between authorities exclusively concerned their co-operation within the scope of implementation of new models of risk management by various banking groups, in order to prepare for the future Basel II regulations.

The CSSF considers that this form of co-operation substantially improves the effectiveness of supervision of cross-border banking groups and is convinced that these can be supervised thoroughly by national authorities collaborating via these memoranda of understanding, so as to cover all dimensions of a group's activities. This underlines the CSSF's belief that there is no need for centralised supervision of cross-border groups at EU level.

3.14. Enforcement of banking regulations

3.14.1. Implementation of the regulations governing compliance

Circular CSSF 04/155 of 27 September 2004 requires the setting up of a compliance function until 1 January 2006 at the latest. Throughout the year 2005, problems of a practical nature as far as the organisation of this function is concerned arose, generally due to the fact that the organisation already in place within institutions was not in line with the framework outlined by the circular.

The most frequent issue related to the requirement that the compliance function should be independent. While the circular requires that this function must not be attached to another function or department, but directly to the management, the organisation set up in many banks does not fulfil this requirement. Indeed, the most frequent organisation models were the following:

- the compliance function was under the charge of internal audit,
- the compliance function was included in the risk management function,
- the compliance function was attached to the legal department.

Many banks therefore needed to review their organisation, which was not an easy thing to do, as these models were often running smoothly and it was important to avoid a loss of acquired competence and the weakening of the compliance function.

As regards the particular case of groups present in Luxembourg with two or several distinct legal entities and using common support functions, the CSSF accepts that a compliance officer with a work contract with one of these legal entities may also work within the other entities based on detachment contracts in place.

While the circular is rigid as far as the organisation mode of the compliance function is concerned, it offers however certain possibilities as regards the resources and the CSSF has widely accepted the use of these possibilities.

Therefore, the CSSF authorised to a large extent the creation of a part-time compliance officer assignment for institutions of which neither the size, nor the business nature nor the risks justify the creation of a full-time assignment. However, the CSSF does not wish to set down *a priori* precise criteria in this respect in order to maintain maximum flexibility as regards these decisions.

Furthermore, the institutions may also delegate certain duties to internal services as well as to external expertise and technical means. Finally, the banks may put a manager in charge of the compliance function.

By combining the possibilities offered as regards the allocation of resources of the compliance function, many options are available to the small-sized banks to organise this function efficiently while keeping the costs down.

3.14.2. Relationships with independent asset managers and authorised agents

An activity that is increasingly developed by the banks consists in offering the services of depositary bank for customers who authorise an independent asset manager to manage their assets.

The CSSF has been contacted regularly with respect to situations where customers claim damages from the bank for the losses sustained due to management decisions taken by this independent manager. These customers often refer to the general due diligence duty of banks with regard to their customers, the duty to supervise the independent manager's operations and the duty to inform and warn.

In order to avoid such disputes, the CSSF recommends that the banks follow certain basic rules:

- Firstly, it should be borne in mind that these customers, as account holders, are fully-fledged customers of the banks and the rules of conduct provided for by circular CSSF 2000/15 are fully applicable, especially the obligation to inquire about the financial standing of their customers, their experience in investments, their objectives concerning the requested services, as well as the obligation to inform the customers on the product-linked risks. On the other hand, the obligations of the professional performing discretionary management, such as the obligation to warn the customer about significant losses, are not applicable to the depositary bank.
- The contractual documents to be signed between the customer and the bank should specify that the bank is not liable for the investment decisions of the independent asset manager and that the bank is not bound to check if the independent manager fulfils the terms of the contracts that binds the latter to the customer. Where investments in particularly risky products, such as derivatives or margin lending are envisaged, it is preferable to specifically state this in the contracts with the bank.
- Where the customer gives clear instructions with respect to his mail, the CSSF considers that the bank cannot be held liable if it complies with these instructions to the letter. Thus, a customer who gives a hold-mail instruction and who does not visit the bank, cannot blame the bank for not informing him on the state of his assets afterwards. The same applies to customers who wish to have their statements sent to the independent asset manager.

DEPARTMENT SUPERVISION OF BANKS

First row, left to right: Frank BISDORFF, Marina SARMENTO, Monica CECCARELLI, Christina PINTO, Françoise DALEIDEN, Jean-Louis BECKERS

Second row, left to right: Claude REISER, Patrick WAGNER, Yves SIMON, Nico GASPARD

Absent: Marco BAUSCH, Marc BORDET, Romain DE BORTOLI, Gilles JANK, Claude MOES, Steve POLFER, Claudine WANDERSCHEID

DEPARTMENT SUPERVISION OF BANKS

Left to right: Michèle DELAGARDELLE, Isabelle LAHR, Jean-Paul STEFFEN, Carlos AZEVEDO PEREIRA, Steve HUMBERT, Michèle TRIERWEILER, Ed. ENGLARO, Jacques STREWELER, Marc WILHELMUS, Joan DE RON

Absent: Anouk DONDELINGER, Jean-Louis DUARTE, Jean LEY, Jean MERSCH, Claudine TOCK, Alain WEIS

CHAPTER II

SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT

1. Developments in the UCI sector in 2005
2. Newly created entities approved in 2005
3. Closed down entities in 2005
4. Developments regarding UCIs investing principally in other UCIs and UCIs that adopt alternative investment strategies
5. Management companies
6. Developments in the regulatory framework
7. Prudential supervisory practice
8. Analysis of the savings plans offered by Luxembourg UCIs

1. DEVELOPMENTS IN THE UCI SECTOR IN 2005

1.1. Key trends

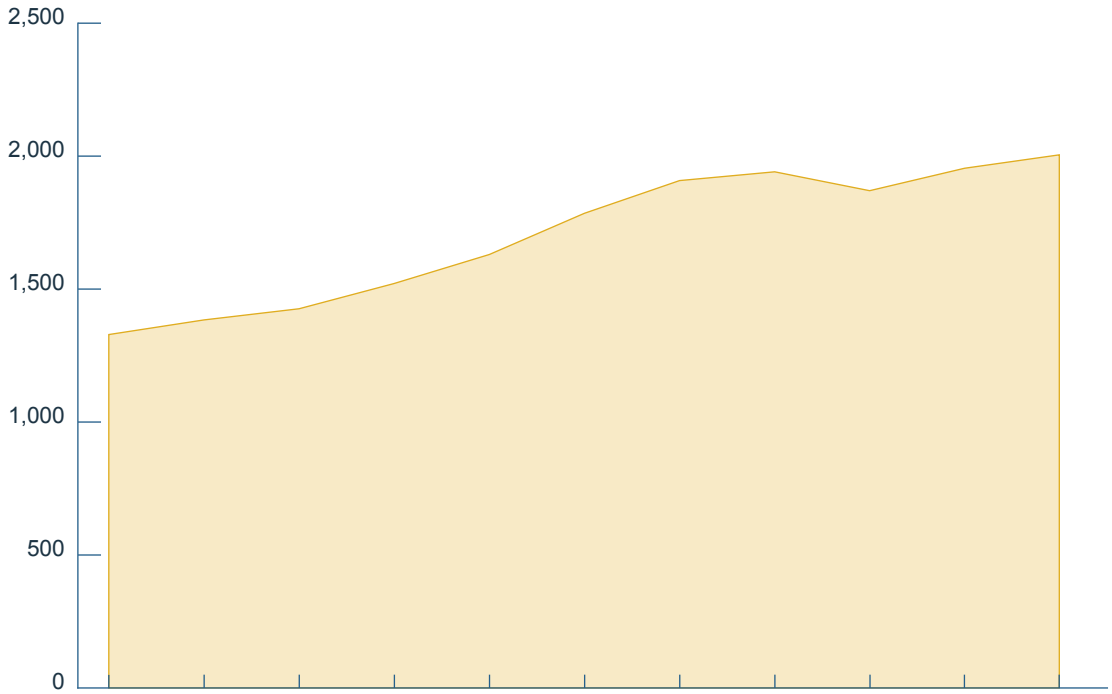
In 2005, the sector of undertakings for collective investment (UCIs) saw a substantial growth in the net assets managed. In only twelve months, net assets managed rose from EUR 1,106.2 billion to EUR 1,525.2 billion as at 31 December 2005, i.e. a 37.9% growth. The number of UCIs registered on the official list increased by 4.7% with 2,060 UCIs at the end of 2005, against 1,968 UCIs at the end of the previous year.

Development in the number and net assets of UCIs

	Number of UCIs	Registrations on the list	With-drawals from the list	Net variation	In %	Net assets *(in bn EUR)*	Net issues *(in bn EUR)*	Variation in net assets *(in bn EUR)*	In %	Average net assets by UCI *(in bn EUR)*
1995	1,329	166	120	46	3.6	261.8	2.0	14.3	5.8	0.197
1996	1,384	182	127	55	4.1	308.6	22.5	46.8	17.9	0.223
1997	1,426	193	151	42	3.0	391.8	50.1	83.2	26.9	0.275
1998	1,521	234	139	95	6.7	486.8	84.1	95.0	24.3	0.320
1999	1,630	265	156	109	7.2	734.5	140.1	247.7	50.9	0.451
2000	1,785	278	123	155	9.5	874.6	168.1	140.1	19.1	0.490
2001	1,908	299	176	123	6.9	928.4	121.7	53.8	6.2	0.487
2002	1,941	222	189	33	1.7	844.5	57.3	-83.9	-9.0	0.435
2003	1,870	175	246	-71	-3.7	953.3	82.6	108.8	12.9	0.510
2004	1,968	202	104	98	5.2	1,106.2	113.7	152.9	16.0	0.562
2005	2,060	266	174	92	4.7	1,525.2	236.3	419.0	37.9	0.740

The number of UCIs registered on the official list increased by 92 entities. On the one hand, the number of newly registered UCIs rose with 266 UCIs. On the other hand, the number of withdrawals amounts to 174 entities. Among these 174 UCIs, 132 have been liquidated and 42 withdrew following a takeover by merger.

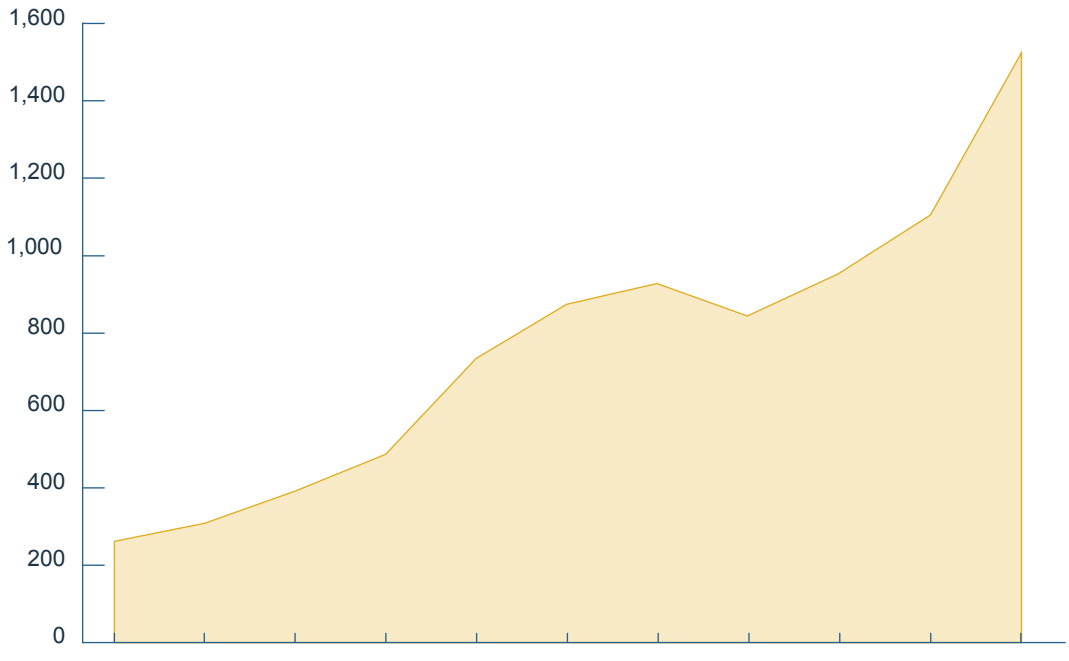
Development in the number of UCIs



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Entities	1,329	1,384	1,426	1,521	1,630	1,785	1,908	1,941	1,870	1,968	2,060

The performances of the main financial stock exchanges and the regular inflow of new capital, amounting to EUR 236.3 billion in 2005, made total net assets of Luxembourg UCIs climb by EUR 419 billion in one year to the new record high of EUR 1,525.2 billion as at 31 December 2005.

Development in the net assets of UCIs (in billion EUR)



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Net assets	261.8	308.6	391.8	486.8	734.5	874.6	928.4	844.5	953.3	1,106.2	1,525.2

The breakdown of UCIs across *fonds communs de placement* (FCP), *sociétés d'investissement à capital variable* (SICAV) and *sociétés d'investissement à capital fixe* (SICAF) reveals that at 31 December 2005, FCPs were still the most prevalent form with 1,099 entities out of a total of 2,060 UCIs in operation, against 946 entities operating as SICAVs and 15 as SICAFs.

Breakdown of UCIs by legal status

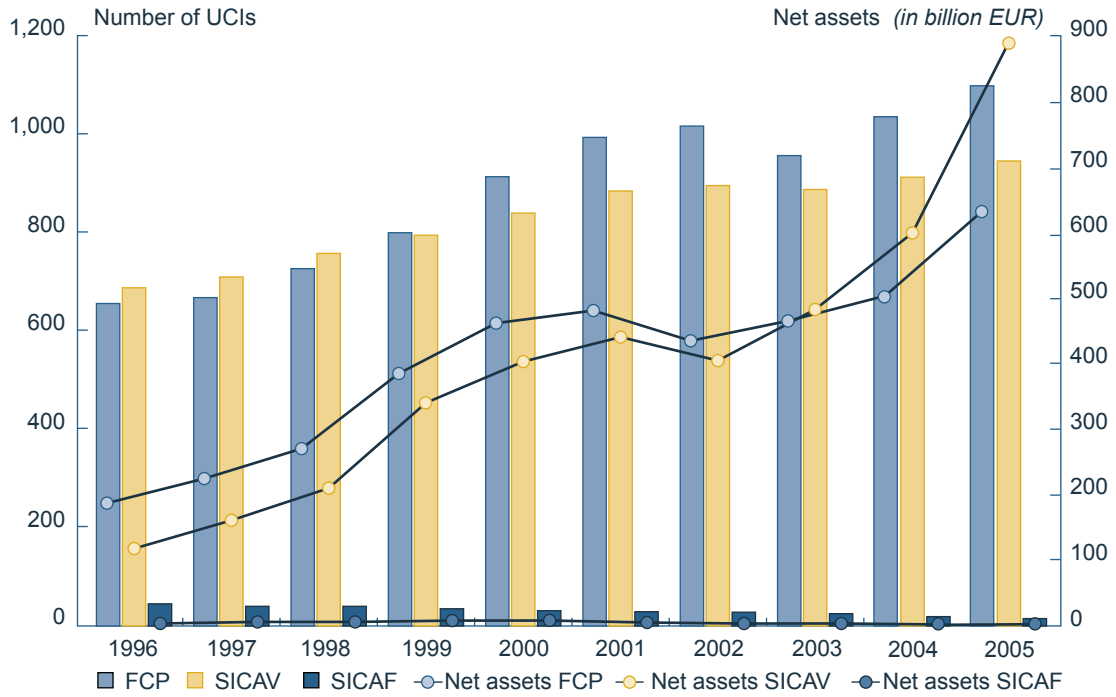
in billion EUR

	FCPs		SICAVs		SICAFs		Total	
	Number	Net assets	Number	Net assets	Number	Net assets	Number	Net assets
1995	622	164.7	662	94.2	45	2.9	1,329	261.8
1996	656	187.4	688	117.9	40	3.3	1,384	308.6
1997	668	225.0	718	161.1	40	5.7	1,426	391.8
1998	727	270.8	758	210.3	36	5.7	1,521	486.8
1999	800	385.8	795	341.0	35	7.7	1,630	734.5
2000	914	462.8	840	404.0	31	7.8	1,785	874.6
2001	994	482.1	885	441.5	29	4.8	1,908	928.4
2002	1,017	435.8	896	405.5	28	3.2	1,941	844.5
2003	957	466.2	888	483.8	25	3.3	1,870	953.3
2004	1,036	504.0	913	600.3	19	1.9	1,968	1,106.2
2005	1,099	624.3	946	898.2	15	2.7	2,060	1,525.2

FCPs' net assets increased to EUR 624.3 billion, representing 40.9% of the total net assets of UCIs at the end of 2005. SICAVs' net assets totalled EUR 898.2 billion at the end of the year, representing 58.9% of the UCIs total net assets. SICAFs' net assets amounted to EUR 2.7 billion at the same date.

SICAVs thus increased their preponderance in terms of net assets with a 49.6% growth rate.

Breakdown of UCIs by legal status



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

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

in billion EUR

	Part I		Part II		Institutional UCIs	
	Number	Net assets	Number	Net assets	Number	Net assets
1995	952	171.9	335	88.1	42	1.8
1996	988	209.2	353	96.2	43	3.2
1997	980	280.4	367	102.2	79	9.2
1998	1,008	360.2	400	111.0	113	15.6
1999	1,048	564.2	450	137.0	132	33.3
2000	1,119	682.0	513	153.3	153	39.3
2001	1,196	708.6	577	178.2	135	41.6
2002	1,206	628.9	602	171.6	133	44.0
2003	1,149	741.1	583	169.3	138	42.9
2004	1,303	929.3	516	131.2	149	45.7
2005	1,358	1,260.0	524	204.0	178	61.2

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

The law of 20 December 2002 as amended provides for an extension of the investment policy of UCITS under Part I of the law. It allows, among other things and under certain conditions, investments in money market instruments, in parts of UCITS and/or other UCIs, in deposits and derivatives. In this context, 36 UCIs under Part II of the older law benefited from these provisions to change into a UCI under Part I of the new law.

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

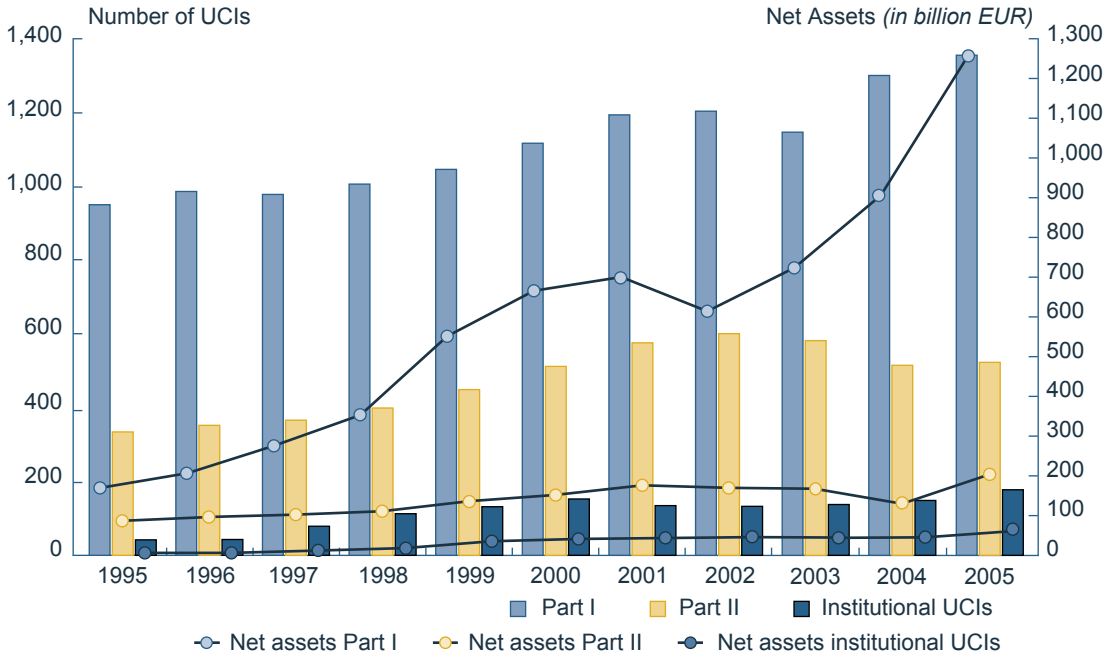
Situation as at 31 December 2005	Number of UCIs				Net assets *(in billion EUR)*			
	FCPs	SICAVs	Others	Total	FCPs	SICAVs	Others	Total
Part I (law 1988)	209	261	3	473	112.264	111.458	0.135	223.857
Part I (law 2002)	605	280	0	885	383.580	652.573	0.000	1,036.153
Sub-total Part I	**814**	**541**	**3**	**1,358**	**495.844**	**764.031**	**0.135**	**1,260.010**
Part II (law 2002)	173	340	11	524	86.492	115.045	2.460	203.997
Institutional UCIs	112	65	1	178	42.011	19.130	0.060	61.201
Total	**1,099**	**946**	**15**	**2,060**	**624.347**	**898.206**	**2.655**	**1,525.208**

65.9% of the UCIs registered on the official list as at 31 December 2005 were UCITS governed by part I of the above-mentioned laws and 25.5% were other UCIs governed by Part II (non-coordinated UCIs). Institutional UCIs represented 8.6% of the 2,060 Luxembourg UCIs. UCIs under Part I, those under Part II and institutional UCIs record 82.6%, 13.4% and 4.0% respectively of net assets.

As far as Part I of the laws of 1988 and 2002 are concerned, the number of UCIs rose by 4.2% as compared to the end of the previous year and net assets recorded a considerable increase by 35.6%. The number and net assets of UCIs under Part II increased by 1.6% and 55.5% respectively.

As regards institutional funds, their number increased by 29 entities (+19.5%) and their net assets by 33.8%. It should be borne in mind in this context that both the amended law of 30 March 1988 and the amended law of 20 December 2002 allow the creation of subfunds and classes of units reserved to one or several institutional investors with respect to the UCIs under these laws. However, the current reporting of UCIs does not allow to discern the institutional investors in Parts I and II of the laws of 1988 and 2002.

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



The following table compares the development in 2005 of the number of UCIs and net assets according both to legal status and to the scope of the laws.

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

	2004				2005				Variation 2004/2005			
Number of UCIs	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total
Part I	751	548	4	1,303	814	541	3	1,358	8.39%	-1.28%	-25.00%	4.22%
Part II	198	305	13	516	173	340	11	524	-12.63%	11.48%	-15.38%	1.55%
Institutional UCIs	87	60	2	149	112	65	1	178	28.74%	8.33%	-50.00%	19.46%
Total	**1,036**	**913**	**19**	**1,968**	**1,099**	**946**	**15**	**2,060**	**6.08%**	**3.61%**	**-21.05%**	**4.67%**
Net assets *(in billion EUR)*	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total	FCPs	SICAVs	SICAFs	Total
Part I	401.969	527.126	0.221	929.316	495.844	764.031	0.135	1,260.010	23.35%	44.94%	-38.91%	35.58%
Part II	71.864	57.670	1.619	131.153	86.492	115.045	2.460	203.997	20.36%	99.49%	51.95%	55.54%
Institutional UCIs	30.124	15.520	0.109	45.753	42.011	19.130	0.060	61.201	39.46%	23.26%	-44.95%	33.76%
Total	**503.957**	**600.316**	**1.949**	**1,106.222**	**624.347**	**898.206**	**2.655**	**1,525.208**	**23.89%**	**49.62%**	**36.22%**	**37.88%**

In 2005, UCIs under part I of the law of 1988 or the law of 2002 (Community UCIs), and mainly UCIs in the form of SICAV, recorded 69.5% of net issues. UCIs under Part II showed net issues totalling EUR 65.0 billion, while net issues of institutional UCIs amounted to EUR 7.0 billion.

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

(in million EUR)	FCPs	SICAVs	SICAFs	Total
Part I	36,950	127,392	-118	164,224
Part II	16,429	48,203	417	65,049
Institutional UCIs	7,118	-74	-39	7,005
Total	**60,497**	**175,521**	**260**	**236,278**

1.2. Developments in umbrella funds

In 2005, the number of umbrella funds increased by 72 entities. This structure, which brings together under the same legal entity several subfunds centered on investment in a given currency, geographical region or economic sector, enables investors to re-focus their investment without having to switch to another investment fund. The promoters may thus offer, within a single entity, a whole range of subfunds investing in equities, debt securities, money market securities or even sometimes warrants, thereby enabling the investor to benefit from the best available returns. The structure of umbrella funds also enables promoters to create new subfunds and to manage a collective pool of assets which were normally not large enough for a separate management in a traditionally structured fund.

Umbrella funds

	Total number of UCIs	Number of umbrella funds	As % of total	Number of subfunds	Average number of subfunds per umbrella fund	Number of entities	Net assets of umbrella funds *(in bn EUR)*	As % of total	Net assets per subfund *(in bn EUR)*
1995	1,329	573	43.1	2,841	4.96	3,597	174.4	66.6	0.061
1996	1,384	632	45.7	3,187	5.04	3,939	222.0	71.9	0.070
1997	1,426	711	49.9	3,903	5.49	4,618	296.1	75.6	0.076
1998	1,521	797	52.4	4,454	5.59	5,178	384.3	78.9	0.086
1999	1,630	913	56.0	5,119	5.61	5,836	604.9	82.4	0.118
2000	1,785	1,028	57.6	6,238	6.07	6,995	739.1	84.5	0.118
2001	1,908	1,129	59.2	6,740	5.97	7,519	797.8	85.9	0.118
2002	1,941	1,190	61.3	7,055	5.93	7,806	724.8	85.9	0.103
2003	1,870	1,180	63.1	6,819	5.78	7,509	820.9	86.1	0.120
2004	1,968	1,226	62.3	7,134	5.82	7,876	962.8	87.0	0.135
2005	2,060	1,298	63.0	7,735	5.96	8,497	1,341.4	87.9	0.173

The development of umbrella funds continued both as regards their number and their net assets managed. The proportion of umbrella funds compared to the total number of UCIs rose from 62.3% to 63.0%. An increase from 87.0% to 87.9% was recorded in terms of total net assets managed.

As at 31 December 2005, 1,298 UCIs out of 2,060 had adopted a multiple subfund structure (+5.9%), while the number of traditionally structured UCIs grew from 742 to 762 (+2.7%). Moreover, the number of active subfunds rose from 7,134 to 7,735, which represents an 8.4% growth as compared to the year 2004. Just as the number of UCIs registered on the official list as at 31 December 2005, the number of active economic entities reached a record high with 8,497 entities (+7.9%) at the same date.

The average number of subfunds per umbrella fund increased slightly and reached 5.96 as at 31 December 2005. However, this figure conceals a wide dispersion between the smallest and largest UCIs.

As at 31 December 2005, umbrella fund net assets totalled EUR 1,341.4 billion, i.e. a substantial increase of 39.3% compared with the previous year-end. Net assets of traditionally structured UCIs have recorded a 28.2% increase over the same period. Their average net assets per UCI amounted to EUR 241 million and thereby exceeded the net assets of umbrella funds (EUR 173 million per subfund).

1.3. Valuation currencies used

As regards the valuation currencies used, the proportions remain the same as in 2004. Most entities (5,684 out of a total of 8,497) are thus denominated in euros, followed by those in US dollars (1,932) and those in Swiss francs (256). In terms of net assets, the entities denominated in euros encompass EUR 974.658 billion of the total EUR 1,525.208 billion, ahead of entities denominated in US dollars (EUR 390.326 billion) and in Swiss francs (EUR 56.820 billion).

1.4. UCIs' investment policy

Net assets of UCIs investing in fixed-income transferable securities increased by 22.51% as compared to the end of 2004, those of UCIs investing in variable-yield transferable securities by 55.32%, those of UCIs investing in diversified securities by 47.32%, those of UCIs investing in funds of funds by 53.12%, those of UCIs investing in cash by 11.08%, those of UCIs investing in real estate by 68.95% and those of UCIs investing in futures, options and warrants by 60.67%.

It should be noted that UCIs investing in other assets include notably UCIs investing in venture capital and UCIs investing in insurance contracts or in debts.

As at 31 December 2005, net assets of UCIs investing in fixed-income transferable securities and UCIs investing in variable-yield transferable securities represented 44.8% and 37.8% of total net assets respectively.

Net assets and entities of UCIs according to their investment policy

	2004		2005		Variation	
	Number of entities	Net assets *(in bn EUR)*	Number of entities	Net assets *(in bn EUR)*	Number of entities	Net assets *(in bn EUR)*
Fixed-income transferable securities	2,619	557.880	2,815	683.447 [1]	7.48%	22.51%
Variable-yield transferable securities	2,907	371.087	2,965	576.361 [2]	2.00%	55.32%
Mixed transferable securities	933	77.357	1,100	113.963 [3]	17.90%	47.32%
Fund of funds	1,212	85.023	1,385	130.184	14.27%	53.12%
Cash	114	6.994	97	7.769	-14.91%	11.08%
Real estate	22	3.130	41	5.288	86.36%	68.95%
Futures, options, warrants	65	4.605	84	7.399	29.23%	60.67%
Others	4	0.146	10	0.797 [4]	150.00%	445.89%
Total	**7,876**	**1,106.222**	**8,497**	**1,525.208**	**7.88%**	**37.88%**

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

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

2- Variable-yield transferable securities (equities)

3- Mixed transferable securities

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

5- Others

[1] Including EUR 194.798 billion in money market instruments and other short-term securities.

[2] Including EUR 2.537 billion in non-listed securities and EUR 0.462 billion in venture capital.

[3] Including EUR 0.058 billion in non-listed securities and EUR 0.279 billion in venture capital.

[4] Including EUR 0.029 billion in venture capital.

in million EUR

	1st quarter 2005			2nd quarter 2005			3rd quarter 2005			4th quarter 2005			Totals		
Pol.	subscr.	red.	n.iss.	subscr.	red.	n.iss.	subscr.	red.	n.iss.	subscr.	red.	n.iss.	subscr.	red.	n.iss.
1	66,543	41,435	25,108	65,507	54,560	10,947	74,076	55,788	18,288	74,107	58,608	15,499	280,233	210,391	69,842
2	79,001	58,898	20,103	64,452	59,179	5,273	94,035	72,069	21,966	96,950	66,617	30,333	334,438	256,763	77,675
3	12,396	7,817	4,579	13,101	8,147	4,954	15,424	7,958	7,466	15,427	11,341	4,086	56,348	35,263	21,085
4	230,616	230,495	121	205,740	205,985	-245	189,967	184,005	5,962	258,599	261,359	-2,760	884,922	881,844	3,078
5	21,157	9,748	11,409	25,362	9,519	15,843	35,077	12,857	22,220	32,234	17,108	15,126	113,830	49,232	64,598
Total	**409,713**	**348,393**	**61,320**	**374,162**	**337,390**	**36,772**	**408,579**	**332,677**	**75,902**	**477,317**	**415,033**	**62,284**	**1,669,771**	**1,433,493**	**236,278**

In 2005, net issues have recorded a substantial increase as compared to the net issues in 2004 (+107.75%). Considerable net issues were mainly recorded during the first, third and fourth quarter of 2005.

The most interest was registered for UCIs investing in variable-yield transferable securities, followed by UCIs investing in fixed-income transferable securities.

UCIs' investment policy

Situation as at 31 December 2005	Number of entities	Net assets *(in bn EUR)*	Net assets *(in %)*
UCITS subject to Part I			
Fixed-income transferable securities[5]	2,230	601.909	39.6
Variable-yield transferable securities	2,663	538.768	35.4
Mixed transferable securities	893	96.441	6.4
Fund of Funds	335	22.049	1.4
Cash	3	0.527	0.0
Futures and/or options	9	0.316	0.0
UCITS subject to Part II[6]			
Fixed-income transferable securities[7]	343	61.372	4.0
Variable-yield transferable securities	178	19.173	1.3
Mixed transferable securities	150	11.718	0.8
Fund of Funds	880	90.542	5.9
Cash	94	7.243	0.5
UCITS subject to Part II[8]			
Non-listed transferable securities	17	2.104	0.1
Venture capital	12	0.591	0.0
Other UCITS subject to Part II			
Real estate	12	3.730	0.2
Futures, options, warrants	72	6.777	0.4
Others	7	0.747	0.0

[5] Including EUR 164.512 billion in money market instruments and other short-term securities (284 entities).

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

[7] Including EUR 28.816 billion in money market instruments and other short-term securities (115 entities).

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

Situation as at 31 December 2005	Number of entities	Net assets *(in bn EUR)*	Net assets *(in %)*
Institutional UCIs			
Fixed-income transferable securities[9]	242	20.167	1.3
Variable-yield transferable securities	92	15.421	1.0
Mixed transferable securities	47	5.466	0.4
Non-listed transferable securities	8	0.491	0.0
Fund of Funds	170	17.593	1.2
Venture capital	6	0.179	0.0
Real estate	29	1.557	0.1
Futures and/or options	3	0.306	0.0
Others	2	0.021	0.0
TOTAL	**8,497**	**1,525.208**	**100.0**

1.5. Development in guarantee-type UCIs

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

In the course of 2005, the number of guarantee-type UCIs rose from 90 to 104 and the number of entities increased from 207 to 248. In terms of entities, the rise is attributable to the launch of 64 new entities while the guarantee given matured or has not been extended for 23 entities.

As at 31 December 2005, the 248 entities comprise 15 entities guaranteeing investors only a proportion of the invested capital, 101 entities guaranteeing repayment in full of the invested capital (money-back guarantee) and 132 entities which offer their investors a surplus as compared to the initial subscription price.

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

Net assets of guarantee-type UCIs increased by EUR 3.29 billion to EUR 24.69 billion in 2005, i.e. an increase of 15.3%. It is also worth noting that guarantee-type UCIs set up by the German promoters alone account for 88.4% of the total net assets of guarantee-type UCIs.

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

Development in guarantee-type UCIs

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

1.6. Promoters of Luxembourg UCIs

The breakdown of Luxembourg UCIs according to geographic origin of their promoters highlights the multitude of countries represented in the financial centre. Promoters of Luxembourg UCIs spread over 43 different countries.

The main countries promoting UCIs in Luxembourg remain, as in the previous years, Switzerland, the United States, Germany, Italy and Belgium. The proportions remained almost the same compared with the previous years, as regards net assets as well as the number of UCIs and the number of entities.

Origin of promoters of Luxembourg UCIs

Situation as at 31 December 2005	Net assets *(in billion EUR)*	In %	Number of UCIs	In %	Number of entities	In %
Switzerland	298.061	19.5%	274	13.3%	1,565	18.4%
United States	288.178	18.9%	117	5.7%	766	9.0%
Germany	257.118	16.9%	808	39.2%	1,438	17.0%
Italy	163.132	10.7%	74	3.6%	679	8.0%
Belgium	137.536	9.0%	146	7.1%	1,293	15.2%
Great Britain	135.929	8.9%	105	5.1%	588	6.9%
France	97.353	6.4%	169	8.2%	775	9.1%
Netherlands	39.774	2.6%	46	2.2%	290	3.4%
Japan	28.107	1.8%	66	3.2%	163	1.9%
Sweden	24.365	1.6%	41	2.0%	165	2.0%
Others	55.655	3.7%	214	10.4%	775	9.1%
Total	**1,525.208**	**100.0%**	**2,060**	**100.0%**	**8,497**	**100.0%**

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

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

Until 31 December 2005, the CSSF had delivered a total of 3,622 Directive compliance certificates for registered UCITS, representing an increase of 301 compared with 31 December 2004, and an increase of 768 compared with 31 December 2003. The certificates issued by the CSSF were delivered for 1,209 different UCIs (2004: 1,165 UCIs, 2003: 1,020 UCIs), which means that 89% of UCIs under Part I of the laws of 1988 and 2002 had requested at least one certificate.

The main countries concerned, in decreasing order, are: Germany (929 certificates), Austria (447), Italy (340), France (304), Spain (280), Belgium (216), Sweden (168), the Netherlands (159) and Great Britain (157).

As regards foreign UCITS marketed in Luxembourg at the end of 2005, 141 foreign EU UCITS (63 from Germany, 33 from Ireland, 28 from France, 11 from Belgium and 6 from Great Britain) took advantage of the marketing facilities provided by the Directive to offer their units/shares in Luxembourg.

Finally, at 31 December 2005, 15 foreign UCIs (9 from Germany and 6 from Switzerland) have been authorised to market their units/shares in Luxembourg in accordance with article 70 of the law of 30 March 1988 as amended and article 76 of the law of 20 December 2002 as amended respectively.

Marketing of foreign UCIs in Luxembourg

	2002	2003	2004	2005
Community UCITS				
Country of origin				
Germany	93	70	69	63
France	26	26	27	28
Ireland	19	22	31	33
Belgium	9	10	10	11
Great Britain	2	3	6	6
Denmark	1	-	-	-
Sub-total	**150**	**131**	**143**	**141**
Other foreign UCIs				
Country of origin				
Germany	13	16	9	9
Switzerland	16	15	9	6
Belgium	1	2	1	-
Sub-total	**30**	**33**	**19**	**15**
Total	**180**	**164**	**162**	**156**

2. NEWLY CREATED ENTITIES APPROVED IN 2005

2.1. General data

The number of newly approved entities[10] has been continuously rising since 2003. During 2005, 1,806 new entities have been granted approval, i.e. 372 more than in 2004 and even 720 entities more than in 2003. This positive development is most probably attributable to the favourable stock market situation. In relative terms, this accounts for a growth of 25.9% as compared to 2004, of 66.3% as compared to 2003 and of 35.0% as compared to 2002.

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

Although the number of approved entities has increased that much, only 1,022 of the 1,806 entities approved, i.e. 56.6%, have been launched in the same year. This figure does not reach the average of the previous years, but it should be noted that more than a third (34.8%) of the 1,806 newly approved entities have received their approval in the last quarter of the year. Given that the lapse between the authorisation of a new entity and its effective launch can be explained, *inter alia*, by the period of time promoters have to wait between the notification to the host country's authority pursuant to European regulations and the effective marketing of units/shares in the host country, a high number of approved entities is expected to be launched during the first months of 2006.

2.2. Analysis of the investment policy of the new entities

Most of the entities approved in 2005 envisage to invest in fixed-income transferable securities. With close to a third, i.e. 569 of the 1,806 entities, this proportion has however slightly decreased compared to 2004.

The proportion of entities that chose to invest in diversified securities has increased and accounts for 5.42%.

The number of entities whose investment policy provides for investment in variable-yield securities has not recorded any change in relative terms and represents almost a quarter of the total number of entities approved in 2005. On the other hand, the proportion of newly approved entities investing in other UCIs decreased as compared to 2004.

In 2005, only 32 of the 1,806 newly approved entities (1.8%) chose to invest in cash, money market instruments and other short-term securities in order to benefit from the reduced subscription tax.

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

Investment policy	2004		2005	
	Number of entities	As % of total	Number of entities	As % of total
Fixed-income transferable securities (excluding money market instruments and other short-term securities)	497	34.65%	569	31.51%
Variable-yield transferable securities	358	24.96%	436	24.14%
Mixed transferable securities	205	14.29%	356	19.71%
Fund of Funds	263	18.34%	295	16.34%
Cash,money market instruments and other short-term securities	48	3.35%	88	4.87%
Futures, options, warrants	52	3.63%	28	1.55%
Others	11	0.78%	34	1.88%
Total	**1,434**	**100.00%**	**1,806**	**100.00%**

2.3. Origin of promoters of new entities

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

- As in 2003 and 2004, Belgian, Swiss and German promoters share the first ranks. The 4% increase of Swiss promoters should nevertheless be underlined.
- American promoters strengthened their presence in the Luxembourg market, their share in the newly approved entities in 2005 having doubled to nearly 12%.
- The number of newly approved entities whose promoters are of French or British origin has slightly decreased compared to 2004.

Origin of promoters of new entities

	2002		2003		2004		2005	
	Entities	In %	Entities	In %	Entities	In %	Entities	In %
Belgium	197	14.72%	192	17.68%	306	21.34%	362	20.04%
Switzerland	289	21.60%	176	16.21%	223	15.55%	353	19.55%
Germany	227	16.97%	160	14.73%	231	16.11%	294	16.28%
United States	99	7.40%	76	7.00%	78	5.44%	213	11.79%
France	82	6.13%	99	9.12%	170	11.85%	156	8.64%
Great Britain	122	9.12%	86	7.92%	108	7.53%	110	6.09%
Italy	97	7.25%	127	11.69%	83	5.79%	108	5.98%
Netherlands	28	2.09%	36	3.31%	70	4.88%	76	4.21%

3. CLOSED DOWN ENTITIES IN 2005

3.1. General data

The number of entities closed down in 2005 has almost stagnated as compared to the previous year. Indeed, the number has increased by only four entities (+0.58%). The number of liquidated entities and matured entities has grown by 8.40% and 9.38% respectively. The number of merged entities has however decreased by 14.77%.

	1999	2000	2001	2002	2003	2004	2005
Liquidated entities	221	254	354	490	643	393	426
Matured entities	65	47	47	49	47	64	70
Merged entities	429	150	150	326	488	237	202
Total	**715**	**451**	**551**	**865**	**1,178**	**694**	**698**

3.2. Investment policy of the closed down entities

The distribution by investment policy of the entities closed down in 2005 has not considerably changed as compared to 2004. Most of the closed down entities had invested in variable-yield transferable securities, even if, in relative terms, this category has recorded a decrease of almost 4% compared to 2004.

Among the 268 closed down entities whose investment policy provided for investment in variable-yield transferable securities, 151 have been liquidated, 110 merged and 7 matured. As regards the category of entities investing in fixed-income transferable securities, 102 entities have been liquidated, 36 matured and 34 merged. As regards the category of entities investing in mixed transferable securities, 80 entities have been closed down, 6 matured and 17 have been merged.

Investment policy	2004		2005	
	Number of entities	As % of total	Number of entities	As % of total
Fixed-income transferable securities (excluding money market instruments and other short-term securities)	168	24.20%	172	24.63%
Variable-yield transferable securities	293	42.22%	268	38.40%
Mixed transferable securities	85	12.25%	103	14.76%
Fund of Funds	97	13.98%	101	14.47%
Cash, money market instruments and other short-term securities	46	6.63%	45	6.45%
Futures, options, warrants	5	0.72%	9	1.29%
Total	**694**	**100.00%**	**698**	**100.00%**

4. DEVELOPMENTS REGARDING UCIS INVESTING PRINCIPALLY IN OTHER UCIS AND UCIS THAT ADOPT ALTERNATIVE INVESTMENT STRATEGIES

4.1. General data

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

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

As UCIs under Part I of the law of 30 March 1988 as amended may invest only up to 5% of their net assets in other open-end UCIs, no "fund of funds" UCI can be subject to this law.

Analyses of the trends of the previous years showed that the number of entities investing mainly in other UCIs has substantially grown between 1999 (213 entities) and 2004 (1,198 entities). This upward trend continued in 2005, the number of entities growing by 179 from 1,198 entities as at 31 December 2004 to 1,377 entities as at 31 December 2005. The annual growth rate in terms of entities stood at 14.94%.

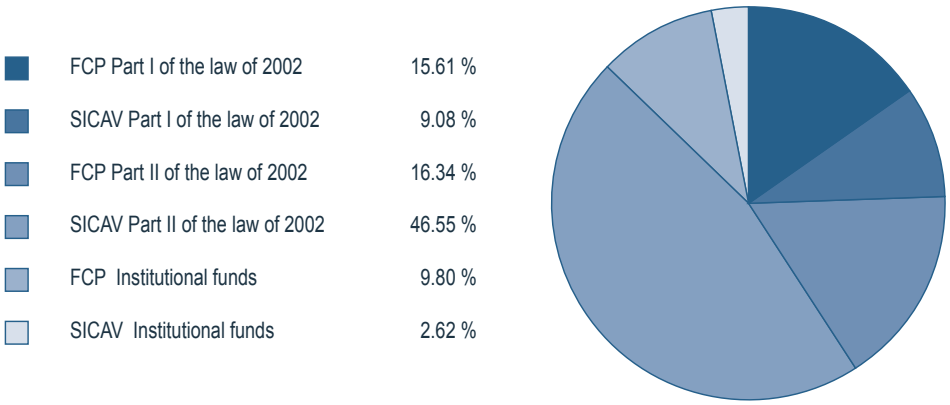
It is worth noting that the share of net assets of entities investing mainly in UCIs known as "funds of funds", compared with the net assets of all UCIs, rose in 2005 and reached 8.76% at the year-end, against 7.68% at the end of 2004. Their proportion had only reached 1.80% in December 1998.

4.2. Legal status of "funds of funds"

As at 31 December 2005, 340 of the 1,377 "funds of funds" entities were governed by Part I and 866 entities by Part II of the law of 20 December 2002 as amended. 171 entities are governed by the law of 19 July 1991.

An additional distinction according to the legal status of the UCI in question, *fonds commun de placement* (FCP) or *société d'investissement à capital variable* (SICAV), is shown in the following graph.

Breakdown of "funds of funds" according to Parts and legal status (in terms of entities)

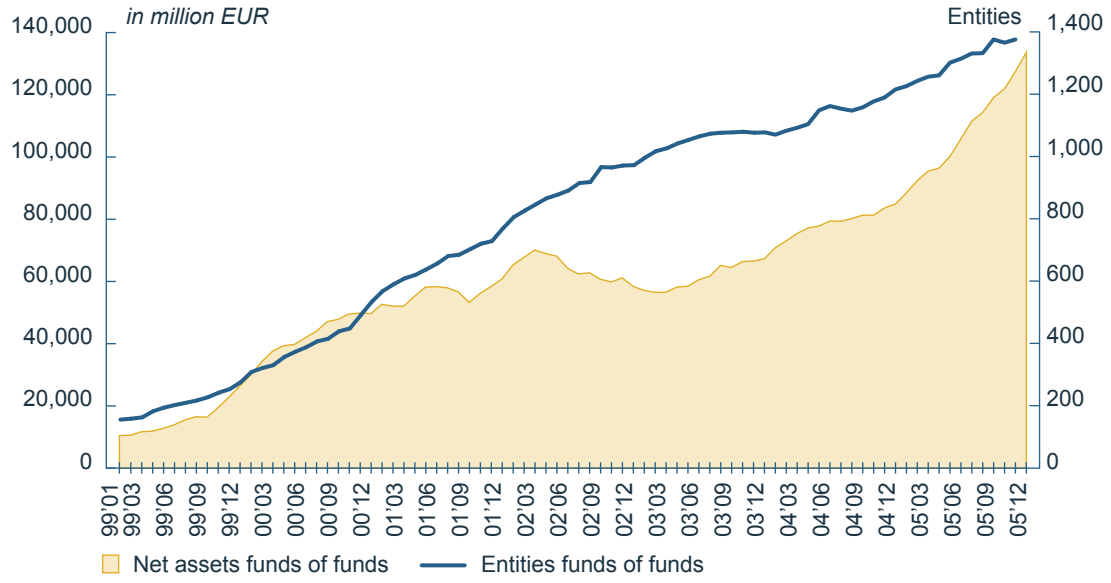


4.3. Development in the number of entities and net assets of "funds of funds"

The number of "funds of funds" entities rose by 14.94% in the course of 2005. From January to October 2005, the number increased by 179 entities. The last two months of 2005 were marked by a short stagnation in terms of entities. In December 2005, a record high since the first analysis in December 1998 was reached with 1,377 entities.

Net assets also achieved a new record at the end of 2005. Thus, "funds of funds" net assets grew in relative terms by 57.61% and in absolute terms by EUR 48.961 billion, totalling EUR 133.946 billion as at 31 December 2005.

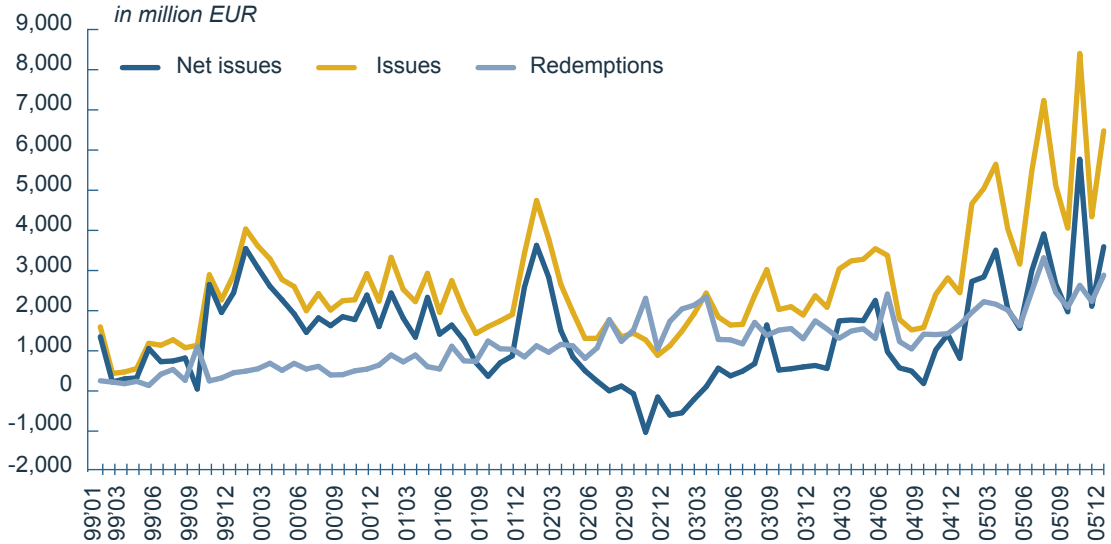
Development in the number of entities and net assets of "funds of funds"



4.4. Development in net issues of "funds of funds"

As far as inflow of new capital for "funds of funds" is concerned, net issues totalled EUR 35.554 billion in 2005. Net issues accounted thus for 72.62% of the total growth of "funds of funds" net assets. Net issues have reached a peak in October 2005 totalling a record EUR 5.769 billion in a single month.

Development in issues, redemptions and net issues of "funds of funds"

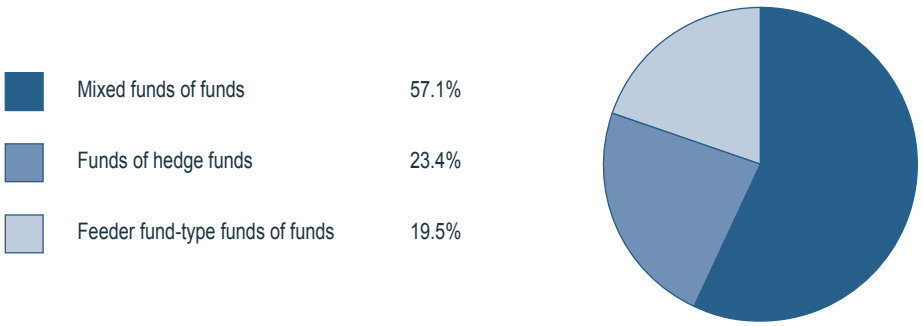


4.5. Classification of "funds of funds" according to their specific investment policy

The "funds of funds" can be classified according to three specific investment policies:

1) those investing in other UCIs by following a risk spreading policy ("mixed funds of funds");
2) those investing in only one or a very limited number of UCIs (maximum of 3) ("feeder fund-type funds of funds");
3) those investing in funds that invest in hedge funds ("funds of hedge funds").

Breakdown of net assets of "funds of funds" according to specific investment policy

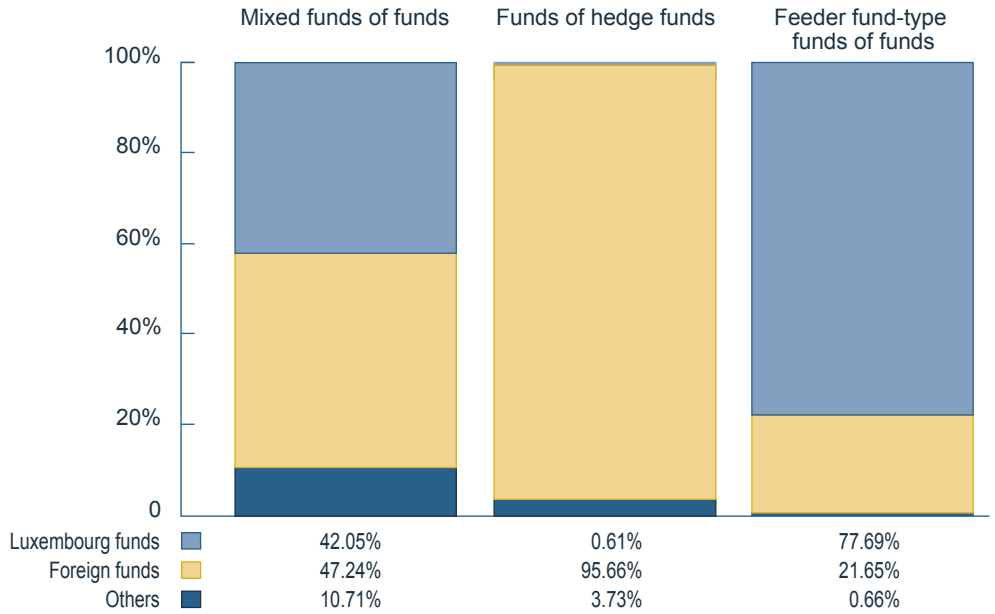


The category "mixed funds of funds" was in the lead in terms of net assets with 57.1%. "Funds of hedge funds" accounted for 23.4% at the end of 2005. The proportion of the "feeder fund-type funds of funds" increased from 14.5% in 2004 to 19.5% in December 2005.

4.6. Breakdown of net assets of "funds of funds" according to nationality of UCIs acquired and to specific investment policy

As at 31 December 2005, UCIs of the type "mixed funds of funds" invested 42.05% of their net assets in Luxembourg UCIs. 77.69% of the net assets of "feeder fund-type funds of funds" have been invested in Luxembourg UCIs. On the other hand, "funds of hedge funds" have invested 95.66% of their assets in foreign UCIs.

Breakdown of net assets of "funds of funds" according to specific investment policy and investment product



4.7. UCIs adopting alternative investment strategies

4.7.1. Regulatory framework

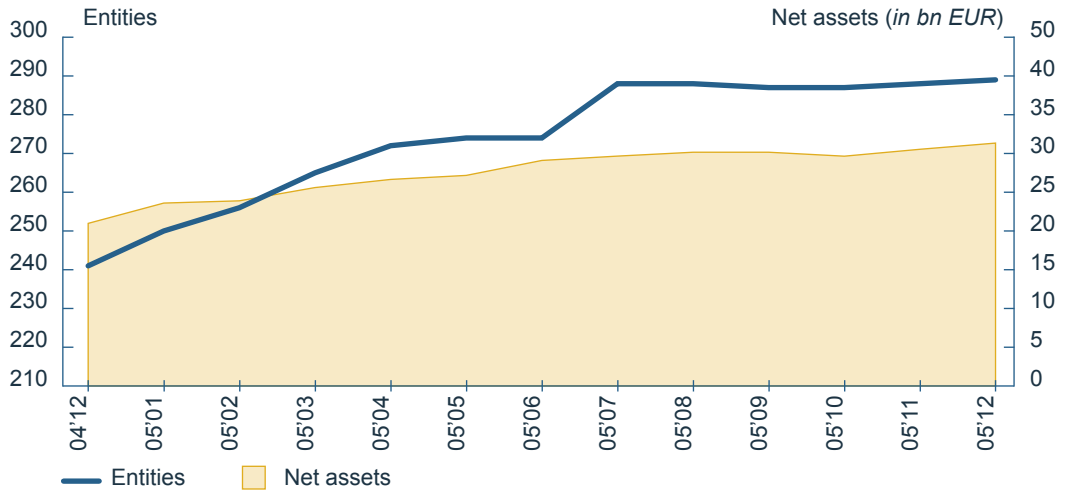
In 2002, circular CSSF 02/80 laid down a specific legal and regulatory framework for UCIs whose aim is to follow investment strategies similar to those pursued by hedge funds. Prior to this circular, investment restrictions that applied to UCIs that adopted alternative strategies had been assessed by the CSSF on a case-by-case basis.

With respect to the launch of hedge funds in Luxembourg, the CSSF adopts a flexible approach by accepting new strategies that have not been provided for by the current texts. The quality, repute and experience of the managers play a major role.

4.7.2. Key figures for 2005

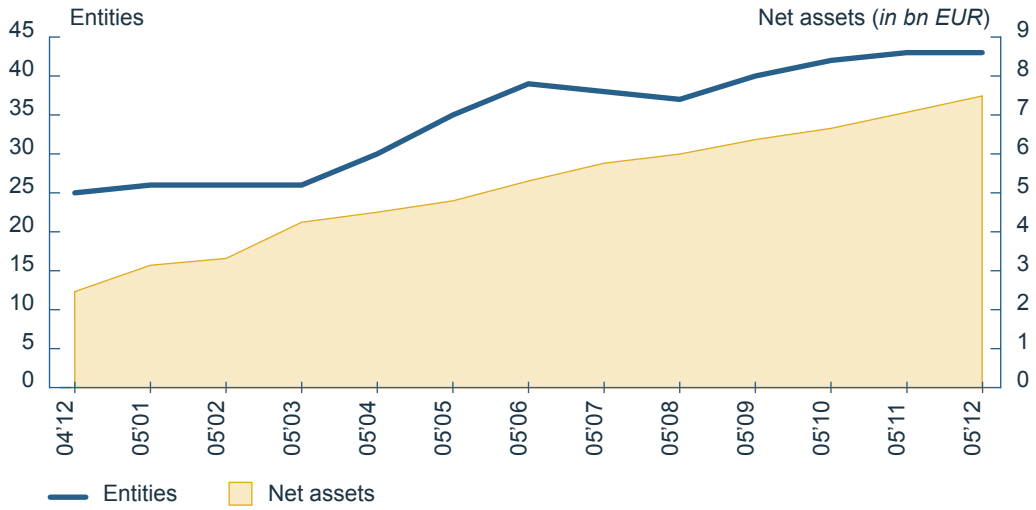
As at 31 December 2005, 249 fund of hedge funds entities are authorised in Luxembourg for a total of EUR 31.345 billion. Thus, the number of funds of hedge funds increased by 48 entities during 2005 and the total net asset rose by EUR 10.437 billion during the same period.

Development of UCIs of the type funds of hedge funds



The number of hedge funds set up under the scope of circular CSSF 02/80 increased by 18 entities to a total of 43 entities as at 31 December 2005. Net assets of these funds grew by EUR 5.024 billion during 2005.

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



5. MANAGEMENT COMPANIES

5.1. Management companies under the provisions of chapter 13 of the law of 20 December 2002 as amended concerning undertakings for collective investment

The year 2005 was characterised by the continuing adaptation of management companies under Chapter 14 of the law of 20 December 2002 as amended to the provisions of Directive 2001/107/EC amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses.

As at 31 December 2005, 72 management companies were registered on the official list of management companies complying with the provisions of Chapter 13 of the law of 20 December 2002 as amended, against 26 companies in the previous year.

Indeed, the number of applications for approval submitted to the CSSF during 2005 has considerably grown compared to 2004. One of the reasons explaining this growth is circular CSSF 05/186 concerning the guidelines of the Committee of European Securities Regulators (CESR) relating to the implementation of the transitional provisions of Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611/EEC (UCITS I). Indeed, one of CESR's guidelines provides that management companies that have launched UCITS III funds before 30 April 2006 must have received before 30 April 2006 at the latest the authorisation of the competent authority as management company complying with the requirements of the UCITS III Directive.

Moreover, it may be interesting to stress in this context that, as at 31 December 2005, twenty investment firms qualified as "self-managed investment firm" under the terms of the law of 20 December 2002 as amended.

During the year under review, 72 management companies have submitted their application for approval to the CSSF in order to become compliant with the provisions of Chapter 13 of the law of 20 December 2002 as amended. These 72 entities fall under the following categories:

- 50 management companies under Chapter 14 of the law of 20 December 2002 as amended have decided to extend their authorisation to a management company subject to Chapter 13 of this law;
- fourteen projects to set up a new management companies have been submitted, of which two have been given up during the process of scrutiny. Among the remaining twelve projects, four new promoters, which were not yet established in Luxembourg, will now set up in the financial centre by way of a management company;
- six institutions decided to give up their former status of professional of the financial sector (PFS) to take on that of management company governed by Chapter 13 of the above law;
- two companies that did not fall under the legislation relating to the financial sector chose to become a management company.

Until 31 December 2005, 47 new entities have been registered on the official list of management companies under Chapter 13 of the law and are able to benefit from the European passport by way of free establishment or free provision of services in another EU Member State. Among the other 25 files that are being scrutinised, a certain number of entities, whose application files have been analysed with a positive outcome, have opted to subject their statutes to the provisions of Chapter 13 of the law only in the first quarter of 2006.

Following the withdrawal of one entity, the number of management companies approved in accordance with Chapter 13 totals 72 entities as at 31 December 2005. Among these 72 entities, 59 are management companies whose approval covers exclusively collective management under the terms of article 77(2) and 13 are management companies whose approval also covers, in addition to collective management, one or several services referred to in article 77(3) of the law.

Geographical origin of the management companies

Country	2004	2005
Germany	8	15
Belgium	2	4
France	3	5
Denmark	1	2
Spain	-	1
United States	1	5
Great Britain	3	6
Italy	3	8
Luxembourg	-	1
Netherlands	2	3
Sweden	2	4
Switzerland	1	18
Total	**26**	**72**

In 2005, management companies with shareholders of German and Swiss origin respectively remain predominant on the Luxembourg market, followed by the entities from Italy and Great Britain.

Total staff of the management companies has risen substantially over a period of twelve months, from 511 persons as at 31 December 2004 to 1,572 persons at the end of December 2005. This development is mainly attributable to the high number of undertakings newly approved in 2005, including two entities with a high number of employees that have given up their PFS status to become a management company.

5.2. Overall situation

As at 31 December 2005, the Luxembourg financial centre counted 303 management companies among which 72 fulfilled the provisions of chapter 13 of the law of 2002.

144 of these 303 entities exclusively manage UCITS and 42 manage UCITS as well as other UCIs. 50 management companies manage exclusively UCIs subject to Part II of the law, 55 management companies manage only UCIs that are governed by the law of 19 July 1991 concerning undertakings for collective investment whose securities are not to be placed with the public and four management companies manage UCIs under Part II of the law of 2002 as well as UCIs under the law of 1991.

Distribution of the management companies (MCs)

	2004	2005
MCs subject to chapter 13 of the law of 2002	26	72
MCs subject to chapter 14 of the law of 2002	269	231
Total	**295**	**303**
of which		
MCs managing exclusively UCITS under Part I of the law	158	144
MCs managing UCITS under Part I of the law as well as other UCIs	39	42
MCs managing UCIs under Part II of the law	52	50
MCs managing UCIs under Part II of the law and UCIs under the law of 1991	4	4
MCs managing UCIs subject to the law of 1991	42	55
MCs set up to manage UCITS and/or UCIs	-	8

The following table breaks down the management companies that manage only one UCITS or UCI.

Management companies (MCs) managing only one UCITS/UCI

	2004	2005
MCs managing only one UCITS under Part I of the law	138	96
MCs managing only one UCI under Part II of the law	50	37
MCs managing only one UCI subject to the law of 1991	41	40

5.3. Cross-border expansion of management companies under chapter 13 of the law of 20 December 2002 as amended

Articles 88 and 89 of the law of 20 December 2002 as amended introduce a European passport for management companies complying with Directive 85/611/EEC as amended by Directive 2001/107/EC. These articles indeed provide that a management company is allowed to carry on in an EU Member State other than its home Member State, the activity for which it has been authorised in its home Member State, by means of a notification under the freedom of establishment or the freedom to provide services.

5.3.1. Freedom of establishment

In 2005, one management company incorporated under Luxembourg law set up a branch in another EU Member State under the freedom of establishment, namely Dexia Asset Management Luxembourg S.A., which set up in Sweden by means of a branch.

The management company Nordea Investment Funds S.A. chose to change its Austrian branch into a representative office in 2005.

The following management companies are represented, as at 31 December 2005, in one or several EU/EEA countries by means of a branch.

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

As at 31 December 2005, no management company of another EU or EEA Member State established a branch in Luxembourg.

5.3.2. Freedom to provide services

In 2005, only five management companies incorporated under Luxembourg law (11 in 2004) applied to pursue business in one or several EU Member States by way of free provision of services. This low figure can be explained notably by circular CSSF 05/186 concerning the guidelines of the Committee of European Securities Regulators (CESR) relating to the implementation of the transitional provisions of Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611 (UCITS I). Indeed, one of the guidelines provides that where a management company envisages to market UCITS under its management in one or several host countries, without wishing to set up branches in this (these) country(ies), it is sufficient to apply the procedure with respect to the product passport. Most of the notification requests in 2005 were submitted by management companies whose business activities were extended to the portfolio management on a client-by-client basis.

On the other hand, the number of notifications to freely provide services in Luxembourg introduced by management companies from other EU Member States totalled thirteen in 2005 (three in 2004).

5.3.3. Representative offices

In 2005, the management company Nordea Investment Funds S.A. has opened a representative office in Italy, Spain and Austria respectively.

5.4. Supervisory practice

5.4.1. Management company and subsidiary

The question arose as to whether and under what conditions, a management company governed by Chapter 13 of the law of 2002 is authorised to establish a subsidiary. The CSSF decided that a management company is allowed to set up a subsidiary subject to compliance with the following requirements:

- the management company shall have sufficient financial bases compared with the minimum own funds required under the terms of articles 77(4) or 78(1)a) of the law of 2002. To this end, it shall have an own fund surplus equivalent to the financing of its participating interest in the subsidiary;
- the activities of the subsidiary shall remain in line with the activities that may be carried out by a management company;
- the management company shall consolidate and control the subsidiary in accordance with the provisions of circular CSSF 2000/22 of 20 December 2000;
- the management company shall draw up and submit to the CSSF consolidated accounts on a quarterly basis.

5.4.2. Management company and risk management

The CSSF had to pronounce itself on the organisation of the risk management function as provided for by article 42(1) of the law of 2002 for a management company under Chapter 13 of this law.

In this respect, the CSSF considers that an independent and permanent control of the risks related to an investment portfolio is an element inherent in a sound organisation of a management company as referred to in article 84 of the law of 2002. It is not acceptable that the persons that take investment decisions are in charge of risk control in relation to the investments. Separating the management function from the risk control function is imperative.

A management company subject to the provisions of Chapter 13 of the law of 2002 shall be able to ensure a permanent and independent control of the risks inherent in investment portfolios it manages with the necessary means. The controls set up will be assessed on a case-by-case basis.

6. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

6.1. Law of 10 July 2005 on prospectuses for securities

The law of 10 July 2005 on prospectuses for securities repeals articles 73 of the law of 30 March 1988 as amended on undertakings for collective investment and 95 of the law of 20 December 2002 as amended on undertakings for collective investment and replaces them with the following provision: "Luxembourg UCIs other than the closed-end type, UCITS governed by harmonised Community law and foreign UCIs in case of a public offer in Luxembourg shall be exempt from publishing a prospectus as provided for in Part III of the law on prospectuses for securities. The prospectus which such UCIs draw up in accordance with the regulatory requirements applicable to UCIs shall be valid for the purposes of an offer to the public of securities or the admission of securities to trading on a regulated market".

Thus, Luxembourg UCIs of the open-end type, UCITS governed by harmonised Community law and foreign UCIs of the open-end type draw up a prospectus in accordance with the regulations that apply to UCIs. This marketing prospectus is valid for the purpose of an offer to the public or an admission to trading, which exempts them from a prospectus for the purpose of an offer to the public or a listing under Part III of the law of 10 July 2005.

Articles 70 of the law of 30 March 1988 as amended and 76 of the law of 20 December 2002 as amended have been modified in order to take account of the above-mentioned amendment. Both articles are now worded as follows: "UCIs other than the closed-end type formed or operating under foreign laws, which are not subject to Chapter 7 of the law and whose securities are the subject of a public announcement, offer or sale in or from Luxembourg, must be submitted in their State of origin to a permanent supervision performed by a supervisory authority set up by law in order to ensure the protection of investors".

As a result, UCIs of the closed-end type formed or operating under foreign laws are not obliged anymore to obtain approval from the CSSF to market their units/shares in Luxembourg. They are solely governed by the law of 10 July 2005 on prospectuses for securities.

6.2. Circular CSSF 05/176 concerning the rules of conduct to be adopted by undertakings for collective investment in transferable securities in relation to the use of financial derivative instruments

Circular CSSF 05/176 of 5 April 2005 sets out guidelines to be observed by undertakings for collective investment in transferable securities subject to Part I of the law of 20 December 2002 as amended in relation to the use of financial derivative instruments as referred to in article 41(1)g) of the law of 20 December 2002 as amended.

The guidelines laid down in this circular are based on those set out in the Recommendation of the European Commission of 27 April 2004 on the use of financial derivative instruments of undertakings for collective investment in transferable securities (UCITS). They provide details on risk assessment systems, limitation to the risk exposure, market risk measurement methods, leverage assessment methods, risk-mitigation techniques, issuer risk concentration, index-based derivatives and cover rules to transactions with both listed and OTC financial derivative instruments.

6.3. Circular CSSF 05/185 on Luxembourg management companies subject to Chapter 13 of the law of 20 December 2002 concerning undertakings for collective investment, as well as Luxembourg self-managed investment companies subject to article 27 or article 40 of the law of 20 December 2002 concerning undertakings for collective investment

Circular CSSF 05/185 of 24 May 2005 supplements circular CSSF 03/108 as regards the conditions for obtaining and maintaining authorisation for management companies which do not engage in activities other than collective portfolio management as provided for by article 77(2) of the law of 20 December 2002 (section I of circular CSSF 03/108).

6.4. Circular CSSF 05/186 relating to the guidelines of the Committee of European Securities Regulators (CESR) relating to the implementation of the transitional provisions of Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611/EEC (UCITS I)

Circular CSSF 05/186 of 25 May 2005 draws the attention of the undertakings for collective investment in transferable securities under Part I of the amended law of 20 December 2002 (UCITS) on the publication of the guidelines of the Committee of European Securities Regulators (CESR) relating to the implementation of the transitional provisions of Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611/EEC (UCITS I). CESRS' guidelines set out a series of new deadlines for certain UCITS and certain management companies.

7. PRUDENTIAL SUPERVISORY PRACTICE

7,1, Prudential supervision

7.1.1. Standards to be observed by UCIs

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

7.1.2. Instruments of prudential supervision

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

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

7.1.3. Means of control

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

Scrutiny of semi-annual and annual reports carried out by the CSSF shows that these reports are in general drawn up in accordance with the applicable legal rules. During 2005, the CSSF had to intervene with several UCI service providers for the following reasons:

- publication deadline not met by several funds subject to Part II of the law of 30 March 1988 as amended and by UCIs that were put into liquidation;
- non-compliance of the financial report with the fund's investment policy or lack of required information;
- insufficient representation of the promoter on the board of directors;
- omission to mention that the subscription can only be made on the basis of the UCI's prospectus;
- omission to mention the exchange rate;
- incorrect statement of the UCI's or compartment's denomination;
- high fees;
- incorrect breakdown of the securities portfolio.

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

In accordance with circular IML 97/136 and pursuant to article 94(1) of the law of 30 March 1988 as amended and article 118 of the law of 20 December 2002 as amended, the central administrations of Luxembourg UCIs must transmit financial information by electronic means to the CSSF, on a monthly (tables O 1.1.) and yearly (tables O 4.1. and O 4.2.) basis. The deadline to transmit the monthly financial information is twenty days following the reference date, which is in principle the last day of each month. As regards yearly financial information, the reference date is the date of the close of the financial year and the time limit is four months.

As far as monthly financial information is concerned, the CSSF considers that UCIs must, on the one hand, scrupulously observe the allocated deadline to submit table O1.1. and, on the other hand, pay due attention when drawing up this table so as to ensure that the format and content are correct. To this end, the CSSF called to order the UCIs that did not meet these conditions, leading the central administrations in charge to review their procedures to make sure that the files are transmitted within the time limit and to improve the quality of this reporting. For information, the format and content of about 8,500 files, representing nearly 20,000 types of units/shares, are controlled every month.

- ***On-site inspections***

During 2005, the CSSF carried out two on-site inspections at the premises of providers of services to UCIs whose purpose was notably to assess the decision-making process and the organisation of the fund management.

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

Following the publication of circular CSSF 04/146 concerning the protection of UCIs and their investors against Late Trading and Market Timing practices, three cases of potential Late Trading and seven cases of potential Market Timing have been reported to the CSSF. The CSSF was able to close nine cases without taking further actions. Investigations regarding one report submitted in 2005 are still in progress.

- ***Meetings***

In 2005, 130 meetings were held between representatives of the CSSF and intermediaries of UCIs. These meetings concerned the presentation of new UCI projects, restructurings of UCIs, but also the application of the laws and regulations of UCIs.

7.2. Circular CSSF 02/77 on the protection of investors in case of NAV calculation errors and compensation following non-compliance with investment rules

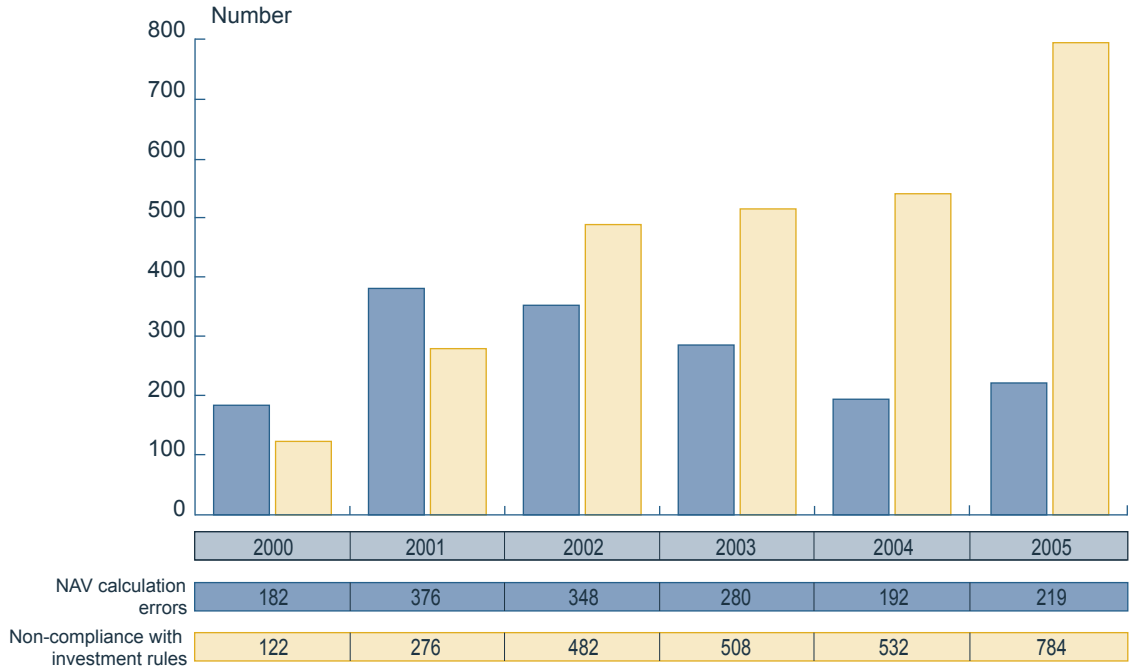
7.2.1. Reports made in 2005 based on circular CSSF 02/77

In 2005, the CSSF received 1,003 reports based on circular CSSF 02/77, against 724 reports in 2004, i.e. an increase of 28%.

Among these reports, 219 cases (192 in 2004) concerned NAV calculation errors and 784 cases (532 in 2004) non-compliance with investment rules, including 148 cases (97 in 2004) of non-compliance with the investment policy.

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

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



While the number of NAV calculation errors has been decreasing since 2002, it has risen in 2005. This growth should however also be seen in the light of the substantially increasing number of registered UCIs.

The number of instances of non-compliance with investment rules continues to grow. In this context, it should be noted that 66% of the reports that represent the difference between 2004 (532 reports) and 2005 (784 reports) stem from a single UCI central administration.

As regards more particularly the reports received in 2005, 99 of the 219 cases of NAV calculation errors and 134 of the 784 cases of non-compliance with investment rules could not be closed as at 31 December 2005, as the CSSF is still awaiting either further information, or the report(s) of the external auditor or the management letter, or the report on the UCI's activity following the application of the simplified procedure as provided for by circular CSSF 02/77.

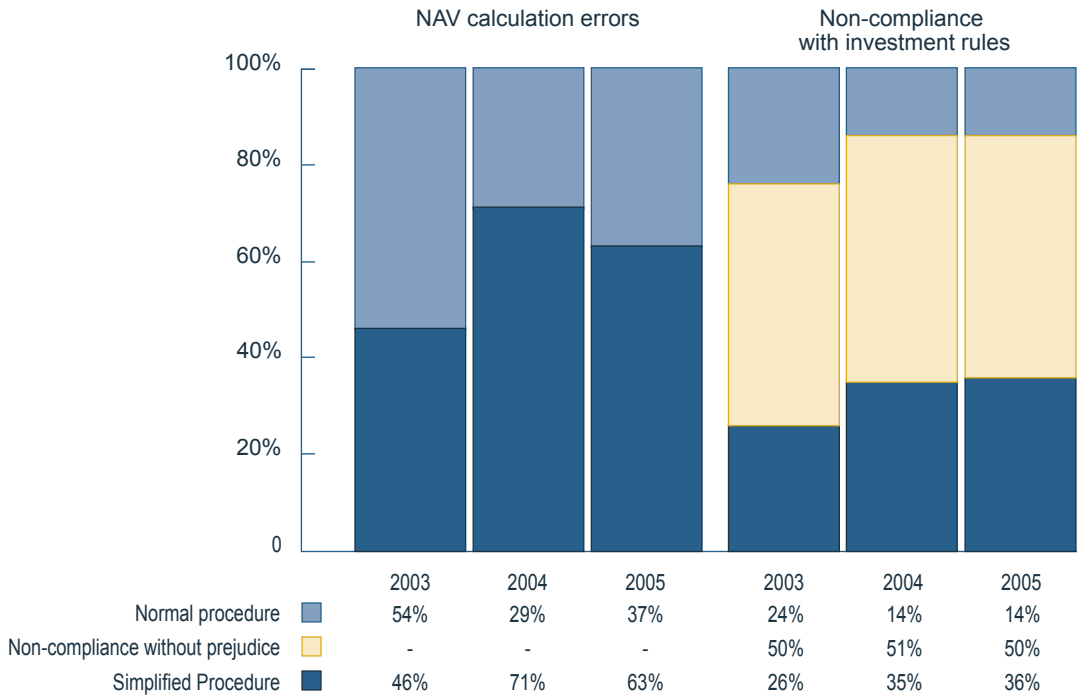
Indeed, circular CSSF 02/77 introduced a simplified procedure for cases of NAV calculation errors or non-compliance with investment rules that entail losses for the UCI, where the indemnification amount does not exceed EUR 25,000 and the amount to be reimbursed to an investor does not exceed EUR 2,500.

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

In 2005, 139 out of 219 cases of NAV calculation errors fall within the scope of the simplified procedure (137 cases of 192 in 2004). 281 out of 784 cases of non-compliance with investment rules have also applied this procedure (131 cases of 532 in 2004).

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

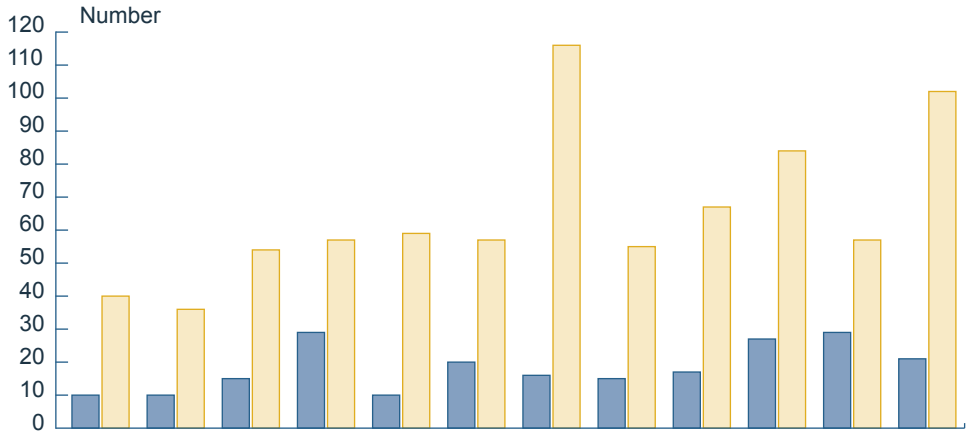
Simplified procedure



Thus, 63% of the reports of NAV calculation errors fall within the scope of the simplified procedure (71% in 2004 and 46% in 2003). As regards the cases of non-compliance with investment rules, 36% of the cases meet the criteria of the simplified procedure (35% in 2004 and 26% in 2003) and 50% of cases have been regularised without harming neither the investors nor the UCIs (51% in 2004 and 50% in 2003).

The following graph sets out in detail the reports made during 2005.

Development in the errors notified in 2005

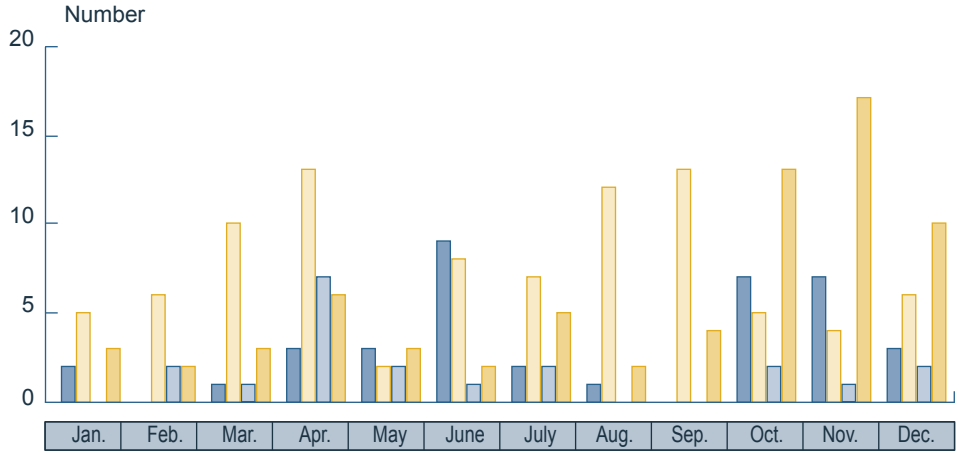


	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
NAV calculation errors	10	10	15	29	10	20	16	15	17	27	29	21
Non-compliance with investment rules	40	36	54	57	59	57	116	55	67	84	57	102

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

The following graph plots the different causes of NAV calculation errors recorded in 2005.

Development of the causes of NAV calculation errors in 2005

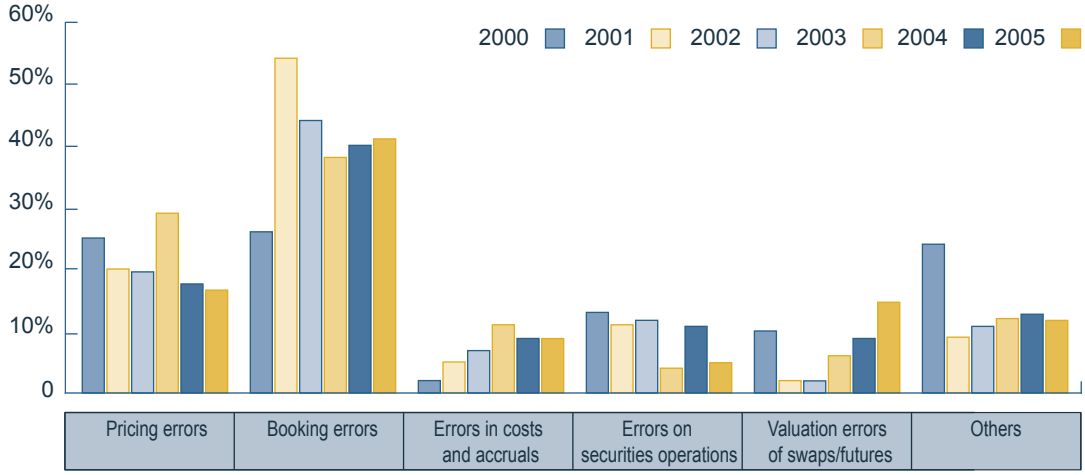


	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
Pricing errors	2	0	1	3	3	9	2	1	0	7	7	3
Booking errors	5	6	10	13	2	8	7	12	13	5	4	6
Errors in costs and accurals	0	2	1	7	2	1	2	0	0	2	1	2
Others	3	2	3	6	3	2	5	2	4	13	17	10

In 2005, 17% of NAV calculation errors were due to pricing errors, 42% to booking errors and 9% to calculation errors in costs and accruals. Among the other causes of error were problems linked to securities operations, representing 5% of cases reported and errors in the valuation of swaps and futures which account for 15% of the NAV calculation errors.

The following table shows the development of the cases of NAV calculation errors since 2000 (coming into force of circular CSSF 2000/8 of 15 March 2000 repealed by circular CSSF 02/77 of 27 November 2002).

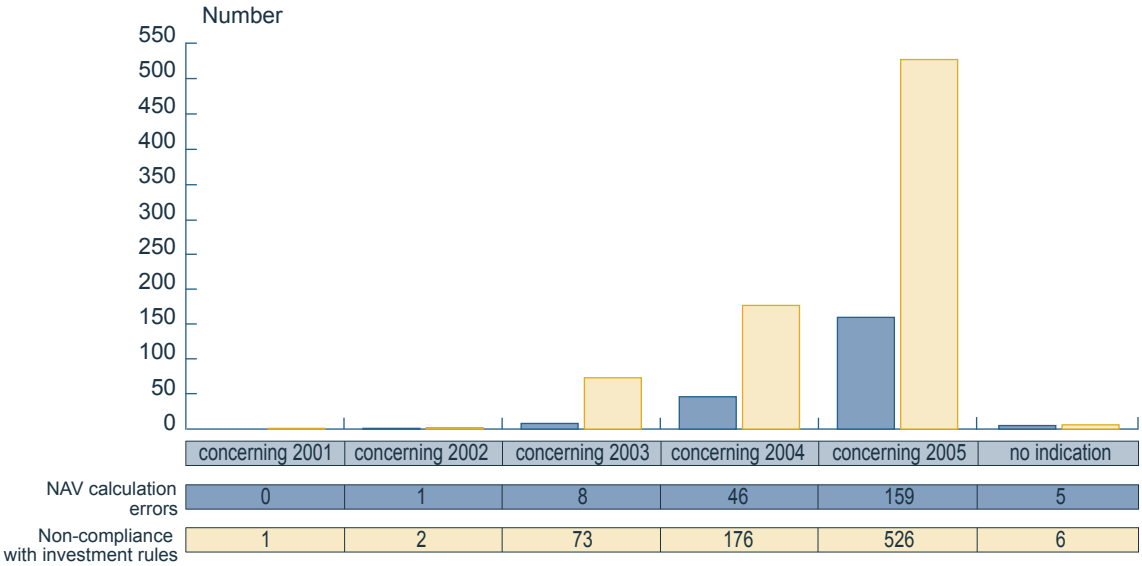
Development of the causes of NAV calculation errors over the last six years



Over the last six years, booking errors and errors in the valuation of securities held by UCIs were the main causes for NAV calculation errors. Also, the number of errors relating to the valuation of swaps/futures increased considerably compared to 2004. Moreover, it is particularly interesting to note that the number of errors due to transactions on securities decreased substantially as compared to 2004.

It should be noted that the reports made during 2005 do not always relate exclusively to errors and instances of non-compliance that occurred during 2005. Thus, they can also relate to errors or instances of non-compliance detected in 2005, but which relate to errors or instances of non-compliance that occurred previously, as shown in the graph below.

Reports made during 2005



Out of 1,003 reports made in 2005, 0.1% and 0.3% respectively were related to errors or instances of non-compliance that had already occurred in 2001 or 2002. 8.1% and 22.1% concerned errors or instances of non-compliance which have occurred in 2003 and 2004, while 68.3% related to errors or instances of non-compliance that had actually occurred in 2005.

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

The table below sets out the amounts of compensation notified in 2004 and 2005. It has to be noted that it is based on data available to the CSSF as at 31 December 2004 and 31 December 2005 respectively, while the amount of compensation had not yet been notified in certain cases.

Compensation paid following NAV calculation errors

	Investors		UCI/Subfund	
	2004	2005	2004	2005
EUR	439,106.11	746,162.82	266,576.98	2,313,212.89
USD	212,624.16	166,386.43	277,787.97	355,830.81
JPY	248,560.00	4,758,732.00	436,200.00	174,529.00
GBP	298.71	2,395.74	83.56	52,904.98
CHF	222.81	3,274.33	-	211.10
Others currencies*	1,171.70	12,471.48	4,775.96	16,327.65
Total *(in EUR**)*	**598,725.98**	**939,535.13**	**478,535.90**	**2,709,760.64**

Compensation paid following non-compliance with investment rules

	Investors		UCI/Subfund	
	2004	2005	2004	2005
EUR	5,605.52	170,696.62	673,865.93	1,323,945.11
USD	-	77,074.72	137,726.03	153,774.00
JPY	-	-	5,567,032.93	193,241.00
GBP	-	-	26,802.85	1,432.28
CHF	-	-	42,253.64	180,060.65
Others currencies*	2,704.75	-	10,118.50	1,850.78
Total *(in EUR**)*	**8,310.27**	**236,030.78**	**890,364.27**	**1,575,414.21**

* converted in EUR at the exchange rate applying on 31 December 2005 and 31 December 2004 respectively.

** exchange rate as at 31 December 2005 and 31 December 2004 respectively.

396 out of the 784 instances of non-compliance with investment rules have been regularised resulting in a profit, while 226 regularisations led to a loss. In 162 instances of non-compliance, the amount realised in the context of regularising operations has not been communicated yet. While compensation paid following instances of non-compliance with investment rules had fallen in recent years, they have risen sharply in 2005, i.e. by 43%.

As compared to 2004, the amounts of compensation paid following NAV calculation errors also increased substantially. It should be noted however that these data are provisional as the amounts for compensation have not been communicated yet in 74 instances. Thus, the downward trend of the previous year does not continue in 2005.

7.2.3. Management letters

Chapter P of circular IML 91/75 of 21 January 1991 states that UCIs must automatically and immediately communicate to the CSSF the management letters issued by external auditors in the context of the audits which the latter are obliged to undertake pursuant to article 89 of the law of 30 March 1988 as amended and article 113 of the law of 20 December 2002 as amended.

The analysis is based on data for the year 2004, since these are more pertinent. Indeed, most UCIs close their financial year on 31 December so that the data relating to 2004 are established by the CSSF in 2005.

As in the previous years, many management letters, namely 75.7%, are management letters that contain no recommendations, i.e. the external auditor has not detected any irregularities in the management of the UCIs. 16.4% are management letters with recommendations by which the external auditors have reported irregularities of various types. 7.9% of the management letters are still lacking.

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

In the course of 2004, 45% of management letters mentioned instances of exceeded investment limits whilst 55% of irregularities came under the other aforementioned categories.

In this context, it should be noted that some major errors or instances of non-compliance considered as "active" that have been reported in management letters, have also been the subject of a report in accordance with circular CSSF 02/77.

Moreover, certain instances of overstepping investment limits reported in management letters could be considered as "passive". With regard to NAV calculation errors, some did not exceed the materiality thresholds laid down in circular CSSF 02/77. Certain management letters (10%) also contained details required by the simplified procedure.

7.3. Long form reports

Circular CSSF 02/81 of 6 December 2002 set down rules concerning the scope of the audit of the annual accounting documents and the content of the audit reports to be drawn up in this context pursuant to the law of 30 March 1988 on undertakings for collective investment as amended.

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

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

1,503 of the 1,786 long form reports relating to the financial year ending 31 December 2004 were drawn up and submitted to the CSSF as at 31 December 2005.

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

7.4. Enforcement of the legislation concerning UCIs

7.4.1. Regulated markets

The CSSF has had to decide on the acceptability of certain markets under the terms of article 41(1) of the law of 20 December 2002 as amended relating to undertakings for collective investment.

Thus, the new EURO MTF market operated by the *Bourse de Luxembourg S.A.* is to be considered as a regulated market, which is operated regularly, is recognised and open to the public. The transferable securities and money market instruments traded on the EURO MTF market are eligible investments for UCITS submitted to Part I of the laws of 1988 and 2002.

As far as the Russian markets are concerned, the CSSF considers that the Russian Trading System Stock Exchange (RTS Stock Exchange) and Moscow Interbank Currency Exchange (MICEX) may be considered as regulated markets under the terms of article 41(1) of the law of 2002. However, it has been decided that UCITS, whose investment policy consists in investing part of or all of their assets in securities traded on the said Russian markets, must comply with the following requirements:

- the sales prospectus of the UCITS must make clear that the UCITS invests in securities traded on the Russian RTS Stock Exchange and MICEX;
- the sales prospectus of the UCITS must include an appropriate risk description, allowing the investor to get a proper view of the UCITS' risk profile.

7.4.2. Acceptability of securities of the type Rule 144A Securities

The CSSF has decided that Rule 144A securities with an exchange agreement registered under the Securities Act of 1933, which provides for an exchange right into shares, are eligible under the terms of article 41(1) of the law of 2002, provided that they meet the following criteria:

- the exchange into shares must be made within one year as from the acquisition of the securities subject to Rule 144A, otherwise the securities will no longer be eligible and will be subject to the limit referred to in article 41(2)a) of the law of 2002;
- the risks inherent in restricted securities are integrated in the UCI's sales prospectus;
- the shares are, in accordance with the law, admitted to trading on a stock exchange or on another regulated market which is operating regularly, recognised and open to the public.

This decision is consistent with the information published in the CSSF's Annual report 1998 as regards bonds registered with the SEC under paragraph 230-144A of the Securities Act of 1933.

7.4.3. Volatility futures

As far as the eligibility of volatility futures as investments of UCITS is concerned, it has been decided that they are eligible investments under the terms of article 41(1)g) of the law of 2002, provided that they fulfil the following conditions:

- the volatility futures must be traded on regulated markets;
- the stock indices underlying the volatility indices must comply with article 44(1) of the law of 2002;
- the UCITS must set up a risk management method that takes adequately account of the risks incurred;
- investors must be informed by means of a detailed description of the use of the volatility futures in the UCITS' prospectus.

7.4.4. Article 41(1)g) of the law of 20 December 2002 as amended – distinction between financial index and basket of assets

The CSSF considers that a distinction must be made between financial derivative instruments (article 41(1)g) of the law of 2002) whose underlying consists in financial indices and financial derivative instruments whose underlying consists in a basket of assets. If an index fulfils the requirements laid down in article 44(1) of the said law, this index is to be considered as a "financial index". If that is not the case, the term "index" should be avoided and the analysis must be aimed at the eligibility of the assets that compose the basket in accordance with article 41(1).

In order to avoid any misunderstanding, the distinction between "financial index" and "basket of assets" should also be reflected in the terminology used with respect to the denomination of a fund or a fund compartment, or in the description of the investment policy.

7.4.5. Open-ended hedge funds

The CSSF has decided that a UCITS submitted to Part I of the law of 2002 may, pursuant to article 41(2)a) of this law, invest up to 10% of its net assets in regulated open-ended hedge funds that are submitted to an equivalent supervision, subject however to compliance with the requirements provided for by CESR (reference document CESR/06-005).

7.4.6. Application of article 43 of the law of 20 December 2002 as amended

The CSSF considers that the notion of group, as defined in article 43(5), does not apply with respect to the application of the limits referred to in articles 43(1) and 43(2) of the law of 2002. Consequently, the CSSF considers that the notion of body referred to in article 43(1), which sets out that a UCITS may invest not more than 10% of its assets in transferable securities or money market instruments issued by the same body, should be interpreted as issuer.

The restrictions set out in article 43(2), which provides that "the total value of the transferable securities and money market instruments held by a UCITS in the issuing bodies in each of which it invests more than 5% of its assets must not exceed 40% of the value of its net assets", also apply to the individual issuer.

Furthermore, the CSSF considers that the consolidation of accounts allows to present the accounts of a group of companies with common interests and considers that the companies comprised within the scope of consolidation are part of the same group. Consequently, article 43(5) applies to all the consolidated companies, irrespective of the consolidation method applied.

Moreover, the CSSF has decided, by analogy with the provisions of article 43(2), that the investment restriction relating to the notion of group provided for by article 43(5), last indent, applies to all instruments (including deposits and transactions on derivatives).

8. ANALYSIS OF SAVINGS PLANS OFFERED BY LUXEMBOURG UCIS

In 2005, the CSSF has analysed the situation of a certain number of Luxembourg UCIs that offer savings plans with periodical payments to their investors.

To this end, the CSSF took into account two important elements, namely adequate investor information on the operation mode of the savings plans and the administrative handling and control of the savings plans.

This analysis was carried out on a sample of eighteen representative central administrations which offer savings plans to investors of one or several UCIs of whose central administration they are in charge.

8.1. Investor information

Overall, it has been observed that the prospectuses mention the existence of the savings plans and refer either to a specific information brochure, or to a specific subscription form, or to a document setting out the subscription conditions of a savings plan, to be signed by the investor.

The CSSF recommends that the issue prospectus or a separate brochure provide all the relevant information on the offered savings plans to the investor. Where a separate brochure is being used, the full prospectus shall of course refer to the existence of this separate brochure.

The following information must be provided in the prospectus or brochure:

- practical details regarding the functioning of the plan, i.e. the amount and frequency of the payments, the fees levied, the time period of payments, the possibility of repurchase before maturity, the situation after maturity of the plan, confirmations of the executed transactions, and the periodic account statement of the investor;
- the warning that the plan is a continuous and regular investment irrespective of the acquisition price, notably during market slumps, unless the possibility is given to stop payments without extra charges;
- the warning that the investor must assess his financial capacity to continue the payments for the whole duration of the plan and that he risks, where applicable, to sustain losses if he suspends and liquidates the programme before maturity;
- all the fees and commissions levied on the investments made within the scope of the savings plan.

8.2. Administrative processing and control of savings plans

The analysis has shown that the central administrations concerned that manage savings plans in Luxembourg are organised in such a way that the CSSF did not need to intervene. Thus, they notably managed the following data properly:

- the name of savings plan investors;
- the number of subscribed plans;
- the amounts subscribed;
- details on the periodic payments;
- the dates of the periodic payments;
- the fees and commissions generated by the plans;
- possible problems.

As regards the savings plans that are not handled in Luxembourg but by a distributor or another professional abroad, the CSSF recommends that the central administration in Luxembourg of the UCI concerned initiates a due diligence procedure on the foreign professionals. This procedure addresses the status of the intermediary, the good repute of its managers and its proper organisation as regards the human and technical / IT infrastructure. The due diligence procedure and the relating conclusions shall be made available to the CSSF, which may, if necessary, request its transmission.

The CSSF considers that it must be notified of any problem likely to have an impact on the proper handling of the savings plans.

DEPARTMENT SUPERVISION OF UCIS

First row, left to right: Irmine GREISCHER, Christel TANA, Pascale SCHMIT, Carole EICHER, Yolanda ALONSO, Alex WEBER

Second row, left to right: Joël GOFFINET, Nathalie REISDORFF, Sophie LEBOULANGER, Patricia JOST, Carole LIS

Third row, left to right: Nathalie WALD, Anica GIEL-MARKOVINOVIC, Charles THILGES, Diane REUTER, Paul HANSEN, Claude WAGNER, Marc SIEBENALER

Absent: Dominique HERR, Francis LIPPERT, Dave REUTER, Alain STROCK

DEPARTMENT SUPERVISION OF UCIS

First row, left to right: Evelyne PIERRARD-HOLZEM, Florence WINANDY, Serge EICHER, Michèle WILHELM, Sandy BETTINELLI, Martine KERGER, Jean-Paul HEGER

Second row, left to right: Francis GASCHE, Carine PELLER, Martin MANNES, Isabelle DOSBOURG, David PHILLIPS, Robert KOELLER

Third row, left to right: Daniel SCHMITZ, Ralph GILLEN, Marc RACKE

Absent: Marie-Rose COLOMBO, Michel FRIOB, Nicole GENGLER, Thierry QUARING, Roberta TUMIOTTO

DEPARTMENT SUPERVISION OF UCIS

First row, left to right: Sandra GHIRELLI, Roberto MONTEBRUSCO, Danièle CHRISTOPHORY, Anne-Marie HOFFELD, Nathalie CUBRIC

Second row, left to right: Géraldine APPENZELLER, Nico BARTHELS, Jean-Claude FRAITURE, Thierry STOFFEL, Damien HOUEL, Jean-Marc LEHNERT

Third row, left to right: Guy MORLAK, Francis KOEPP, Pierre REDING, Pascal BERCHEM, Eric TANSON, Pierre BODRY, Marc DECKER, Gilles OTH

Absent: Anne CONRATH, Pascale FELTEN-ENDERS

DEPARTMENT SUPERVISION OF UCIS

First row, left to right: Sabine SCHIAVO, Christiane STREEF, Simone KUEHLER, Joëlle HERTGES, Jolanda BOS, Claude STEINBACH

Second row, left to right: Claudine THIELEN, Géraldine OLIVERA, Christiane CAZZARO, Fabio ONTANO, Christian SCHAACK

Third row, left to right: Stéphanie BONIFAS, Suzanne WAGNER, André SCHROEDER, Claude KRIER, Alain BRESSAGLIA

Absent: Adrienne ANDRE-ZIMMER, Marie-Louise BARITUSSIO, Angela DE CILLIA, François HENTGEN, Danielle NEUMANN

CHAPTER III

SUPERVISION OF PENSION FUNDS

1. Developments in the pension funds sector in 2005

2. Developments in the legal framework

1. DEVELOPMENTS IN THE PENSION FUNDS SECTOR IN 2005

1.1. Pension funds

During the course of 2005, the CSSF authorised three 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), including two multiple compartment sepcav:

- THE PAULIG GROUP SEPCAV,
- FORTIS LUX PRIME PENSION A SEPCAV,

and one multiple compartment assep:

- RBC DEXIA INVESTOR SERVICES PENSION FUND.

The authorisation of these new pension funds raises the number of pension funds subject to the law of 13 July 2005 to fifteen as at 31 December 2005.

It has to be noted that the growth rate of the pension funds sector is very slow. The entry into force on 23 September 2005 of Directive 2003/41/EC, which confers a European passport on institutions for occupational retirement provision, will hopefully facilitate the setting-up of pan-European pension funds in the medium term.

The CSSF expects activities to continue their slow but ongoing pace in 2006. Indeed, various potential promoters have shown an interest in setting up a pension fund in Luxembourg.

1.2. Liability managers

Following the registration in 2005 of AMAZON INSURANCE & PENSION SERVICES S.A R.L. and AXA ASSURANCES VIE LUXEMBOURG S.A. on the official list of professionals authorised to act as liability managers for pension funds subject to the law of 13 July 2005, the number of liability managers of pension funds authorised by the CSSF amounted to thirteen as at 31 December 2005.

2. DEVELOPMENTS IN THE LEGAL FRAMEWORK

The Luxembourg legislation governing sepcav and assep underwent a major change in 2005 with the adoption of the law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep).

The law of 13 July 2005 transposes Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision into Luxembourg law and replaces the law of 8 June 1999 creating pension funds in the form of sepcav and assep. For the majority of provisions, the new law reproduces the text and the wording of Directive 2003/41/EC and leaves unchanged, as far as possible, the provisions of the law of 8 June 1999 as amended. Circular CSSF 05/201 outlines the main amendments this law brings about.

The law of 13 July 2005 confirms the qualitative approach adopted by the law of 8 June 1999. Indeed, the text of the law of 13 July 2005 recognises the qualitative approach for the calculation of technical provisions and introduces two alternative bases for the definition of the maximum interest rate. The law also lays down a requirement for additional assets where the institution itself, and neither the sponsoring undertaking nor a financial institution, underwrites biometrical risks or guarantees a given level of benefits or a given return.

The law also adopts a qualitative approach as regards investment rules for assets. Assets shall be invested in accordance with the principles of security, quality, liquidity, profitability and diversification and in the light of the commitments entered into by the fund ("prudent person rule") and not in accordance with quantitative rules that apply uniformly to all pension funds. Every three years, pension funds shall prepare, respectively review, a statement of their investment strategy containing elements such as the risk measurement methods and the strategic asset diversification.

In accordance with the requirements of the Directive, the law introduces a European passport for asset managers and depositaries of sepcav and assep, operating pursuant to the principle of free provision of services.

Asset managers established in Luxembourg or in another EU Member State and duly authorised for the management of the investment portfolio, in accordance with Directives 85/611/EEC, 93/22/EEC, 2000/12/EC, 2002/83/EC and 2003/41/EC are henceforth eligible as asset managers.

The law also allows the appointment of asset managers of non-EU origin provided that they have been authorised by the CSSF. The Grand-Ducal regulation of 20 September 2005 specifies the criteria of competence, good repute and financial soundness that need to be fulfilled for the authorisation of non-EU professionals as asset managers of institutions for occupational retirement provision in the form of sepcav and assep.

As regards the depositaries of sepcav and assep, they shall be established in Luxembourg or in another EU Member State and duly authorised for the activity of custodian of assets in accordance with Directive 93/22/EEC or Directive 2000/12/EC, or authorised as depositary for the purposes of Directive 85/611/EEC.

For umbrella-type pension funds, the law lays down the possibility that the articles of incorporation can provide for the appointment of a depositary per subfund, provided that the assets of a subfund exclusively respond to the members' rights relating to this subfund and to the creditors' rights whose debt arose from the establishment, operation or liquidation of this subfund.

The law also strengthens the role of the liability manager. Liability managers are henceforth required to co-operate with the CSSF. The Grand-Ducal regulation of 20 September 2005 specifies the criteria of competence, good repute and financial soundness that need to be fulfilled for the approval of liability managers.

As regards the structure of the pension funds' constitutive documents, the pension rules are now separated from the articles of incorporation and can have a life of their own. The articles shall specify the terms of establishment and amendment of the pension rules and can provide for the possibility of multiple pension rules within a fund or a structure in the form of general rules accompanied with specific rules per subfund, employer or scheme. Certain technical elements which have so far featured in the pension rules shall henceforth be included in a separate technical note. A more comprehensive description of the characteristics of every pension scheme shall be made in the pension rules and in a technical note.

The central administration of the pension fund shall be located in Luxembourg. Every pension fund shall have a sound administrative and accounting organisation and adequate internal control procedures.

In accordance with the Directive, the law introduces the right for institutions for occupational retirement provision to freely accept sponsorship by undertakings located abroad. It establishes, within the European Union, the legal basis for notification and co-operation mechanisms between competent authorities for the cross-border management of pension schemes by institutions for occupational retirement provision in the form of sepcav and assep.

Henceforth, any institution for occupational retirement provision that has been granted authorisation and falls under the supervision of a competent authority of another Member State can accept sponsorship from sponsoring undertakings established in Luxembourg. Performing these activities is not subject to an authorisation by the Luxembourg competent authorities, but submitted to a notification procedure by the home Member State.

Likewise, where Luxembourg sepcav and assep wish to manage pension schemes for a sponsoring undertaking in other EU Member States, they shall notify their intention to the CSSF in accordance with article 97, paragraphs (2) and (3) of the law. The notification file shall comprise the following information:

- the host Member State(s);
- the name of the sponsoring undertaking(s);
- the main characteristics of the pension scheme to be operated for the sponsoring undertaking(s).

Where the CSSF receives such notification, and unless it has reason to doubt that the administrative structures or the financial situation of the pension fund or the good repute and professional qualifications or experience of the persons running the pension fund are compatible with the operations proposed in the host Member State, it shall within three months of receiving all the information comprised in the notification file, communicate that information to the competent authorities of the host Member State and inform the pension fund accordingly.

Before a pension fund starts to operate a pension scheme for a sponsoring undertaking in another Member State, the competent authorities of the host Member State shall, within two months of receiving the information, inform the CSSF, if appropriate, of the requirements of social and labour law relevant to the field of occupational pensions under which the pension scheme sponsored by an undertaking in the host Member State must be operated and of any rules that are to be applied in accordance with article 83(1) and article 97(7) of the law. The CSSF communicates this information to the pension fund.

On receiving the communication, or if no communication is received from the CSSF on expiry of the period of two months, the pension fund may start to operate the pension scheme sponsored by an undertaking in the host Member State in accordance with the latter's requirements of social and labour law relevant to the field of occupational pensions, as well as any provisions that are to be applied in accordance with article 83(1) and article 97(7) of the law.

Pension funds sponsored by an undertaking located in another Member State shall also be subject, in respect of the relevant members, to any information requirements imposed by the competent authorities of the host Member State on institutions for occupational retirement provision located in that Member State.

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

CHAPTER IV

SUPERVISORY FRAMEWORK FOR SICARS

1. Developments in the SICAR sector in 2005
2. Regulatory framework
3. Prudential practice

1. DEVELOPMENTS IN THE SICAR SECTOR IN 2005

During the year 2005, the CSSF has received 67 files from SICARs applying for registration on the CSSF's official list of SICARs, four of them having however been abandoned, at the initiators' request, during the process of scrutiny.

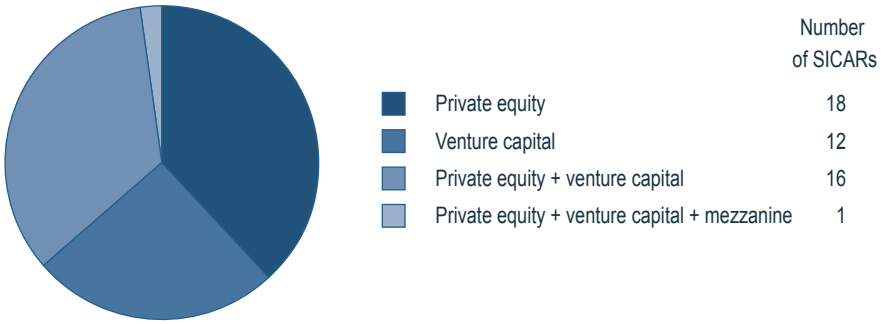
As at 31 December 2005, 47 SICARs were registered on the official list of the CSSF and about thirty application files were being processed.

As regards the financial assets of the SICARs registered on the official list, it should be noted that many SICARs are currently in the process of collecting funds, or identifying investment opportunities. Thus, only 32 out of the 47 SICARs registered on the official list had already made investments as at 31 December 2005.

The provisional total balance sheet of the SICARs reached EUR 2,695.6 million as at 31 December 2005. The total subscribed capital amounted to approximately EUR 2,597 million, of which EUR 1,009 million have been paid up.

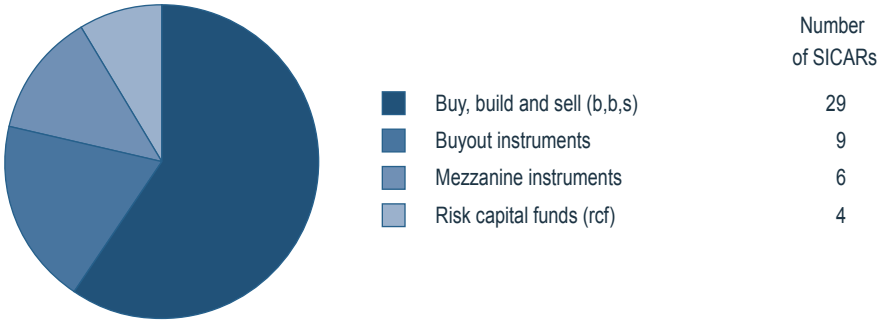
The following graph on the nature of the investment policy of SICARs shows a slight preference for private equity, followed by venture capital, without however revealing an actual trend.

Nature of the investment policy of SICARs



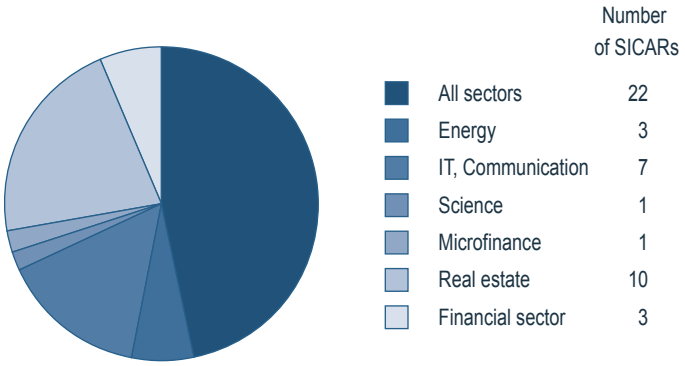
As regards the investment strategy, it can be observed that SICARs choose either to limit their policy to a particular strategy (buy, build and sell, buyouts, mezzanine financing or indirect investment via funds), or to adopt a combination of strategies generally used in the field of risk capital.

Investment strategy



As for the sectoral distribution of investment policies, a considerable number of SICARs would rather not limit their investment policy to a particular investment sector. As regards SICARs opting for a specialised policy, a slight predominance of the high technology and telecommunications sectors can be observed. A certain interest also exists for SICARs investing in private equity real estate.

Sectoral distribution



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

Geographical origin of the initiators

Country	Number
United States	11
France	6
Great Britain	6
Switzerland	6
Luxembourg	5
Italy	3
Belgium	2
Egypt	2
Germany	1
Denmark	1
Spain	1
Finland	1
Guernsey	1
Netherlands	1
Total	**47**

2. REGULATORY FRAMEWORK

SICARs are governed by the law of 15 June 2004 relating to the investment company in risk capital ("the SICAR law") whose article 1 specifies that investment in risk capital refers to capital provided directly or indirectly to entities in view of their launch, development or listing on a stock exchange.

On 5 April 2006, the CSSF has published circular CSSF 06/241 whose objective is to provide a general description of the notion of risk capital and the criteria applied by the CSSF to assess the acceptability of the investment policies proposed for SICARs.

The circular specifies that risk capital under the SICAR law is defined by the concurrent existence of two elements, namely a high risk and an intention to develop the target entities (portfolio companies).

The main objective of the SICAR should be to contribute to the development of the entities in which it invests. The notion of development is understood in the broad sense as value creation with respect to the target companies. It should also be noted that as an investment company in risk capital, the declared intention of the SICAR shall be in general to acquire financial assets in order to sell them with a profit, as opposed to a holding company that acquires to hold, and to make investors benefit from an increased yield as a remuneration of the higher risk that they accepted to incur.

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

3. PRUDENTIAL PRACTICE

3.1. Composition of an application file

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

- the draft offering;
- the draft articles of incorporation of the SICAR;
- the draft articles of incorporation of the SICAR's general partner, for SICARs in the form of a limited partnership or a partnership limited by shares;
- the *curricula vitae* of the managers of the SICAR, as well as the information allowing to assess their experience to perform their function;
- a document attesting their professional repute, notably a recent extract from their police record or an affidavit in case of nationals of countries whose authorities do not issue such extracts;
- the draft agreements between the SICAR and its main service providers (central administration, depositary bank, registrar and transfer agent, domiciliation agent, etc.);
- the identity of the initiator(s);
- information on the marketing of the shares/units of the SICAR. In this context, it should also be stated whether the SICAR's securities will be offered to the public under the terms of the law of 10 July 2005 on prospectuses for securities. In the affirmative, the offering prospectus shall be adapted in order to take account of the provisions of this law.

This list is of course not exhaustive and the CSSF reserves the right, at any moment, to request any additional document or information it deems necessary for the fulfilment of its supervisory tasks.

As regards the content of the SICAR's offering documents, it should be borne in mind, generally-speaking, that they shall provide investors with transparent and adequate information, for example on the investment policy and the inherent risks, the decision-making processes of the SICAR, the rules regarding the distribution of dividends and the remuneration of managers, as well as the other costs and commissions to be borne by the investors.

3.2. Notion of central administration

The law of 15 June 2004 requires the SICARs to appoint a central administration in Luxembourg.

It should be stressed that the notion of central administration of a SICAR can be interpreted in a more flexible way as for undertakings for collective investment. Indeed, the entity in charge of the SICAR's central administration task is not always obliged to be authorised as professional of the financial sector under the terms of the law of 5 April 1993 on the financial sector as amended.

The entity appointed as central administration shall in any case establish that it has the necessary human and technical resources to properly fulfil its mission.

In this context, the CSSF can authorise this central administration located in Luxembourg to outsource certain tasks related to its function to an entity abroad. Outsourcing is analysed on a case-by-case basis and is subject to the following non-exhaustive conditions:

- delegation must be made under the responsibility and coordination of the central administration in Luxembourg;
- the foreign entity appointed by the central administration shall have sufficient human and technical means to perform its role;
- the central administration shall have direct and immediate access to the data processed by the entity abroad and shall monitor this data;
- the CSSF, as well as the shareholders, shall be aware of the structure in place;
- a system shall be set up to ensure the information flow between the different parties involved.

3.3. Half-yearly reporting

By the time of their authorisation, SICARs are invited to submit half-yearly financial information to the CSSF. The details of the information to be submitted are outlined in a circular letter from the CSSF. This information can be submitted to the CSSF in a format and on a data support chosen by the SICAR, for instance in the form of copies of the reports drawn up by the SICAR for reporting and internal control purposes.

The information to provide on a half-yearly basis within 45 days following the reference date shall at least include the following:

- a statement of the SICAR's financial situation and notably the total of its assets;
- a detailed account of its portfolio;
- the amount of the SICAR's subscribed and paid-up capital, as well as the total of investors' subscription commitments;
- information concerning the profile of the investors that subscribed to the SICAR's shares;
- where applicable, information on the level of the SICAR's indebtedness.

Furthermore, the CSSF wishes to receive, automatically and on an *ad hoc* basis, copies of the SICAR's financial statements drawn up for its shareholders.

3.4. Update of the prospectus

The CSSF considers that an annual update of the prospectus is not always required in accordance with article 23(1) of the SICAR law. Pursuant to article 26 of this law, the essential elements of the prospectus shall however be up-to-date when additional securities are issued.

3.5. SICARs that wish to make an offer to the public under the terms of the law of 10 July 2005 on prospectuses for securities (Prospectus law)

Where a SICAR, wishing to make an offer of securities to the public under the Prospectus law, cannot invoke the exemptions provided for in article 5 of this law, the Prospectus law requires the CSSF to observe certain response time limits for the analyses of the issue prospectus.

In these events, the CSSF advocates a two-stage procedure both for issues of securities by newly incorporated SICARs and for subsequent issues of securities under the Prospectus law by existing SICARs.

The formal procedure laid down in the Prospectus law would thus be preceded by an informal procedure, consisting in introducing the draft prospectus (in general one of the elements of the SICAR's application file), in order to allow the CSSF to assess the compliance of the submitted documents with the SICAR law and with the Prospectus law.

This informal procedure having resulted in the authorisation of the SICAR and the approval of its constituent documents under the SICAR law, the formal application for prospectus approval under the Prospectus law can be submitted.

It should be noted that the CSSF circulars dealing with technical specifications regarding communications to the CSSF of documents for approval or for filing and of notices for offers to the public and admissions to trading on a regulated transferable securities market under the Prospectus law do not apply to offers of securities of SICARs.

DEPARTMENT SUPERVISION OF PENSION FUNDS, SICARS AND SECURITISATION UNDERTAKINGS

Left to right: Isabelle Maryline SCHMIT, Daniel CICCARELLI, Josiane LAUX, Christiane CAMPILL, Marc PAULY, Natalia RADICHEVSKAIA, Carla DOS SANTOS, Son BACKES, René SCHOTT

CHAPTER V

SUPERVISION OF SECURITISATION UNDERTAKINGS

1. Developments in the sector of securitisation undertakings in 2005

2. Developments in the regulatory framework

3. Prudential supervisory practice

1. DEVELOPMENTS IN THE SECTOR OF SECURITISATION UNDERTAKINGS IN 2005

In 2005, four securitisation undertakings governed by the law of 22 March 2004 on securitisation have been granted authorisation by the CSSF, namely the following multiple-compartment securitisation undertakings, which have all been incorporated in the legal form of a public limited company:

- H.E.A.T. Mezzanine I-2005 S.A.
- iStructure S.A.
- Vivaldis, Gesellschaft für strukturierte Lösungen S.A.
- GPB Credit Risk Management S.A.

The authorisation of these new securitisation undertakings brings the total number of securitisation undertakings authorised as at 31 December 2005 to six. The total balance sheet of the authorised securitisation undertakings exceeds EUR 11 billion at the end of 2005.

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

The files submitted reveal however that the securitisation undertaking seems to arouse keen interest, mainly among German initiators. The securities issued are in general bonds and subject to foreign law. In the vast majority of cases, the articles of incorporation reserve the possibility for the securitisation undertaking to securitise by means of shares. The securitisation transactions mainly consist in the securitisation of credits and other comparable assets, as well as in repackaging transactions in the form of issues of structured products.

To date, the CSSF has not received any application file for the licensing of a fiduciary representative under Luxembourg law, even though the law of 22 March 2004 on securitisation has established a specific legal framework for these independent professionals charged with representing the interests of the investors. Until now, the authorised securitisation undertakings have all appointed a trustee governed by foreign law.

The CSSF expects securitisation activities to continue their slow but ongoing pace in 2006, a trend that is confirmed by several application files that are currently being scrutinised.

2. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

In 2005, no changes have been made to the Luxembourg legal framework governing securitisation undertakings.

Until a more sophisticated standard reporting is implemented, the CSSF has however considered it useful to specify, by means of a circular letter, both categories of information it requests from securitisation undertakings pursuant to articles 23 and 24 of the law of 22 March 2004 on securitisation. One of the categories has to be submitted on an *ad hoc* basis, and the other one on a half-yearly basis.

Thus, without prejudice to the provisions of article 20 of the law of 22 March 2004 on securitisation, the following documents shall be automatically transmitted to the CSSF as soon as they are available:

- the final issue documents relating to every issue of securities;
- a copy of the financial statements drawn up by the securitisation undertaking for its investors and rating agencies, where applicable;
- a copy of the annual reports and documents issued by the external auditor resulting from its audit of annual accounts.

As far as half-yearly reports are concerned, the CSSF requires securitisation undertakings to provide a statement on their new issues of securities, the other outstanding issues and the issues that have been redeemed during the period under review. It should be noted that the nominal amount issued, the nature of the securitisation transaction, the investor profile and, where applicable, the compartment concerned should be included "per issue". In addition, the half-yearly report should include a brief statement of the financial situation of the securitisation undertaking and notably a breakdown (by compartment where applicable) of its assets and liabilities. At the financial year-end, a draft balance sheet and profit and loss account are also to be added.

The half-yearly information shall be submitted to the CSSF within 30 days following the reference date. They can be drawn up in a format and on a data support chosen by the securitisation undertaking.

3. PRUDENTIAL SUPERVISORY PRACTICE

Several decisions have been taken in particular cases submitted to the CSSF in 2005. The most important are set out hereunder.

3.1. Organisation of securitisation undertakings and supervision of the CSSF

In accordance with article 19 of the law on securitisation, only the undertakings that issue securities to the public on a continuous basis must be under the CSSF's supervision.

Since neither the law nor the parliamentary works define the notion of "public", the administrative practice of the CSSF allowed to bring out the following criteria:

- issues to professional investors and private placements are not considered as issues to the public;
- on the other hand, the subscription of securities by an institutional investor or financial intermediary for a subsequent placement of such securities with the public constitutes a placement with the public;
- the issues whose denominations exceed EUR 125,000 are assumed not to be placed with the public, and the listing of an issue on a regulated market does not *ipso facto* entail that this issue will be placed with the public.

It should be noted that the definition of the term "public" in the field of securitisation is not in line with that of the law of 10 July 2005 on prospectuses for securities, which introduced for the first time into Luxembourg law a definition of the notion "offer to the public" and whose determining criteria is that of a proactive approach of sollicitation and a specific offer adopted by the banker.

As regards the criterion of issue "on a continuous basis", the CSSF considers that it is assumed to be fulfilled from the moment the securitisation undertaking has made at least four issues per year. However, a securitisation undertaking that makes at least four issues on an annual basis is not subject to the supervision of the CSSF if it issues denominations exceeding EUR 125,000.

In order to preserve its flexible approach, the CSSF has not drawn up an exhaustive list of the "securities" a securitisation undertaking may issue. The securities issued shall in any case fulfil the characteristics and minimum conditions of fungible securities that can be traded on the capital market.

The CSSF has been asked to decide on the possibility to appoint legal persons to the board of directors of a securitisation undertaking. While the CSSF can accept, in principle, the appointment of legal persons, the criteria of competence and professional repute of the directors, in such constellations, will be assessed by the CSSF for both the legal persons and the natural persons appointed to represent the legal persons.

As far as the accounting is concerned, the CSSF confirmed that multiple-compartment securitisation companies should present their annual accounts, as well as the relating financial notes in such a form that the financial data for each compartment are clearly stated. It is possible however to regroup the notes to the financial statements for several compartments.

In order to avoid accounting asymmetries that can result from the application of different assessment rules depending on the legal form of the securitisation undertaking, the CSSF accepts that the securitisation undertakings apply the exemption provided for in article 26(5) of the law of 19 December 2002 on the trade and companies register and the accounting and the annual accounts of the companies, under the condition that they append an appropriate explanation to their accounts.

3.2. Nature of the securitisation transactions

The CSSF has accepted that some securitisations can be made through credits granted by a securitisation undertaking on condition that, on the one hand, the required funds to grant this loan are obtained via an issue of securities whose repayment is linked to the repayment of the said loan and that, on the other hand, the loan is a mode of assuming a risk linked to an underlying asset and whose repayment is linked to the value or yield of this underlying.

As regards active management activities, as well as concluding transactions on derivative instruments or forward transactions, repo-style transactions to value assets, securities lending activities and repurchase agreements, the CSSF considers that given their mainly static nature, the securitisation undertakings shall limit them to the strict minimum where these activities have been made necessary by or are an integral part of the securitisation transactions. Similarly, these activities shall be performed in accordance with article 61(1) of the law of 22 March 2004, which provides that a securitisation undertaking can only assign its assets in accordance with the provisions laid down in its articles of incorporation or its management regulations.

CHAPTER VI

SUPERVISION OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR

1. Developments in 2005 of the other professionals of the financial sector (PFS)

2. Prudential supervisory practice

1. DEVELOPMENTS IN 2005 OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR (PFS)

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

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

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

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

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

The year 2005 confirms the positive trend already observed in the previous year, the number of financial professionals increasing substantially as compared to the end of 2004. Indeed, after a stagnation between 2001 and 2003, the following years show a continuous growth in the number of PFS subject to the supervision of the CSSF. The growth in 2005 is still mainly attributable to the introduction by the law of 2 August 2003 of new specific PFS categories, as most of the entities authorised during this period have opted for one of these statuses.

The number of PFS thus rose from 166 entities as at 31 December 2004 to 185 entities at the end of 2005. The number of undertakings newly authorised in 2005 has however dropped compared to the number of entities that have been granted authorisation in the previous year (32 undertakings in 2005 against 43 in 2004). At the same time, it should be noted that the number of entities having given up their PFS status has slightly decreased (13 entities in 2005 against 19 entities in 2004).

Development in the number of PFS

Categories	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Investment firms										
Commission agents			4	7	10	14	15	17	15	14
(Brokers and commission agents)	14	14	/	/	/	/	/	/	/	/
Private portfolio managers	36	34	37	38	46	51	51	48	46	46
Professionals acting for their own account	18	20	15	17	14	17	16	16	16	14
Distributors of units/shares of investment funds	20	18	22	25	35	43	45	47	37	37
Underwriters			1	2	4	4	3	3	3	2
(Underwriters and market makers)	3	3	/	/	/	/	/	/	/	/
Professional custodians of securities or other financial instruments	3	3	1	1	3	4	3	3	3	3
Registrar and transfer agents								1	8	11
PFS other than investment firms										
Financial advisors	6	7	9	10	9	10	9	9	8	12
Brokers			10	8	7	6	6	5	4	6
Market makers			1	2	2	2	2	2	2	1
Professionals performing cash-exchange transactions									1	/
Debt recovery									3	2
Professionals performing credit offering									5	7
Professionals performing securities lending									1	1
Administrators of collective savings funds									1	1
PFS performing a connected or complementary activity of the financial sector										
Domiciliation agents of companies				1	14	32	36	34	31	32
Client communication agents								2	8	12
Administrative agents of the financial sector									6	8
IT systems and communication networks operators of the financial sector								1	11	24
Professionals performing services of setting up and of management of companies.									2	2

…Next page

Categories	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the amended 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									3	4
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services						1	1	1	1	1
Total [1]	**82**	**80**	**83**	**90**	**113**	**145**	**145**	**142**	**166**	**185**

Notes concerning the registration of PFS on the official list

- This table, just as the official list of PFS published on the CSSF website, includes, under the heading of company domiciliation agents, only entities that have been approved exclusively as company domiciliation agents under article 29 of the law of 5 April 1993 on the financial sector as amended. Entities authorised to exercise, in addition to the status of domiciliation agent, another PFS activity covered by chapter 2 of Part 1 of the aforementioned law are included in this category, since approval obtained as other professional of the financial sector implicitly allows the provision of company domiciliation services in accordance with the law of 31 May 1999 on company domiciliation.

- Similarly, the entities listed in the category of professionals performing services of setting up and of management of companies have been approved exclusively to perform this activity, in accordance with article 29-4 of the law of 5 April 1993 on the financial sector as amended. Those entities that are authorised to exercise another additional PFS activity are listed in that category. Indeed, as authorisation obtained as other professional of the financial sector implies the authorisation to also provide company domiciliation services and as the persons allowed to provide company domiciliation services under article 29 of this law are *ipso jure* authorised to also act as professional performing services of setting up and of management of companies, all professionals of the financial sector are authorised to perform services of setting up and of management of companies.

- Following the entry into force of the law of 2 August 2003, the above-mentioned lists include, since 31 December 2004, the professionals performing debt recovery, the professionals performing cash-exchange transactions and the PFS authorised under the general provisions of the law of 5 April 1993 on the financial sector as amended, whose activities do not fall under a specific PFS category. The latter are registered on the official list as professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 on the financial sector as amended, except for the categories of PFS also referred to in section 2 of the same chapter.

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

The table outlining the development in the number of PFS by categories over the years confirms the positive development observed in 2004 of the PFS statuses created by the law of 2 August 2003. It is especially the category of IT systems and communication networks operators of the financial sector that has boomed during 2005, with a significant increase of thirteen entities. This development reflects the special interest aroused by this new activity.

The IT systems and communication networks operators of the financial sector are followed by the client communication agents (+4 entities as compared to the previous year) and the registrar and transfer agents (+3 entities), as well as by the administrative agents of the financial sector and the professionals performing credit offering, showing an increase of two entities each.

Among the traditional PFS categories, the positive development of financial advisors (+4 entities as compared to the previous year) and brokers (+2 entities) should be underlined, a situation which reflects the renewed interest in this field of activity.

A slight decrease was recorded in the number of professionals acting for their own account, whereas the number of private portfolio managers, as well as that of the distributors of units/shares of investment funds remained stable during the year. The latter category has been less affected by the transformations into management companies under Chapter 13 of the law of 20 December 2002, the number of such changes of status having indeed fallen as compared to 2004.

It should also be noted that the sole financial player authorised as professional performing cash-exchange transactions ceased its activities in 2005.

As at 31 December 2005, no authorisation has been granted as yet in two categories introduced by the law of 2 August 2003, i.e. the professionals performing money transfer services and the management companies of non-coordinated UCIs.

Breakdown of PFS by geographic origin

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Germany	6	6	6	7	11	11	10	10	10	13
Belgium	29	27	25	24	21	22	22	18	21	23
United States	6	3	4	3	4	8	8	8	11	13
France	11	10	10	10	11	14	13	9	12	12
Luxembourg	8	11	12	17	22	31	31	32	48	56
Netherlands	2	2	3	3	7	12	15	15	18	19
United Kingdom	9	10	9	8	8	9	10	11	8	8
Switzerland	5	6	4	4	7	11	10	10	10	12
Others	6	5	10	14	22	27	26	29	28	29[2]
Total	**82**	**80**	**83**	**90**	**113**	**145**	**145**	**142**	**166**	**185**

The number of PFS originating from Luxembourg has again increased considerably in 2005, although less than in 2004, from 48 entities at the end of 2004 to 56 entities as at 31 December 2005, thereby remaining by far in the majority.

[2] Including Italy (4 entities), Sweden (3 entities), Denmark (3 entities).

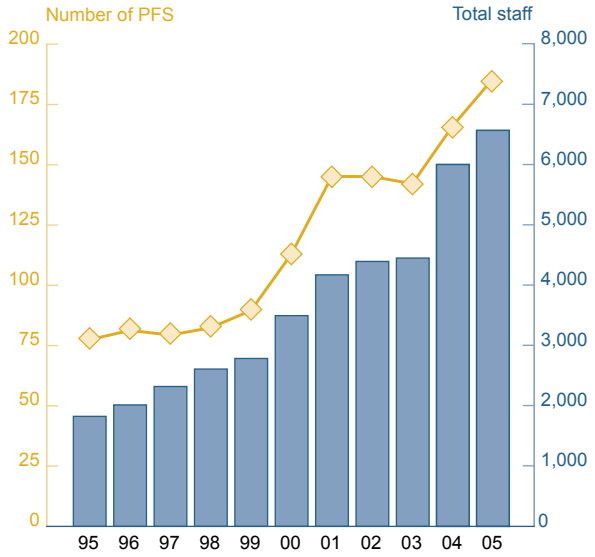
The diversification of the geographical origin of the PFS newly submitted to the supervision of the CSSF in 2005 should also be mentioned. Indeed, the number of PFS from Germany increased by 3 entities while the number of PFS from Belgium, Switzerland and the United States increased by two entities each, a development which bears witness to the attractiveness of the Luxembourg financial centre at international level.

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

The upward trend of employment is closely related to the increase in the number of PFS active in the financial centre. The year 2005 is indeed marked by a considerable growth both in the number of PFS (+19 entities) and in the number of persons employed. The positive development of employment, rising from 6,059 people as at 31 December 2004 to 6,547 people as at 31 December 2005, i.e. an annual growth of 8.05%, thus mainly results from the high number of newly approved PFS in 2005 and, to a lesser extent, from the increase in employment of certain entities already acting as PFS in the financial centre.

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



The development in the number of staff per quarter shows a slight increase during the first quarter (+101 entities), stemming mostly from newly authorised institutions during this period. The second quarter however shows a decrease in the number of PFS staff, falling from 6,160 people as at 31 March 2005 to 6,122 people as at 30 June 2005. This drop is notably due to the change of a PFS with a high number of staff into a management company governed by Chapter 13 of the law of 20 December 2002 as amended on undertakings for collective investment. This decrease is nevertheless partially offset by the staff of the entities approved during the second quarter.

The analysis of employment during the last two quarters clearly shows a continuous growth in total PFS staff, rising from 6,122 as at 30 June 2005 to 6,334 people as at 30 September 2005 and to 6,547 as at 31 December 2005, i.e. an 6.94% increase over the second half-year. This growth is mainly due to the positive development of the number of PFS performing a connected or complementary PFS activity of the financial sector during this period, but also to the increase in staff of certain institutions acting as registrar and transfer agent or distributor of units/shares of investment funds.

1.3. Changes in 2005 in the official list of PFS

1.3.1. PFS under Luxembourg law authorised in 2005

- ***Investment firms***

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

The following undertakings were authorised as investment firms in 2005:

• Banque Invik Asset Management S.A.	Private portfolio manager
• Fund Channel S.A.	Commission agent and distributor of units/shares of investment funds
• Investindustrial S.A.	Registrar and transfer agent[3]
• Tareno (Luxembourg) S.A.	Private portfolio manager
• Value-Call S.à r.l.	Private portfolio manager

In 2005, five entities were approved as investment firms, including three entities active as private portfolio manager. One entity has adopted the statuses of commission agent and distributor of units/shares of investment funds, while one company has applied for authorisation as registrar and transfer agent. The latter has also been granted the status of financial adviser and is therefore registered on the official list of PFS other than investment firms.

Position of the CSSF with respect to circular CSSF 2000/12 on the definition of capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended

In accordance with point 1. of Part III, circular CSSF 2000/12 applies to all investment firms incorporated under Luxembourg law, except for those undertakings to which article 13(2) of the law of 5 April 1993 on the financial sector as amended applies and for undertakings that only receive and transmit the instructions of investors without holding themselves customers' funds and/or securities.

In this context, the CSSF stresses that commission agents (article 24A of the law on the financial sector) and distributors of units/shares of investment funds that do not accept nor make payments (article 24D) do not fall, owing to their activities defined by the law, under the scope of circular CSSF 2000/12 and are thus not required to periodically report on their own funds and risks to the CSSF.

The CSSF considers that the same is true for registrar and transfer agents (article 24G), as their business activity consists in the reception and execution of orders on one or several instruments referred to in section B of annexe II. The execution of these orders includes keeping the register for the issuer. Given the above and considering that registrar and transfer agents do not hold themselves the funds and/or securities of their customers, this category of investment firm is also excluded from the scope of circular CSSF 2000/12 on the definition of capital ratios.

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

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

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

The following undertakings were approved as PFS other than investment firms in 2005:

- Family Trust Management Europe S.A. — Financial advisor[4]
- Farad Investment Advisor S.A. — Broker
- Figed S.A. — Broker[5]
- Fortis Commercial Finance S.A. — Professional performing credit offering
- Fortis Lease Luxembourg S.A. — Professional performing credit offering
- Investindustrial S.A. — Financial advisor[6]
- Logiver S.A. — Financial advisor
- Luxequip Bail S.A. — Professional performing credit offering
- Services Généraux de Gestion S.A., in abbreviated form "S.G.G." — Financial advisor[7]
- Stradivari Advisors S.A. — Financial advisor

Among these ten entities that have been granted authorisation in 2005, five are registered as financial advisor and two undertakings as broker, which also bears witness to the renewed interest in traditional PFS activities. Three entities have adopted the status of professional performing credit offering, one of the categories introduced by the law of 2 August 2003.

Four of the newly authorised companies had applied for more than one PFS status, which confirms the diversification of activities in the financial sector. These institutions are thus also registered on the official list of investment firms and on the table of PFS performing a connected or complementary activity of the financial sector respectively.

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

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

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

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

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

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

The following undertakings have been authorised as PFS performing a connected or complementary activity of the financial sector in 2005:

• Allied Arthur Pierre S.A.	Client communication agent
• American Express Financial Services (Luxembourg) S.A.	Administrative agent of the financial sector
• Cofinor S.A.	Domiciliation agent
• Computacenter PSF S.A.	IT systems and communication networks operator of the financial sector
• Computer Task Group Luxembourg PSF S.A., in abbreviated form "CTG Luxembourg PSF S.A."	IT systems and communication networks operator of the financial sector
• Dimension Data Financial Services S.A.	IT systems and communication networks operator of the financial sector
• Family Trust Management Europe S.A.	Professional performing services of setting up and of management of companies[8]
• Figed S.A.	Professional performing services of setting up and of management of companies[9]
• Hewlett-Packard PSF Luxembourg S.à r.l.	IT systems and communication networks operator of the financial sector
• N.R.G. Luxembourg S.à r.l.	Client communication agent
• Services Généraux de Gestion S.A., in abbreviated form "S.G.G."	Domiciliation agent[10]
• Siemens Financial Business Services S.A.	IT systems and communication networks operator of the financial sector
• Sogeti PSF	IT systems and communication networks operator of the financial sector
• Streff S.à r.l.	Client communication agent
• Sun Microsystems Financial Sector S.à r.l.	IT systems and communication networks operator of the financial sector
• Systemat Luxembourg PSF S.A.	IT systems and communication networks operator of the financial sector
• Tata Consultancy Services Luxembourg S.A.	IT systems and communication networks operator of the financial sector
• Telindus PSF	IT systems and communication networks operator of the financial sector
• T-Systems Luxembourg S.A.	IT systems and communication networks operator of the financial sector
• Xerox Luxembourg S.A.	IT systems and communication networks operator of the financial sector and client communication agent

The table shows the considerable interest in the connected or complementary activities in the financial sector, including in particular the activity of IT systems and communication networks operator of the financial sector in the light of the developments in the field of data processing and outsourcing.

Indeed, twelve institutions have requested an authorisation to perform this activity during the year under review, including one entity that has opted in addition for the status of client communication agent. Four entities have been approved as client communication agent, three of them performing only this activity. In 2005, only one undertaking has been granted authorisation to act as administrative agent of the financial sector.

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

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

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

The status of domiciliation agent of companies has been requested by two undertakings in 2005, a trend which is slightly decreasing as compared to the previous years. One of these players has also been granted authorisation as financial advisor and is therefore registered on the official list of PFS other than investment firms. It should also be mentioned that one of the professionals performing services of setting up and of management of companies has also been authorised as financial advisor and one as broker.

The majority of establishments authorised in 2005 as PFS performing a connected or complementary activity of the financial sector, including notably IT systems and communication networks operators of the financial sector, has applied for only one PFS status.

Definition of the activity of a professional performing services of setting up and of management of companies (article 29-4 of the law on the financial sector): additional information regarding the services relating to the setting up or management of companies

- The services pertaining to the setting up of companies consist in performing, for the account of the customer, all kinds of steps to set up the type of company requested, including the service of intermediary offered to a customer to draw up memoranda of association of a company (Luxembourg or foreign), as well as the representation of a customer for the incorporation of a company.

  As regards the services relating to the management of companies, article 29-4 notably aims at natural and legal persons that provide directors, administrators or managers to third companies, who may act as intermediary charged with seeking representatives, or by intervening actively in the management of the client company.

  The CSSF specifies however that the persons active as director, administrator or manager for their own account and independently from any third-party request based on a professional/customer relationship are not referred to under article 29-4.

- As regards the definition of the activity of a professional performing services of setting up and of management of companies, the CSSF specifies, in accordance with article 29-4 of the law on the financial sector, that the relationship between the professional and the customer is the deciding element. Indeed, it implies that the activity in question is performed in a repetitive manner or that the service provider is remunerated for the services provided.

- ***Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the amended 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***

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

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

Only one institution has been granted approval as professional of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the law of 5 April 1993 as amended, except for the categories of PFS also referred to in section 2 of the same chapter, namely:

- Cyberservices S.à r.l.

1.3.2. PFS that gave up their status in 2005

Thirteen institutions, including nine investment firms, gave up their PFS status in 2005. Three entities have been taken over by merger, one PFS has split into two new companies and three entities gave up their PFS status in order to become a management company under Chapter 13 of the law of 20 December 2002 as amended on undertakings for collective investment. The other withdrawals are due to the winding-up of the institution (two entities), the liquidation (one entity), the change into a bank (one entity), the discontinuation of activities (one entity) and the switch to activities which no longer require an authorisation as PFS as they no longer fall under the scope of the law of 5 April 1993 on the financial sector as amended (one entity).

• **ACM Global Investor Services S.A.** Registrar and transfer agent Domiciliation agent	Takeover by merger by Alliance Capital (Luxembourg) S.A.
• **Bearbull (Luxembourg) S.A.** Private portfolio manager	Takeover by merger by Banque Degroof Luxembourg S.A.
• **Crédit Lyonnais Management Services (Luxembourg) S.A.,** in abbreviated form "C.L.M.S. (Luxembourg) S.A." Professional acting for its own account Private portfolio manager	Takeover by merger by Crédit Agricole Luxembourg Conseil S.A.
• **E Oppenheimer & Son (Luxembourg) Limited** Commission agent Administrative agent of the financial sector Domiciliation agent	Cessation of PFS activities
• **Eurolease-Factor S.A.** Professional performing credit offering	Split into two new companies
• **Fund-Market Research & Development S.A.** Private portfolio manager	Change into management company
• **GMI-Conseils en Valeurs Mobilières Internationales S.A.** Financial advisor	Winding-up
• **J.P. Morgan Fleming Asset Management (Europe) S.à r.l.** Private portfolio manager Distributor of units/shares of investment funds	Change into management company
• **Key Asset Management S.A.** Private portfolio manager	Liquidation
• **Le Recours S.à r.l.** Debt recovery	Winding-up
• **Schroder Investment Management (Luxembourg) S.A.** Distributor of units/shares of investment funds Registrar and transfer agent	Change into management company
• **Travelex Belgium N.V., Bruges (Belgium), succursale de Luxembourg** Professional performing cash-exchange transactions	Cessation of activities
• **V.M.S. Luxembourg S.A.** Professional acting for its own account Market maker Underwriter	Change into a bank

1.3.3. Changes in category in 2005

The changes in categories of the professionals of the financial sector in 2005 continue the trend initiated in 2004, i.e. the financial players seek to diversify the services they provide. Despite a drop in the total number of changes requested in 2005 as compared to the previous year, the changes concerning the adoption of an additional PFS status remain in the majority.

Name of the PFS	Category(ies) before the change	Category(ies) after the change
• Atag Asset Management (Luxembourg) S.A.	Private portfolio manager	Private portfolio manager Registrar and transfer agent
• BNP Paribas Fund Services S.A.	Private portfolio manager Distributor of units/shares of investment funds	Private portfolio manager Distributor of units/shares of investment funds Administrative agent of the financial sector
• Compagnie Financière et Boursière Luxembourgeoise S.A., in abbreviated form "Cofibol"	Professional acting for its own account	Professional acting for its own account Registrar and transfer agent
• Crédit Agricole Luxembourg Conseil S.A., in abbreviated form "CAL Conseil"	Commission agent Domiciliation agent	Private portfolio manager Domiciliation agent
• Farad Investment Advisor S.A.	Broker	Broker Distributor of units/shares of investment funds
• ING Lease Luxembourg S.A.	Professional performing credit offering	Professional performing credit offering Administrative agent of the financial sector
• Maitland Luxembourg S.A.	Administrative agent of the financial sector Domiciliation agent	Administrative agent of the financial sector Domiciliation agent Registrar and transfer agent
• MeesPierson Intertrust (Luxembourg) S.A.	Professional acting for its own account	Professional acting for its own account Administrative agent of the financial sector
• Unico Financial Services S.A.	Professional acting for its own account Distributor of units/shares of investment funds	Professional acting for its own account Distributor of units/shares of investment funds IT systems and communication networks operator of the financial sector

This table reflects the growing interest in 2005 of the existing PFS for the activity of registrar and transfer agent and administrative agent of the financial sector. Indeed, three extensions of status concern the activity of registrar and transfer agent, and the same number of PFS has opted for the category administrative agent of the financial sector as additional activity.

The majority of undertakings that had requested a change of status during 2005 are investment firms, including five that have adopted an additional status, while only one entity had requested a change of category.

1.4. Development in the balance sheet totals and results

Categories	Balance sheet total in EUR		
	2003	2004	2005[11]
Investment firms			
Commission agents	164,866,179	228,721,820	234,666,635
Private portfolio managers	907,099,509	450,342,614	370,458,735
Professionals acting for their own account	271,124,494	390,557,957	277,183,833
Distributors of units/shares of investment funds	928,085,917	952,754,027	695,462,369
Underwriters	106,781,684	152,646,460	21,421,713
Professional custodians of securities or other financial instruments	925,418,041	916,534,933	810,804,535
Registrar and transfer agents	1,590,054	110,412,089	96,074,387
PFS other than investment firms			
Financial advisors	10,644,954	8,979,377	27,395,755
Brokers	43,277,682	44,019,211	54,723,126
Market makers	17,284,792	21,122,130	8,017,222
Professionals performing cash-exchange transactions	/	1,903,163	/
Debt recovery	/	754,826	485,913
Professionals performing credit offering	/	1,892,660,216	1,837,798,018
Professionals performing securities lending	/	39,449,146,884	46,388,629,755
Administrators of collective savings funds	/	143,153	161,740
PFS performing a connected or complementary activity of the financial sector			
Domiciliation agents	111,916,406	55,966,969	60,173,984
Client communication agents	4,174,686	55,064,446	56,366,648
Administrative agents of the financial sector	/	206,256,933	408,892,280
IT systems and communication networks operators of the financial sector	1,590,054	248,310,954	304,042,871
Professionals performing services of setting up and of management of companies	/	2,252,807	2,584,453
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the amended 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	/	110,073,668	119,090,708
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services	/	1,230,334,511	1,424,821,083
Total	**2,481,838,773**	**45,130,954,839**	**51,980,617,087**

[11] Preliminary figures.

Categories	Balance sheet total in EUR		
	2003	2004	2005[12]
Investment firms			
Commission agents	6,033,898	16,071,631	26,513,298
Private portfolio managers	153,179,404	63,749,770	45,289,874
Professionals acting for their own account	28,023,437	17,628,734	32,712,225
Distributors of units/shares of investment funds	94,658,705	134,295,503	127,725,962
Underwriters	2,556,767	1,886,846	1,350,825
Professional custodians of securities or other financial instruments	143,413,235	102,565,558	191,918,600
Registrar and transfer agents	-479,488	9,801,438	8,573,108
PFS other than investment firms			
Financial advisors	1,934,732	1,466,072	4,766,525
Brokers	16,585,941	20,620,214	24,190,329
Market makers	239,971	211,142	82,242
Professionals performing cash-exchange transactions	/	197,219	/
Debt recovery	/	-12,631	40,692
Professionals performing credit offering	/	38,326,556	41,652,278
Professionals performing securities lending	/	1,248,775	1,396,450
Administrators of collective savings funds	/	0	0
PFS performing a connected or complementary activity of the financial sector			
Domiciliation agents	8,569,665	7,927,475	6,846,693
Client communication agents	601,679	1,607,668	5,044,949
Administrative agents of the financial sector	/	5,417,473	21,889,476
IT systems and communication networks operators of the financial sector	-479,488,	10,975,582	20,915,551
Professionals performing services of setting up and of management of companies	/	54,630	-41,211
Professionals of the financial sector authorised to exercise any activity referred to in section 1 of chapter 2 of Part I of the amended 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	/	541,904	866,130
Establishments authorised to exercise all the PFS activities permitted by article 28 of the law of 15 December 2000 on postal services and financial postal services	/	-3,478,195	-3,088,217
Total	**367,168,643**	**317,371,968**	**433,943,575**

[12] Preliminary figures

Comment as regards the tables

Since the same company can operate in several business sectors, the total does not reflect the arithmetical sum of headings under the different PFS categories. For professionals of the financial sector authorised to conduct business under articles 24A to 24D, 24G, 25, 26, 29-1 and 29-2 of the law of 5 April 1993 as amended, the balance sheet total and the results respectively are recorded only once in the total, i.e. in the category for which the capital requirements are the most stringent. If the professional conducts additional business outside of the above-mentioned categories, governed by section 2 of chapter 2 of the aforementioned law, the balance sheet total and net result respectively are aggregated for each category but are not included in the grand total to avoid double counting.

The balance sheet total of the PFS established in Luxembourg reached EUR 51,981 million as at 31 December 2005 against EUR 45,131 million at the end of 2004, which represents a 15.18% increase. This significant increase stems mainly from a substantial growth in the business volume of the institution authorised as professional performing securities lending. The considerable increase in the number of PFS in 2005, rising from 166 as at 31 December 2004 to 185 entities at the end of 2005, is another factor that explains the growth in the balance sheet total over a period of twelve months.

The positive development in the balance sheet total goes hand in hand with a rise in net results of the PFS, which amount to EUR 434 million as at 31 December 2005 against EUR 317 million as at 31 December 2004, representing a 36.73% increase year-on-year. This substantial growth can be explained, on the one hand, by the important number of PFS newly authorised in 2005, and, on the other hand, by an improved profitability of some important players acting as professional custodians of securities or other financial instruments and distributors of units/shares of investment funds.

The table plotting the development of the balance sheet total and net results in 2005 reveals differences according to the different categories of PFS. Certain categories recorded a fall in their results compared to last year, while the balance sheet total and/or net results of other categories remained either stable or increased at a more or less sustained rate.

- ***Commission agents***

Both the balance sheet total and net results of the commission agents increased substantially as compared to the end of 2004. This development is mainly due to the positive development of the figures of several significant professionals in this category.

- ***Private portfolio managers***
  Distributors of units/shares of investment funds

Private portfolio managers and distributors of units/shares of investment funds, whose total number remained stable year-on-year with 46 and 37 entities respectively, have recorded a considerable decrease in their balance sheet total as compared to the previous year. This drop, which is mainly related to the change of an important player active as private portfolio manager and distributor of units/shares of investment funds into a management company, namely J.P. Morgan Fleming Asset Management (Europe) S.à r.l., could only be partially offset through the positive development of the balance sheet total of several other undertakings active in these fields.

Net results of the private portfolio managers have fallen considerably over twelve months. This development is mainly attributable to the aforementioned entity having given up its status. Distributors of units/shares of investment funds only record a slight decrease in their net results as compared to the previous year. Indeed, the improved profitability in 2005 of several important players in this PFS category did not allow to fully offset the negative development in the net results due to the change of two large-sized distributors of units/shares of investment funds into a management company.

- ***Underwriters***

  The considerable decrease in the balance sheet total of one undertaking in this category, as well as the decrease in the number of underwriters, from three entities as at 31 December 2004 to two entities in 2005 following the change from one PFS into a bank, explain the significant fall in the balance sheet total. Nevertheless, this development did not have any major impact on net results, which only recorded a slight decrease year-on-year.

- ***Professional custodians of securities or other financial instruments***

  Despite the stability in the number of professional custodians of securities or other financial instruments as compared to the previous year (three entities), this category recorded a fall in the balance sheet total and a significant increase in net results. The latter is mainly attributable to one major player in the financial centre, namely Clearstream International S.A..

- ***Financial advisors***
  Brokers

  The increase in the number of financial advisors (+4 entities) and brokers (+2 entities) in 2005 is the reason for the growth both in the balance sheet total and in the net results as compared to the end of 2004. This variation is due to a lesser extent to the positive development in the financial results of some other players authorised to perform these activities.

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

  The table reveals a net increase in the balance sheet total, as well as in net results for these three PFS categories in 2005. This rise is mainly due to the substantial increase in the number of entities authorised as client communication agents (+4 entities), administrative agents of the financial sector (+2 entities) and IT systems and communication networks operators of the financial sector (+13 entities), as these categories introduced by the law of 2 August 2003 have indeed boomed in 2005.

1.5. Expansion of PFS at international level

1.5.1. Formation of subsidiaries during 2005

In 2005, the CSSF has not received any request from an investment firm incorporated under Luxembourg law to open a subsidiary abroad.

1.5.2. Freedom of establishment

In 2005, three investment firms incorporated under Luxembourg law set up branches in one or several other EU/EEA countries under the freedom of establishment, namely IAM Strategic S.A., which set up a branch in Sweden, Notz, Stucki Europe S.A. which set up a branch in Italy, as well as Vontobel Europe S.A., which set up in Austria by means of a branch.

Due to its change into a management company under the law of 20 December 2002 concerning undertakings for collective investment, J.P. Morgan Fleming Asset Management (Europe) S.à r.l. gave up its PFS status during 2005 and is therefore not registered anymore on the list of Luxembourg-incorporated investment firms having established a branch in one or several EU/EEA countries.

As at 31 December 2005, the following Luxembourg investment firms are represented by way of a branch in one or several other EU/EEA countries.

• **BNP Paribas Fund Services** Private portfolio manager Distributor of units/shares of investment funds Administrative agent of the financial sector	Spain
• **Clearstream International S.A.** Professional custodian of securities or other financial instruments	United Kingdom
• **Compagnie Financière et Boursière Luxembourgeoise S.A., in abbreviated form "Cofibol"** Professional acting for its own account Registrar and transfer agent	Belgium
• **Createrra S.A.** Professional acting for its own account Domiciliation agent	Belgium
• **Creutz & Partners, Global Asset Management S.A.** Private portfolio manager	Germany
• **Financial Advisor Services (Europe) S.A.** Distributor of units/shares of investment funds	Germany Italy
• **IAM Strategic S.A.** Private portfolio manager	Sweden
• **Le Foyer, Patrimonium & Associés S.A.** Private portfolio manager Distributor of units/shares of investment funds	Belgium
• **Moventum S.A.** Private portfolio manager Distributor of units/shares of investment funds Registrar and transfer agent	Germany
• **Notz, Stucki Europe S.A.** Private portfolio manager	Italy
• **SZL S.A.** Professional acting for its own account	Belgium
• **Vontobel Europe S.A.** Private portfolio manager Distributor of units/shares of investment funds	Germany Austria
• **WH Selfinvest S.A.** Commission agent	Belgium

The number of branches set up in Luxembourg by investment firms originating from another EU/EEA Member State totals four entities as at 31 December 2005:

• Gadd Capital Management Ltd	Gibraltar
• Morgan Stanley Investment Management Limited	United Kingdom
• PFPC International Limited	Ireland
• T. Rowe Price Global Investment Services Limited, in abbreviated form "TRPGIS"	United Kingdom

Although their number has not changed as compared to the previous year, the situation of branches has nevertheless undergone two changes as compared to the end of 2004. Indeed, while one branch from the United Kingdom, namely T. Rowe Price Global Investment Services Limited, has started its activities in Luxembourg in 2005, the British branch Bache Financial Limited stopped its activities in Luxembourg during the same year.

1.5.3. Freedom to provide services

In 2005, eleven investment firms incorporated under Luxembourg law applied to pursue business in one or several EU/EEA Member States under the freedom to provide services. The total number of investment firms active in one or several EU/EEA Member States, following a notification, amounts to 35 as at 31 December 2005. The majority of the investment firms freely provide services in several other EU/EEA countries.

Following several years of decrease, the clear upward trend in the number of notifications to freely provide services in Luxembourg introduced by investment firms from other EU/EEA countries, as already noted in 2004, has been confirmed in 2005. The number of foreign entities having applied for free provision of services in Luxembourg has indeed risen from 108 entities in 2004 to 128 entities in 2005. This growth, although weaker than in the previous year (108 entities in 2004 compared to 68 entities in 2003), bears witness to the internationalisation of the financial activities and more specifically the vivid interest for the Luxembourg financial centre.

The geographical breakdown of foreign investment firms having introduced a notification in 2005 reveals that the British investment firms remain by far the most important in number to apply for free provision of services in Luxembourg, followed by the Dutch and German investment firms.

Country of origin	Number of entities having applied for free provision of services in 2004	Number of entities having applied for free provision of services in 2005
Germany	6	12
Austria	7	5
Belgium	1	/
Cyprus	1	8
Denmark	/	2
Spain	2	/
Finland	1	/
France	13	4
[Gibraltar]	/	1
Greece	1	/
Ireland	1	3
Italy	1	/
Malta	/	1
Norway	/	1
Netherlands	13	12
United Kingdom	59	77
Slovenia	2	/
Sweden	/	2
Total	**108**	**128**

While the geographical breakdown shows only slight changes for the majority of countries compared to the previous year, the number of entities from the United Kingdom has increased substantially by 18 entities, which mainly explains the important increase in the total number of notification as compared to 2004.

The number of notifications received by the CSSF from Cypriot investment firms has risen by seven entities over a year, closely followed by entities from Germany, with an increase of six entities. On the contrary, the table reveals a strong decrease in the notifications from France, decreasing from thirteen in 2004 to four in 2005. Furthermore, the CSSF has received the first notification to freely provide services in Luxembourg from an entity from Malta, a Member of the EU since 1 May 2004. Thus, the new EU Member States begin to show interest in Luxembourg, as nine Cypriot, two Slovene and one Maltese entities have introduced a notification in the last two years.

As at 31 December 2005, a total of 1,115 EU/EEA investment firms were authorised to freely provide their services on Luxembourg territory.

2. PRUDENTIAL SUPERVISORY PRACTICE

2.1. Instruments of prudential supervision

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

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

2.2. On-site inspections

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

In 2005, the CSSF carried out on-site inspections at the premises of two professionals of the financial sector.

The purpose of one on-site inspection of a PFS was to make sure that the entity is operating properly, notably as regards the central administration and the administrative and accounting organisation. The CSSF's checks concerned in particular the appropriateness of the administrative structures set up in relation with the notification to open a branch in a EU/EEA Member State.

The CSSF's inspection at the premises of the second PFS concerned more particularly the principle of asset separation, in accordance with the provisions of article 36-1 of the law of 5 April 1993 on the financial sector as amended. A PFS managing third party funds must indeed enter them in accounts separate from those relating to its own assets. Appropriate corrective measures have been taken in relation to the irregularities observed in order to remedy the situation.

2.3. Meetings

A total of 125 meetings concerning the activities of professionals of the financial sector were held at the CSSF's premises during the year under review.

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

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

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

2.4. Specific controls

Article 54(2) of the law of 5 April 1993 on the financial sector as amended entitles the CSSF to require external auditors to carry out a specific audit of a financial professional, covering one or several specific aspects of the business or operation of the entity concerned. The ensuing costs are to be borne by the professional concerned. The CSSF has not made formally use of this right in 2005.

2.5. Supervision on a consolidated basis

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

As at 31 December 2005, the CSSF had carried out supervision on a consolidated basis of fourteen investment firms falling under the scope of the above-mentioned law. An in-depth study of the financial groups to which most of the PFS investment firms belong was required in order to determine whether, at what level and in what form, consolidation should apply. For the investment firms concerned, circular CSSF 00/22 on the supervision of investment firms on a consolidated basis specifies the practical aspects of the rules as regards this type of supervision. Many companies supervised on a consolidated basis belong to major groups operating in the financial sector and whose ultimate parent company is usually a credit institution.

The following PFS were subject to supervision by the CSSF on a consolidated basis at 31 December 2005:

- BNP Paribas Fund Services
- Brianfid-Lux S.A.
- Capital @ Work International S.A.
- Citco (Luxembourg) S.A.
- Clearstream International S.A.
- Foyer Asset Management S.A.
- Hottinger & Cie
- Interinvest S.à r.l.
- Kredietrust Luxembourg S.A.
- MeesPierson Intertrust (Luxembourg) S.A.
- Petercam (Luxembourg) S.A.
- Premium Select Lux S.A.
- Puilaetco Dewaay Luxembourg S.A.
- UBS Fund Services (Luxembourg) S.A.

Reminder concerning the interpretation of article 52(3) of the law of 5 April 1993 on the financial sector as amended

Article 52 relating to the official lists and the protection of titles provides in paragraph 3 that no person shall make use for commercial purposes of his registration in an official list or of the fact of his being subject to supervision by the CSSF.

The CSSF insists on the importance it attaches to the interpretation of this article, even more so given the topicality of this subject. Indeed, some entities apply for authorisation as PFS, in particular as PFS performing a connected or complementary activity of the financial sector, as they consider that this authorisation provides them with a quality label.

The CSSF reiterates its position in this respect, that is to say that authorisation as PFS cannot in any case be interpreted as corporate image and that being officially under the supervision of the competent authority does not *de facto* constitute a quality label.

An application for authorisation as PFS shall be submitted where the activities fall under the scope of the law on the financial sector and shall not be motivated by the will to become a PFS in order to mention this fact for advertising purposes or to use it as corporate image.

DEPARTMENT SUPERVISION OF PFS

Left to right: Carole NEY, Simone GLOESENER, Claudia MIOTTO, Elisabeth DEMUTH, Nicole LAHIRE, Denise LOSCH, Gérard BRIMEYER, Sylvie MAMER, Luc PLETSCHETTE, Sonny BISDORFF-LETSCH, Carlo FELICETTI

Absent: Emilie LAUTERBOUR, Anne MARSON

CHAPTER VII

SUPERVISION OF SECURITIES MARKETS

1. Reporting of transactions on financial assets
2. Investigations conducted by the CSSF in its supervision of securities markets
3. Supervisory practice
4. Developments in the regulatory framework

1. REPORTING OF TRANSACTIONS ON FINANCIAL ASSETS

1.1. Reporting requirements

No changes have been made in 2005 to the legislation as regards reporting of transactions on financial assets. With respect to the reporting requirement that applies to credit institutions and investment firms, the CSSF supervises their compliance with the requirements laid down in circular CSSF 99/7 on reporting to the CSSF, in accordance with the law of 23 December 1998 on the supervision of securities markets as amended.

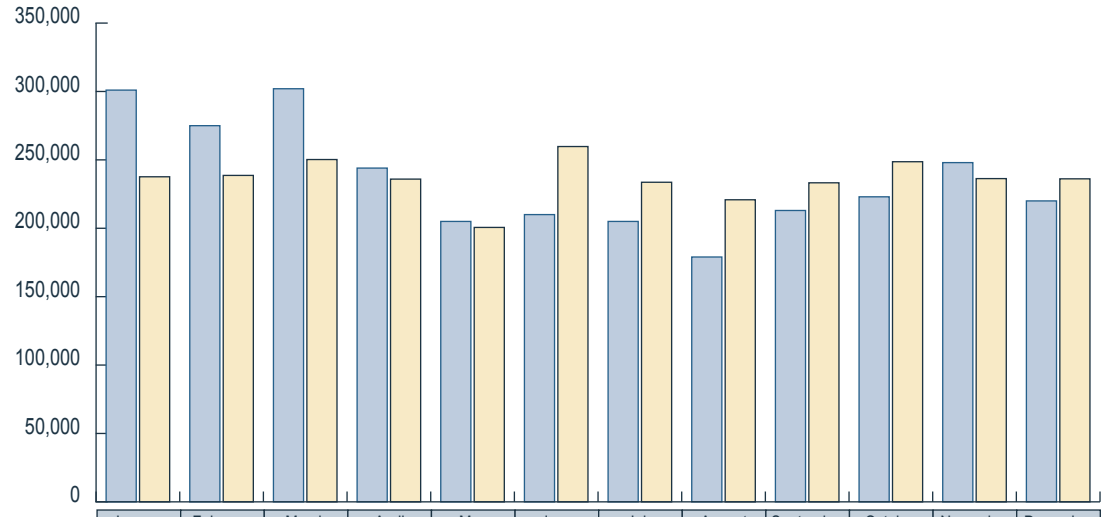
In this context and within the scope of its daily supervisory mission, the CSSF addressed a total of 42 letters, covering the following subjects, to investment firms:

Subject	Number
Mailing of the *Recueil* to new firms	9
Authorisations (reporting via fax, exemptions, deferrals)	6
TAF reporting irregularities	12
Request for explanations regarding transactions	2
Reminders	8
Others	5
Total	**42**

1.2. Development in the number of trades reported

The number of trades reported in 2005 amounted to 2,830,548, which is almost the same as in 2004 (2,830,270 trades reported).

Monthly volume of trades reported



	January	February	March	April	May	June	July	August	September	October	November	December
2004	301,472	275,355	302,339	244,932	205,452	210,510	205,614	179,677	213,039	223,319	248,535	220,026
2005	237,519	238,528	250,181	235,887	200,544	259,696	233,509	220,783	233,151	248,577	236,171	236,002

Breakdown of transactions by type of instrument

Type of instrument	Number of trades reported (as a % of total)	
	2004	2005
Shares	63.11%	66.08%
Bonds	32.78%	29.48%
Futures	0.90%	0.92%
Options	1.67%	1.81%
Warrants	1.38%	1.51%
Bonds with warrants attached	0.16%	0.20%

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

2. INVESTIGATIONS CONDUCTED BY THE CSSF IN ITS SUPERVISION OF SECURITIES MARKETS

A distinction should be drawn between investigations conducted into breaches of stock exchange regulations, investigations into non-compliance with the rules of conduct in the financial sector as laid down more specifically in circular CSSF 2000/15 of 2 August 2000 as amended and investigations conducted within the scope of general supervision of securities markets.

2.1. Investigations into breaches of stock exchange regulations

The CSSF is the administrative authority competent to ensure that the provisions of the law of 3 May 1991 on insider dealing are applied. Its aim is twofold: ensure fair and equal treatment of investors, as well as protection against the illegal use of insider information.

In the context of its supervision of securities markets, the CSSF either initiates inquiries itself or conducts them in response to a request for assistance from a foreign administrative authority within the framework of international co-operation.

2.1.1. Inquiries initiated by the CSSF

- ***Inquiries into insider dealing***

In 2005, the CSSF initiated three inquiries into a possible infringement of the law of 3 May 1991 on insider dealing. These investigations are still in progress.

One inquiry already opened in 2004 has been closed without further action taken.

- ***Inquiries into price manipulation***

The CSSF has not opened any inquiry into price manipulation in 2005.

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

- ***Inquiries into insider dealing***

In 2005, the CSSF processed 54 requests concerning inquiries into insider dealing (against 47 in 2004). Among these requests, one was received from an administrative authority of a country outside the European Economic Area.

The CSSF handled all these requests with the necessary diligence befitting co-operation between authorities and no major issues relating to the requests of information submitted to the involved financial institutions have arisen.

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

The CSSF received six inquiries into price manipulation, three inquiries into breaches of the requirement to report major stockholdings, one inquiry regarding an illegal offer of securities from an administrative authority of a non-EEA country, two inquiries regarding dissemination of false information on listed companies, one inquiry regarding an illegal offer of financial services, four various inquiries regarding Luxemburg-incorporated companies and one inquiry regarding UCI management.

The CSSF responded to all these requests within the scope of its legal competence.

2.2. Inquiries into non-compliance with the rules of conduct in the financial sector initiated by the CSSF and inquiries within the scope of general supervision of securities markets

The CSSF's interventions as regards non-compliance with the rules of conduct in the financial sector and/or within the scope of its general supervision of securities markets are mainly motivated by the will to protect investors and ensure market integrity. The decisions to open an investigation or to intervene with a professional of the financial sector are, at first, based on analytical reports of daily trading activity at the Luxembourg Stock Exchange, as well as on the analysis of trades reported to the CSSF. The CSSF then analyses this information and decides on the appropriateness of an intervention.

In this context, the CSSF continued its investigations relating to a preliminary inquiry into breaches of stock market rules initiated in 2004 and has been able to close all the aspects of this case without needing to open a formal investigation.

In 2005, the CSSF conducted five preliminary inquiries within the scope of its general supervision of the markets, including one relating to a suspicion of price manipulation and four in relation to suspicions of insider dealing. Two of these preliminary inquiries led the CSSF to initiate inquiries into possible infringements of the law of 3 May 1991 on insider dealing (please refer to point 2.1.1. "Inquiries initiated by the CSSF").

3. SUPERVISORY PRACTICE

In accordance with the law of 23 December 1998 on the supervision of securities markets as amended, the CSSF performs its statutory missions with regard to the supervision of stock exchanges and the listed Luxembourg companies.

3.1. Supervision of stock exchanges

The establishment of a stock exchange in Luxembourg is subject to a concession to be granted by Grand-Ducal decree. The only stock exchange currently licensed under Luxembourg law is the Société de la Bourse de Luxembourg S.A. (Luxembourg Stock Exchange). The CSSF monitors the proper functioning of the markets operated by the Luxembourg Stock Exchange, as well as the compliance with the regulations applying to securities markets.

3.1.1. Regulatory changes

The law of 10 July 2005 on prospectuses for securities introduces a precise definition of "regulated market" into the Luxembourg legislation. Thus, a regulated market is a "multilateral system operated and/or managed by a market operator as defined in Directive 2004/39/EC on markets in financial instruments, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions on regulated markets of the European Economic Area. These regulated markets shall be included in the list of all regulated markets published by the European Commission."

This law also amends the law of 23 December 1998 on the supervision of securities markets by inserting the following definition of the notion of "stock exchange": "A stock exchange shall be a market operator which has the capacity to manage and/or operate one or several markets of financial assets".

This amendment of the law of 23 December 1998 on the supervision of securities markets allows the launch, on 18 July 2005, of the Euro MTF market by the Luxembourg Stock Exchange. The Euro MTF is a market that is not included in the list of regulated markets published by the European Commission. The creation of the Euro MTF market prepares for the coming European legal framework that will be introduced in Luxembourg through the transposition of Directive 2004/39/EC on markets in financial instruments. It is an option offered to issuers that are willing to benefit from an efficient regulatory framework, but that do not require a European passport for prospectuses.

The Euro MTF market is meant for issuers who decide not to be governed by the new rules applicable as of July 2005 in terms of financial information to be provided in a prospectus and as of beginning of 2007 in terms of financial statements to be published in accordance with the provisions of Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive).

The operating rules of this new market are specified in the Rules and Regulations of the Luxembourg Stock Exchange, which have been subject to significant amendments in order to be adapted to the new legal framework.

Securities admitted to trading on the Euro MTF market are subject to the requirement to publish a prospectus in accordance with Part IV of the law on prospectuses for securities. The provisions governing the drawing-up of these prospectuses and their content are laid down in the operating rules of the market operator, i.e. the Rules and Regulations of the Luxembourg Stock Exchange.

Trading on the Euro MTF market is subject to the prohibition of market abuse referred to in Chapter IX of the Rules and Regulations of the Luxembourg Stock Exchange. In this context, it should be noted that the scope of the prohibition in relation to market abuse and notably insider dealing referred to in draft law no. 5415 on market abuse also covers the financial instruments admitted on the Euro MTF market. Indeed, it has been decided, following the creation of the new market, to extend the scope of the prohibition of market abuse referred to in the above-mentioned draft law to the financial instruments admitted to the alternative markets in order to strengthen the credibility and reliability of these markets. The Rules and Regulations of the Luxembourg Stock Exchange refer to the Euro MTF market as a "market regulated by the Stock Exchange".

On 29 August 2005, the CSSF announced that the new Euro MTF market operating with the Luxembourg Stock Exchange is to be considered as a "regulated market, which is regularly operating, recognised and open to the public." The CSSF insisted on specifying that the securities and money market instruments traded on the Euro MTF market are eligible investments for undertakings for collective investment under Part I of the law of 30 March 1988, respectively of the law of 20 December 2002 concerning undertakings for collective investment. On 10 August 2005, the UK tax authorities also announced that the securities admitted to the official listing and to trading on the Euro MTF market meet the requirement to be listed on a "recognised" stock exchange. According to a positive decision of the Governing Council of the European Central Bank, the Euro MTF market is listed since 7 October 2005 on the list of non-regulated markets accepted by the Eurosystem. The assessment criteria of the European Central Bank for non-regulated markets are the following: safety, transparency and accessibility. The acceptance of the Euro MTF market by the different authorities is an important criterion to ensure the success of this non-regulated market under the terms of the European Directives. At the end of 2005, 871 securities were already listed on the Euro MTF market.

Finally, it should be noted that the law on prospectuses for securities also repeals certain articles of the law of 10 August 1915 concerning commercial companies, including notably the articles on the filing of a legal notice for public displays, offers or sales of securities and on the requirement to establish the subscription in duplicate.

3.1.2. Markets operated by the Luxembourg Stock Exchange

The CSSF is kept informed of market activities and related issues on a daily basis by means of an activity report provided by the Luxembourg Stock Exchange.

As far as market activities are concerned, turnover increased by 86.3% as compared to 2004 to EUR 2,227.2 million (1,195.64 million in 2004). Total turnover of variable income securities represented 12.15% of trading (50.55% in 2004) against 87.85% (49.45% in 2004) for bonds.

At the end of 2005, the Luxembourg Stock Exchange counted 65 members (against 68 in 2004), including nine cross members.

The year 2005 was again characterised by intense activity as regards new admissions to the Luxembourg Stock Exchange. 9,092 new securities have been admitted (9,143 in 2004). The total number of admissions as at 31 December 2005 on the regulated market under the terms of the European Directives and on the Euro MTF market reached 36,054 securities (33,022 in 2004), composed of 26,782 bonds, 279 shares, 2,821 warrants and rights and 6,172 Luxembourg and foreign undertakings for collective investment and compartments.

3.2. Luxembourg companies listed on the Luxembourg Stock Exchange

3.2.1. Financial information disclosed by the listed companies

The law of 23 December 1998 on the supervision of securities markets as amended lays down the principle that financial information disclosed by companies listed on the Luxembourg Stock Exchange shall be monitored. The number of Luxembourg companies whose shares are listed amounted to 39 as at 31 December 2005.

Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting standards (IAS Regulation) introduces the obligation for companies under the national law of a Member State, the securities of which are traded on a regulated market, to draw up their consolidated financial statements in accordance with the international accounting standards IAS/IFRS for each financial year starting on 1 January 2005 or later.

In relation with the transition of the listed companies to the IAS/IFRS accounting standards, the CSSF is regularly contacted with a view to clarifying the implementation in Luxembourg of the provisions laid down in the IAS Regulation and the interaction of this Regulation, the law on prospectuses for securities and the Transparency Directive.

The CSSF has thus alerted the listed Luxembourg companies that the semi-annual reports 2006 must include the comparative accounts drawn up in accordance with the IAS/IFRS standards for 2005.

The CSSF verifies financial data submitted, in particular the yearly and half-yearly reports published by Luxembourg companies whose shares and units are listed on the Luxembourg stock exchange. The CSSF is entitled to request an independent external auditor to prepare a written report on individual and consolidated annual accounts of these companies.

Within the framework of its interventions, the CSSF has notably clarified that the provisions of the Luxembourg law that transpose the 7th Directive do not exclude the listed companies from the benefit of the exemption of consolidation.

3.2.2. Reporting of major shareholdings

The CSSF systematically verifies compliance with the law of 4 December 1992 on the information to be published when a major holding in a listed company is acquired or disposed of, notably by considering attendance registers of ordinary and extraordinary meetings, as well as any other source of information.

In particular, the CSSF has stressed that the provisions of the aforementioned law refer to “the voting rights” and do not expressly exclude the suspended voting rights or the voting rights that could not be exercised, for one reason or another, for a certain period of time. In order to determine the trigger thresholds provided for by this law, the total voting rights that exist when the situation giving rise to a report arises, must thus be taken into account.

4. DEVELOPMENTS IN THE REGULATORY FRAMEWORK

4.1. New regulatory framework governing the drawing-up, approval and dissemination of prospectuses

The regulatory texts and other documents governing the drawing-up, approval and dissemination of the prospectuses that fall under the competence of the CSSF under the new prospectus regime are the following:

- the law of 10 July 2005 on prospectuses for securities which mainly aims at transposing Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading ("Prospectus Directive");
- Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements ("Prospectus Regulation");
- Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting rules;
- Grand-ducal regulation of 3 August 2005 on prospectuses for securities that lays down the fees to be levied by the CSSF and amends the Concession;
- circular CSSF 05/210 of 10 October 2005 on the drawing-up of a simplified prospectus within the scope of Chapter 1 of Part III of the law on prospectuses for securities;
- circular CSSF 05/224 of 15 December 2005 concerning the choice of the home Member State for third country issuers whose securities are admitted to trading at 1 July 2005 and the notification by these issuers of their choice by 31 December 2005;
- circular CSSF 05/225 of 16 December 2005 on the notion "offer to the public of securities" as defined in the law on prospectuses for securities and the "obligation to publish a prospectus" that may ensue;
- circular CSSF 05/226 of 16 December 2005 concerning the general presentation of the law on prospectuses for securities and the technical specifications regarding communications to the CSSF of documents for the approval or for filing and of notices for offers of securities to the public and admissions of securities to trading on a regulated market (replacing circulars CSSF 05/195 and CSSF 05/196);
- CESR's recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses No 809/2004;
- the document published by the CSSF "New prospectus regime: Questions and Answers".

4.2. General presentation of the law of 10 July 2005 on prospectuses for securities

The law on prospectuses for securities was adopted on 29 June 2005 by the *Chambre des Députés* (Parliament) and published on 12 July 2005 in the *Mémorial* A no. 98. It sets up a new framework for the drawing-up, approval and distribution of prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market.

This law transposes, among other things, the Prospectus Directive into Luxembourg law. As a result of this transposition, the provisions relating to the prospectus to be published when securities are offered to the public and/or admitted to trading laid down in the law of 23 December 1998 as amended on the supervision of securities markets (implemented by Grand-Ducal regulation of 28 December 1990 on the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published where transferable securities are offered to the public or of listing particulars to be published for the admission of transferable securities to official stock exchange listing) are repealed. Moreover, certain provisions related to the prospectuses and other terms governing an offer referred to in the law of 30 March 1988 as amended on undertakings for collective investment, the law of 20 December 2002 as amended on undertakings for collective investment, the law of 15 June 2004 on the investment company in risk capital and the law of 10 August 1915 concerning commercial companies are amended.

Concurrently, the Prospectus Regulation becomes directly applicable in Luxembourg as from 1 July 2005. This European Regulation plays an important role with respect to the implementation of the law on prospectuses for securities, as it mainly sets down the detailed information to include in a prospectus and also contains many provisions governing the drawing-up of prospectuses for programmes.

The purpose of the Prospectus Directive is to allow companies to raise capital across the European Union more easily and at lower costs, based on a single approval granted by the authority of the home Member State, as well as to strengthen investor protection by ensuring that all prospectuses, wherever they are issued and approved in the European Union, provide investors with the clear and comprehensive information they need to take their investment decision.

The purpose of the Prospectus Directive and of the Prospectus Regulation is to harmonise, within the European Union, the requirements relating to the drawing-up, approval and distribution of the prospectus to be published when securities are offered to the public and/or admitted to trading on a regulated market situated or operating within the territory of a Member State. No prospectus shall be published until it was granted "approval" by the home Member State's competent authority. This approval is however subject to the compliance with common European standards relating to the content of the information to be published and the terms governing its publication. The detailed information that has to be included in a prospectus falling under Community scope is defined by the Prospectus Regulation which notably follows the principles laid down by IOSCO (International Organisation of Securities Commissions) and the accounting standards IAS/IFRS.

The Prospectus Directive also sets down, at European level, a harmonised definition of "offer to the public", which Luxembourg has fully integrated into the law on prospectuses for securities, thereby introducing for the first time a definition of an "offer to the public" in Luxembourg. Indeed, Luxembourg has always had a pragmatic approach regarding this notion, taking into account certain criteria such as the solicitation method of the public, which allowed to categorise a large part of placements as private placements. The law on prospectuses for securities introduces a relatively broad definition, which also applies to the placing of securities through financial intermediaries. Circular CSSF 05/225 of 16 December 2005 specifies the elements constituting this notion of offer to the public.

With the transposition of the Prospectus Directive, the Luxembourg legislator opted to introduce a law that covers all offers to the public and all admissions to trading on a securities market.

Thus, the law on prospectuses for securities provides for three different prospectus regimes:

- a first regime (Part II of the law on prospectuses for securities) with respect to offers of securities to the public and admissions of securities to trading on a **regulated market**, which are subject to **Community harmonisation**, and transposing the rules of the Prospectus Directive;
- a second regime (Part III of the law on prospectuses for securities) defining the Luxembourg rules that apply to offers to the public and to admissions to trading on a **regulated market** of securities and other comparable instruments, which are **outside the scope of the Prospectus Directive**, and providing for a simplified prospectus regime; and
- a third regime (Part IV of the law on prospectuses for securities), setting up a Luxembourg-specific regime applying to admissions of securities to trading on **a market which is not included in the list of regulated markets** published by the European Commission.

The law on prospectuses for securities designates the CSSF as the competent authority to ensure the enforcement of:

- the provisions of Part II (when Luxembourg is the home Member State), which deals with the drawing-up, approval and distribution of the prospectus to be published when securities are offered to the public and/or admitted to trading on a regulated market, which are subject to Community harmonisation under the Prospectus Directive; and
- the provisions of Chapter 1 of Part III which deals with the drawing-up, approval and distribution of prospectuses to be published when securities and other comparable instruments not covered by Part II are offered to the public.

The Luxembourg Stock Exchange (*Bourse de Luxembourg*, which is currently the only market operator authorised to operate one or several securities markets situated or operating within the territory of Luxembourg) is the competent authority for the approval of:

- prospectuses subject to the provisions of Chapter 2 of Part III (admissions of securities not covered by Part II to trading on a regulated market operated by the Luxembourg Stock Exchange); and
- prospectuses subject to the provisions of Part IV (admissions of securities to trading on a Luxembourg market not included in the list of regulated markets published by the European Commission).

The simplified prospectuses subject to Part III do not benefit from the European passport and the rules as regards their content are in principle laid down in circular CSSF 05/210 of 10 October 2005 on the drawing-up of a simplified prospectus within the scope of Chapter 1 of Part III of the law on prospectuses for securities.

The more extended powers of the CSSF entail that the issuers, offerors and persons asking for the admission to trading on a regulated market fall henceforth under the direct authority of the CSSF, when Luxembourg is the home Member State under the terms of the law on prospectuses for securities. The CSSF thus obtains general and direct competences with respect to the information that issuers must publish, by means of the prospectus or of a supplement to the prospectus. Moreover, the CSSF is notably empowered to suspend an offer to the public or admission to trading on a regulated market for ten working days, prohibit an offer to the public, suspend trading on a regulated market at any moment, require the issuer, offeror or person asking for admission to trading on a regulated market to refrain from any practices infringing the law on prospectuses for securities.

A particularly important power in the context of financial markets is that the CSSF can make public the fact that the issuer, offeror or person asking for admission to trading on a regulated market is failing to comply with its obligations. Furthermore, the law on prospectuses for securities entitles the CSSF to impose administrative sanctions.

The competence regarding the decisions with respect to the admission of securities to trading on a market and/or official listing are not affected by the law on prospectuses for securities. Indeed, the decisions with respect to the admission of securities to a market and/or official listing continue to fall within the remit of the relevant market operator and are taken in accordance with the provisions laid down in the rules governing the functioning of this operator (currently in Luxembourg: the Rules and Regulations of the Luxembourg Stock Exchange), it being understood that compliance of the underlying documents with the law on prospectuses for securities is one of the requirements to be fulfilled.

4.3. Implementation of the law on prospectuses for securities

Until 1 July 2005, the Luxembourg Stock Exchange approved the prospectuses to be published where transferable securities are admitted to official listing and where public offers of transferable securities are followed by a listing on the Luxembourg Stock Exchange. The prospectuses relating to offers of securities to the public not followed by a listing were approved by the CSSF, even though the reading and scrutiny of the offer document were in fact also carried out by the Luxembourg Stock Exchange based on a delegation by the CSSF of these tasks.

The Luxembourg procedure regarding the approval of prospectuses for securities has been completely reshuffled by the law on prospectuses for securities. The implementation of this law entailed that the competences for the approval of all the prospectuses in relation with Part II (Community scope) and the offers under Part III of said law (offers to the public outside Community scope) have been transferred from the Luxembourg Stock Exchange to the CSSF, which has been designated as the competent administrative authority in Luxembourg under the law on prospectuses for securities.

At European level, the CESR Chairmen have decided, during their meeting on 27 and 28 June 2005, to implement the new framework provided for by the Prospectus Directive as from 1 July 2005 as regards the right to a European passport that the Prospectus Directive confers on the issuer, the offeror or the person who seeks admission of securities to trading on a regulated market, even if certain Member States have not yet transposed the Prospectus Directive into their national law.

As the draft law no. 5444 on the prospectuses and the Prospectus Regulation gave rise to a certain number of questions with respect to the legal interpretation, the CSSF established an *ad hoc* interpretation group of the draft law in June 2005, shortly before the coming into force of the law on prospectuses for securities.

Within the *ad hoc* legal interpretation group of the "prospectus" legislation, the CSSF provides certain prospectus-related responses it has already given or it intends to give to issuers. The members of the group can also put questions that they have been asked by their customers to the CSSF. The objective of this group is to gather all the substantial questions of the market players, to define, within a small group, coherent positions based on all the elements and legal arguments that seem crucial and to ensure enhanced communication with the issuers notably through their Luxembourg lawyers. The *ad hoc* group was quite active in 2005 with around twenty meetings and was notably strongly involved in the drawing-up of the circular relating to the notion of "offer to the public" and the document of 60 Questions/Answers that have all been discussed within the *ad hoc* group.

Practically speaking, during the first six months of implementation of the new prospectus regime, the CSSF had agreed with the Luxembourg Stock Exchange that the latter would assist the CSSF in the prospectus approval process. To this end, the CSSF had entrusted the Luxembourg Stock Exchange with the preliminary analysis of the documents filed for approval with respect to their compliance with the law on prospectuses for securities and the Prospectus Regulation. After having revised and commented on the submitted prospectuses, the Luxembourg Stock Exchange communicated its opinion to the CSSF in the form of a report. Based on this opinion, submitted together with the documents concerned, the CSSF undertook a control before it decided on the approval of the prospectus.

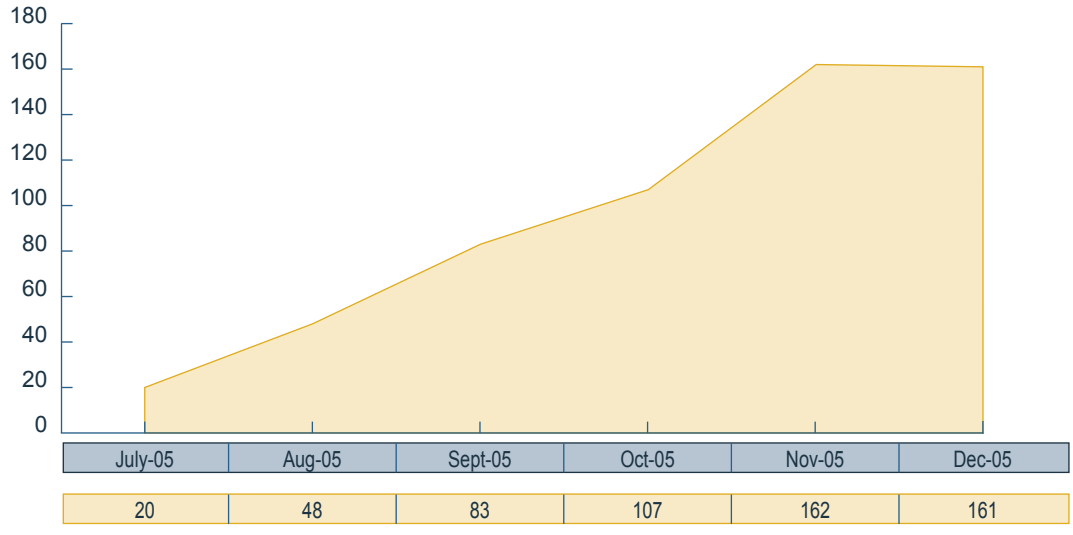
In December 2005, both entities announced their decision according to which the CSSF would fulfil alone, as from 1 January 2006, the tasks relating to the approval of prospectuses, so as to make the procedure more efficient, coherent and transparent.

As from 1 January 2006, the CSSF has become the sole intervening party for approving the prospectuses relating to offers to the public and admissions to a regulated market of securities falling into the scope of the Prospectus Directive and for approving the simplified prospectuses relating to the offers to the public of securities that are outside the scope of Part II of the law on prospectuses for securities.

In order to strengthen the team existing within the CSSF since 1 July 2005 to ensure enforcement of the law on prospectuses for securities, thirteen Luxembourg Stock Exchange employees who worked in this field have been transferred to the Department Supervision of Securities Markets and the approval process went on coherently. As far as the internal organisation is concerned, the team in charge of the prospectus approval within the department is divided into three groups that handle specific approval files and one group that fulfils administrative tasks resulting from the implementation of the law on prospectuses for securities. With the aim of ensuring that applications for approval are handled efficiently, they are in principle distributed by category between the three groups within which file managers are in charge of scrutinising the prospectuses. Every group is assisted by a coordinator for issues relating to the application and interpretation of the regulations. Communication between the file managers, the coordinators and the agents ensuring the consistent application of the established standards and procedures takes place continuously in order to allow swift and coherent decision-making.

A total of 581 documents have been approved until 31 December 2005 under the new approval regime introduced by the law on prospectuses for securities since 1 July 2005, i.e. 283 prospectuses, 210 base prospectuses, 11 registration documents and 77 supplements.

Number of documents approved in 2005



DEPARTMENT SUPERVISION OF SECURITIES MARKETS

First row, left to right: Michèle DEBOUCHE, Karin WEIRICH, Maggy WAMPACH, Estelle BOTTEMER, Joëlle PAULUS, Laurent CHARNAUT

Second row, left to right: Annick ZIMMER, Cyrille UWUKULI, Claude FRIDRICI, Gilles HAUBEN

Third row, left to right: David SCHMITZ, Daniel JEITZ, Eric FRITZ, Marc REUTER, Olivier WEINS

Absent: Malou HOFFMANN, Sylvie NICOLAY-HOFFMANN, Maureen WIWINIUS

DEPARTMENT SUPERVISION OF SECURITIES MARKETS

First row, left to right: Cornelia BERNHARDT, Martine SIMON, Andrea HARIS, Patrick FRICKE, Fanny BREUSKIN

Second row, left to right: Julien MAY, Marc LIMPACH, Frédéric DEHALU, Françoise KAUTHEN, Marie-Josée PULCINI

Third row, left to right: Olivier FERRY, Pierre VAN DE BERG, Manuel RODA, Jean-Christian MEYER, Jerry OSWALD

Absent: Mylène HENGEN, Stéphanie JAMOTTE

CHAPTER VIII

SUPERVISION OF INFORMATION SYSTEMS

1. Activities in 2005

2. Supervisory practice

1. ACTIVITIES IN 2005

1.1. Meetings and participation in national groups

In 2005, IT audit took part in 127 meetings of following categories:

- meetings relating to the scrutiny of applications for authorisation to perform a support PFS activity, in co-operation with the other departments concerned;
- meetings on subjects covering the operation and security of the IT systems of the supervised entities, most of which are granted the PFS status "IT systems and communication networks operators of the financial sector" under article 29-3 of the law of 5 April 1993 on the financial sector as amended;
- meetings with companies that provide services to the financial sector in order to define their activities and determine whether an authorisation is required or not.

These meetings were held with companies offering subcontractor services to the financial sector, IT services companies, law firms, consultancy firms, auditing firms and supervised entities.

IT audit also took part in two international conferences as speaker and attended sixteen seminars or national conferences on subjects relating to IT systems security.

Works related to ISO within the *Comité de Normalisation de la Sécurité de l'Information* (CNLSI – Luxembourg standardisation committee for IT security) have been carried on, as well as those on the design of a professional Master in "Management of IT systems security" (*Management de la Securité des Systèmes d'Informations*, MSSI), in co-operation with the University of Luxembourg and the *Centre de Recherche Public Henri Tudor* (CRP-HT). It should be noted in this context that IT audit participates in two strategic sub-committees set up by CRP-HT to determine the research fields to explore in the areas of Quality and IT systems Security.

1.2. The GRIF research project

The GRIF research project started in 2003 in co-operation with the *Centre de Recherche Public Henri Tudor*. Its purpose is to carry out an applied research project, which was renamed *Gestion des Risques dans les Intitutions Financières* (Risk Management in Financial Institutions)[1] in 2005.

This project, which is co-financed by CRP-HT and the CSSF, has been set up in the context of the international harmonisation of banking supervision as defined by the New Basel Accord (Basel II) and more particularly the supervisory mission of the CSSF under Pillar 2, which requires that the supervisory authority reviews and assesses capital adequacy and the internal rating system of credit institutions.

The main objective of the CSSF and CRP-HT consists in studying new methodological approaches allowing to assess IT-related risks, preferably in a quantitative manner. The findings in this highly specific field of research aim to formalise and quantify the consideration of IT risks within the global operational risks of financial institutions.

At year-end 2004, the CSSF and CRP-HT defined a standardised methodology, which does not only apply to IT operational risks, but which may also cover the entire operational risks as defined by Basel II. Consequently, the project's results exceed the initial objectives and entailed the revision of the project's title in order to reflect the broader scope covered by this model.

[1] The initial title was *Gestion des Risques Informatiques dans le Secteur Financier* (IT Risk Management in the Financial Sector).

The considered model is based on the ISO/IEC 15504 standard, which allows to assess the process maturity. As these processes concern risks, the model could contribute to meeting the new prudential supervisory requirements without imposing constraints on specific procedures, but by promoting the enhancement of the know-how of financial institutions, of their providers (of advice, products and services), as well as of supervisory authorities.

The work achieved within the GRIF project allowed to put forward the advantages of the ISO/IEC 15504 standard, which allows to assess all types of organisations through the maturity of its processes and can thus be implemented by financial institutions to assess the maturity of the operational risk management, as well as of business lines. The undeniable advantage of the ISO/IEC 15504 standard is that it focuses on the expected results (the "what") and not on the way to achieve them (the "how"), which is left at the discretion of the players, but which may nevertheless rely on commonly accepted basic practices that are reflected in assessment questionnaires.

The research done in the context of the GRIF project concerned the establishment of a Process Reference Model (PRM) based on the criteria set down by the New Basel Accord on operational risks. The obtained traceability is bidirectional and allows to validate the origin in Basel II of the processes to assess. The Process Assessment Model (PAM) was developed subsequently, but in order to be able to carry out the assessments, the assessment questionnaires, which should also contain basic practices that should be observed, still need to be drawn up.

The current results of the project, applied within the scope of Pillar 2 of Basel II, would allow the CSSF to obtain an objective assessment of the operational risk management model submitted by the institutions.

At the end of 2005, it appears, following the presentation of the GRIF project to the financial players concerned, that the major appeal of the project is the applicability of the ISO/IEC 15504 standard within the financial sector as assessment and improvement tool for processes, whether they relate to business line or risk management processes. The interested players in the financial sector, as well as CRP-HT and the CSSF, identify several potential application areas for the ISO/IEC 15504 standard within the financial sector. The following list is not exhaustive:

- in the field of outsourcing, in order to assess the aptitude of a provider to deliver its services
  - for the business of investment funds or depositary banks, for example, by developing "business" PRM and associated PAM;
  - for IT businesses, with the AIDA[2] project, which leads to the development of a PRM and a PAM on ITIL[3] , and which would allow to assess the capability of the providers, including the PFS authorised as system operators, to implement ITIL.
- in the field of audit, by establishing a PRM and PAM specific to
  - internal controls;
  - the implementation of IAS accounting standards;
  - the legal requirements, be it the implementation of new functions (e.g. the compliance function), risk management (Pillar 1) or the IT function (circular CSSF 05/178).

The advantage of this method lies in the normative assessment that leads to coherent results and allows, as a consequence, to be carried out by a third party to define the capability level of an institution to manage its processes (or its operational risks in the context of Basel II) in a repeatable manner.

[2] Assessment and Improvement Integrated Approach", CRP Henri Tudor project (www.crpht.lu).

[3] IT Information Library (ITIL) is a set of good practice used to deliver high quality IT services.

It is also possible to carry out a self-assessment by or on behalf of an institution to define the relevance of its own processes and to improve them, for a particular purpose or for a whole set of requirements (Pillar 1 of Basel II).

The full documentation on the GRIF project is available on the CSSF website (www.cssf.lu) under the heading "Info kits", sub-heading "Capital adequacy", section "GRIF project: Operational risk management in financial institutions".

1.3. International co-operation

IT audit took part in the annual International Supervisory Group on IT conference, which gathers the persons responsible for the prudential supervision of the IT systems of the different authorities[4]. The aim of this group is to promote the exchange of information relating to the current technological stakes and covers aspects such as business continuity plans, electronic banking, countermeasures against the phishing[5] phenomenon and the supervision of cross-border IT outsourcing. Throughout the year, the group's members exchange information concerning frauds related to IT and Internet, attacks against information systems, identity theft or weaknesses of certain systems.

2. SUPERVISORY PRACTICE

Supervision covers verification that the supervised entities implement the legal and regulatory framework, with the direct or indirect purpose to maintain or improve the professionalism of the activities, focusing in particular on aspects related to implemented technologies as regards information systems and taking account of the specificities of the support PFS, which offer their subcontracting services to the other supervised institutions.

2.1. Reminder of the fundamental prudential considerations

As far as the supervision of support PFS is concerned, the CSSF invites the reader to refer to Chapter VII, point 2.1 of the CSSF's Annual Report 2004, which underlines the importance of segregation of environments and customer data (the financial professionals). Indeed, IT audit considers that it is crucial for a support PFS to guarantee impermeability between environments, irrespective of the technological options set up to mutualise resources. Moreover, the prudential principle of segregation of functions, which improves controls, allows to reduce errors or frauds and is widely implemented by financial professionals, shall also be implemented by providers, whether they are authorised as support PFS or not. IT audit insists on the importance that this prudential principle is applied within support PFS and, in particular, IT systems and communication networks operators of the financial sector.

The CSSF also observed a relatively large cultural gap between certain support PFS, authorised as client communication agent or IT systems and communication networks operator of the financial sector, and the financial professionals they serve. This cultural difference is expressed by an often insufficient understanding of ethical rules pertaining to the financial sector and, in particular, by a commercial use, or even advertising use, made of the ministerial authorisation. Yet, the wording of article 52(3) of the law of 5 April 1993 on the financial sector as amended leaves no room for doubt: "No person shall make use for commercial purposes of his registration on an official list or of the fact of his being subject to supervision by the CSSF".

[4] The group was initially named "HITS" (Head of IT Supervision). The authorities of the following countries were present: United States, France, Belgium, the Netherlands, Luxembourg, Italy, Spain, Singapore, Hong Kong, Australia, Canada, Germany, Norway and Great Britain (Sweden and Switzerland were absent in 2005).

[5] Phishing = (Phreaking + Fishing). Phreaking: hacking of telephone exchanges, since the blue Box of John Draper in the seventies. Fishing: reference to password fishing in the Internet ocean.

It appears that many support PFS wrongly assume that the authorisation and the associated supervision are equivalent to a certification or quality label. The major consequence of an authorisation is however that it imposes the same legal and regulatory framework as the one applicable to financial professionals. It is a legal obligation in order to be authorised to exercise this activity and not a voluntary recognition. Bringing out the ministerial authorisation too visibly and commercially *vis-à-vis* financial professionals, which are potential customers, can have the opposite effect as that pursued, if the ethical divide observed by the CSSF is thereby revealed.

2.2. Clarifications of certain questions put to the CSSF

2.2.1. Remote accesses: use by a supervised entity of the mobile messaging "push-mail" and the "BlackBerry" product

A "push-mail" solution is based on a messaging infrastructure that involves one or several mobile network operators to convey electronic messages from the company's internal messaging system to a mobile equipment, and vice-versa. This type of messaging relies on the principle of proactivity of the mobile equipment, which queries the messaging server very regularly in order to retrieve any messages awaiting transfer. Everything takes places as if the server would contact the mobile equipment when messages are queued, hence the term "push-mail". Mobile equipment shall thus be able to operate specific "push-mail" programmes. This is the reason why such equipments are currently mobile phones with a sophisticated operating system (such as Symbian) or PDAs[6] with mobile phone functionalities, which communicate through a GPRS or UMTS connection of GSM network operators.

In order to define the security criteria to be fulfilled in order to be allowed to use a push-mail solution, it is necessary to qualify the information that will transit from the professional of the financial sector to the mobile equipment. This information is, *a priori*, considered by the CSSF as confidential, as it stems from the internal messaging system of the company and contains inevitably references to customers at one point or another. Consequently, the solution must ensure confidentiality and, preferably, the integrity of the information exchanged between the push-mail server and the mobile equipment.

The push-mail server shall therefore be under the exclusive control of the professional of the financial sector and be located on its premises in Luxembourg.

The unavoidable use of mobile operators also imposes the encryption of the exchanged data.

The mobile user shall also be identified by the server in order to ensure that the latter is really entitled to read the confidential data. The sole use of the PIN code of the SIM[7] card cannot suffice, in particular if the unentitled user replaces the original SIM card by a card of which he knows the PIN code. The solution should thus provide for a specific PIN code or be linked to the SIM card of the entitled user.

Finally, if the mobile equipment is lost or stolen, the data it contains shall not be legible by a third party and shall therefore be strongly encrypted and, preferably, remotely deletable.

The most commonly known push-mail solution has been designed by the British company Research In Motion Ltd (RIM) and is called BlackBerry®.

Many entities under the supervision of the CSSF enquired about the possibilities or restrictions as regards the use of the BlackBerry® solution.

[6] PDA: Personal Digital Assistant (palmtop computer, running the operating system Palm OS or WindowsCE and derivatives).

[7] Chip card provided by the mobile operator.

Since the mobile equipment and the server are provided by RIM, knowing that all messages pass through a platform of RIM in the United Kingdom, and unless the said company provides high-level third-party certifications proving the security measures it sets forth and the impossibility for third parties, including itself, to decode the transmitted data, the CSSF advises to be prudent with respect to this solution. Nevertheless, the trust placed in RIM is being checked by certain States, such as the United States of America and France, which use this solution at the highest State and corporate level. Certifications should thus be available soon. The professionals of the financial sector will be responsible for verifying the coverage thereof and for determining the trust to be placed in this solution.

Certain implementation rules should however be complied with. On the one hand, the professional of the financial sector shall at least use the option proposed by RIM, which consists in allowing the professional of the financial sector to manage the cryptography keys itself, and on the other hand, the professional shall dispose of the function of remote deleting of the messages stored on the lost or stolen mobile equipment.

As long as the professionals of the financial sector manage their BlackBerry® infrastructure themselves, this solution should not be considered as outsourcing and a prior approval by the CSSF is not required.

2.2.2. Monitoring services performed by a provider without support PFS status

The CSSF confirms that monitoring services, whether they consist in overseeing applications, IT systems or networks, are not considered as operating services and are not subject to an authorisation if the service provider is not able to intervene on the monitored equipment.

The essential condition for the provision of such services without authorisation is to impose in the contract and operationally that the provider's customer is to carry out the necessary corrective intervention. In this case, the professional of the financial sector decides on the actions to be taken following the monitoring and shall oversee the actions of the provider in accordance with the indications given in circular CSSF 05/178.

2.2.3. Cryptography of very high bandwitdh lines relying on fibre optics

The development of telecommunications allows to use very high bandwidth transmission lines that rely on fibre optics and that enable the connections of central units at processors level so as to make remote "multi-processing" possible. Thus, the workload of the central processing units can be divided over distances of several kilometres, thereby ensuring a redundancy of equipment in the event of a disaster on one of them.

The main drawback of these technologies is that cryptography of these high bandwidth highways becomes very costly, even prohibitive, while the CSSF requires that the communication between the professional of the financial sector and the remote processing centre is protected.

Where it is technically impossible, or disproportionately costly, to encrypt the line or data, the professional of the financial sector shall nevertheless ensure that no third party, and in particular, no access provider to telecommunication lines not legally bound by the communication secrecy, has non-controlled access to the data that pass through this line. The specificities of fibre optics however allow to envisage a control of the line's integrity, which would rely on the identification and justification by all providers involved in the supply of this line, of any communication breakdown. Indeed, it is highly unlikely for a third party to connect to or to track the content of the data exchanged on this type of line without having to physically intervene on the network and to provoke in this case a temporary failure of the fibre optics.

Nevertheless, the CSSF invites the professionals of the financial sector:

- on the one hand, to envisage solutions that provide for a prior encryption of each service, according to the criticality of the exchanged data, which amounts to not encrypting the whole line, but only the different flows that concentrate on the line (logic multiplexing of flows);
- on the other hand, to set up a technology watch aiming to assess on a regular basis the new cryptographic possibilities, in order to identify those that would be technically and financially accessible.

2.2.4. Anti-money laundering obligations of the support PFS

The CSSF reminds the financial professional that have a support PFS status that they are also subject to the obligation to identify suspicious transactions, and that they shall apply the anti-money laundering laws and regulations as any other professional of the financial sector.

Nevertheless, the CSSF is aware of the specificities of the support PFS' activities and specifies that they are not required to substitute for their customers, in case they are other professionals of the financial sector, to carry out the controls instead of them. However, if an employee of the support PFS becomes aware of an obvious fact that should be reported, for example, if he identifies the name of a notorious terrorist included in the list of the Public Prosecutor's office, he shall apply the predefined reporting procedure set up within its institution and refrain from informing the customer, i.e. the professional of the financial sector to which he provides his services.

The financial professionals authorised as support PFS shall also ensure that they only contract with professionals of the financial sector that have been granted the appropriate authorisation and prove that they have a sound professional repute. This is particularly true for the financial professionals located abroad. As far as those established in Luxembourg are concerned, the support PFS shall look up the CSSF's official lists of institutions authorised in Luxembourg.

Left to right: Constant BACKES (Systems Security), Pascale DAMSCHEN (IT Coordination),
Pascal DUCARN (IT Audit), Marie-Anne VOLTAIRE (Internal Audit), David HAGEN (IT Audit)
Absent: Claude BERNARD (IT Audit), Geneviève PESCATORE, Marc WEITZEL (Director General's advisors)

EXECUTIVE SECRETARIES

Left to right: Monique REISDORFFER, Karin FRANTZ, Marcelle MICHELS
Absent : Joëlle DELOOS

CHAPTER IX

MEANS OF SANCTION AVAILABLE TO THE CSSF

1. Means of intervention available to the CSSF

2. Sanctions imposed in 2005

1. MEANS OF INTERVENTION AVAILABLE TO THE CSSF

The following means of intervention are available to the CSSF to ensure that the persons subject to its supervision comply with the laws and regulations relating to the financial sector:

- injunction, sent by registered letter, requesting the establishment concerned to remedy the particular situation;
- suspension of persons, suspension of the voting rights of certain shareholders or suspension of the activities or of a sector of activities of the establishment concerned.

In addition, the CSSF has the right to:

- impose or ask the Minister of Treasury and Budget to impose disciplinary fines on the persons in charge of the administration or management of the establishments concerned;
- under certain conditions, request the District Court responsible for commercial affairs to have payments towards an establishment suspended;
- ask the Minister of Treasury and Budget to refuse or withdraw registration from the official list of credit institutions or the other professionals of the financial sector, if an establishment does not fulfil or no longer fulfils the conditions for being or continuing to be registered on the official list in question;
- refuse or withdraw registration from the official list of undertakings for collective investment, pension funds, management companies (Chapter 13 of the law of 20 December 2002 as amended), SICARs or securitisation undertakings, if an establishment does not fulfil or no longer fulfils the conditions for being or continuing to be registered on the official list in question;
- in extreme cases and under precise conditions laid down by law, request the District Court responsible for commercial affairs to order the winding up and liquidation of an undertaking.

Moreover, the CSSF informs the Public Prosecutor of any instance of non-compliance with legal provisions relating to the financial sector, giving rise to penal sanctions and that could entail prosecution against the implicated persons. The following cases are concerned:

- persons performing an activity of the financial sector without holding a licence;
- persons active in the field of company domiciliation without belonging to any of the professions entitled by the law of 31 May 1999 governing the domiciliation of companies as amended to carry on this activity;
- persons other than those registered on the official lists of the CSSF, who use a title or appellation, thereby breaching article 52(2) of the law of 5 April 1993 on the financial sector as amended, that gives the appearance that they are authorised to perform one of the activities reserved for persons registered on one of the lists;
- attempted fraud.

2. SANCTIONS IMPOSED IN 2005

2.1. Credit institutions

In 2005, the CSSF did not need to order fines nor to impose sanctions against managers (against two cases in 2004).

However, the CSSF exercised its right of injunction with respect to one case, as the specific information it had required had not been delivered within the granted time limit despite several reminders.

2.2. Other professionals of the financial sector (PFS)

During 2005, the CSSF did not impose disciplinary fines under article 63 of the law of 5 April 1993 on the financial sector as amended on persons responsible for the daily administration or management of PFS.

However, the CSSF used its right of injunction, in accordance with article 59 of the abovementioned law, on two occasions. One of the imposed injunctions concerned a situation of non-compliance with various legal provisions, including, among other things, insufficient financial bases, non-compliance with the shareholder structure as laid down in article 18(6) of the law on the financial sector, as well as the failure to deliver information as provided for by article 53 of this law.

The other injunction related more particularly to serious deficiencies with regard to legal provisions concerning professional repute under article 19(1) of the law on the financial sector, as well as to shareholder quality governed by article 18(1) of this law.

In the latter case, the CSSF exercised its right of suspension conferred on it by the law on the financial sector. Considering that, at the expiry of the deadline, the situation had not been remedied, and given the need to ensure proper and prudent management of the PFS, the CSSF decided indeed, in accordance with article 59(2) of the aforementioned law, to suspend the voting rights attached to the shares held by one of the shareholders of the PFS concerned.

In 2005, the CSSF filed two complaints with the Public Prosecutor's Office for illegal domiciliation activities of companies not authorised thereto. The CSSF also lodged three complaints for illegal financial activity with the Public Prosecutor's Office. In two cases, the entities concerned had pooled funds from the public without being authorised thereto.

2.3. Undertakings for collective investment

According to article 94(2) of the law of 20 December 2002 as amended on undertakings for collective investment, the registration and maintaining on the official list of UCIs are subject to observance of all the provisions of laws, regulations and agreements relating to the organisation and operation of UCIs, as well as to the distribution, placing or sale of their securities.

Pursuant to this legal provision, the CSSF has decided to withdraw AMIS FUNDS SICAV and TOP TEN MULTIFONDS SICAV from the official list of collective investment schemes with effect from 7 November 2005. The decision of the CSSF to withdraw the SICAVs was motivated by the fact that AMIS FUNDS SICAV and TOP TEN MULTIFONDS SICAV no longer observed all the legal provisions relating to their operation, as well as to the distribution and investment of their securities.

On 23 December 2005, the Luxembourg District Court ordered the liquidation of AMIS FUNDS SICAV and TOP TEN MULTIFONDS SICAV and appointed Mrs Yvette Hamilius, Attorney-at-law, 2, rue du Nord / rue du Palais de Justice, L-2229 Luxembourg, as liquidator.

CHAPTER X

GENERAL SECRETARIAT

1. Activities in 2005

2. Customer complaints

3. Communications related to the fight against money laundering and terrorist financing

1. ACTIVITIES IN 2005

The responsibilities of the General Secretariat (SG) cover the following fields:

- ***General Secretariat***

The SG is entrusted with coordinating the external relations and communications of the CSSF, i.e. the contacts with foreign supervisory authorities, national and international administrations, professional associations, as well as with any other counterpart that does not fall under the competence of the other functions and departments of the CSSF.

In 2005, the SG has thus had contact in writing with the supervisory authorities of 42 different countries on subjects as diverse as the organisation of co-operation meetings between the CSSF and the other authorities as home or host authorities, consultation procedures provided for by the European Directives, handling notifications regarding the freedom to provide services and establish branches, requests for information relating to national laws and regulations or authorised entities and natural persons, etc..

Moreover, the SG answers the requests for general information of the public in relation to the CSSF's activities or the financial centre.

The SG is also in charge of producing, where applicable in co-operation with the functions and departments concerned, the CSSF's publications in the broad sense (annual reports, brochures, press releases, monthly Newsletter, management of the website, etc.). In this context, the year 2005 was marked more particularly by the introduction of a new design for the CSSF's monthly Newsletter and by the design of a new CSSF website (www.cssf.lu) in co-operation with an external company and the CSSF's IT team. The new website includes an entirely revised graphic identity, a reorganisation of its content, a more powerful search engine and a subscription feature that allows internet users to be kept informed on a regular basis on the news published by the CSSF. An English version of the website has been created in order to meet the needs of the financial centre. The new website has been put online on 1 February 2006.

- ***Legal issues***

The SG is entrusted with handling general legal issues and cases of presumption of fraudulent and illegal activities in the financial sector (such as the performance of unauthorised or illegal activities), including the response to be reserved, if necessary, by the CSSF.

- ***Professional obligations and consumer protection***

The SG handles concrete files relating to professional obligations, rules of conduct and consumer protection.

In this context, it deals with the complaints of customers against professionals under the supervision of the CSSF (credit institutions, UCIs, PFS, SICARs, pension funds, securitisation undertakings) and the intervention with these professionals with a view of reaching an amicable settlement in accordance with article 58 of the law of 5 April 1993 on the financial sector as amended (please refer to point 2 hereinafter).

Furthermore, based on concrete files (*inter alia*, on reports to the Public Prosecutor and observations following on-site inspections), the SG controls compliance with anti-money laundering rules (please refer to point 3 hereinafter) and rules of conduct.

2. CUSTOMER COMPLAINTS

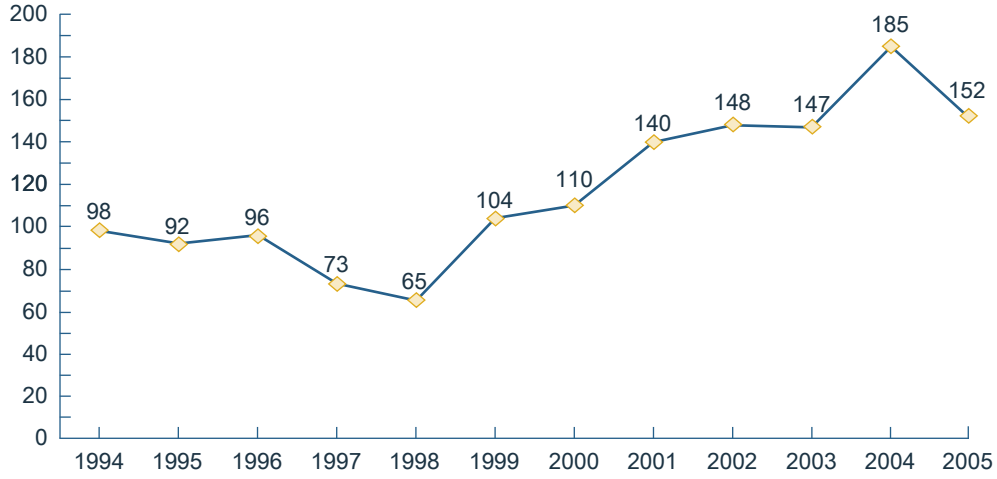
The law of 5 April 1993 on the financial sector as amended confers on the CSSF the task of mediating between the professionals and their customers. Under the terms of article 58 of this law, the CSSF "is competent to receive complaints from clients of the entities subject to its supervision and to intercede with these entities with a view to settling the disputes amicably".

Within the CSSF, it is the General Secretariat that handles these disputes.

2.1. General data

In 2005, the number of complaints has decreased as compared to 2004, which can be explained by a stabilisation of the markets, as well as an improved handling of complaints by the professionals.

Development in the number of complaints



Among the 152 complaints received in 2005, 144 were lodged by natural and 8 by legal persons. 28 complainants contacted the CSSF through a lawyer or a representative. The European Consumer Centre had forwarded three complaints to the CSSF. The majority of complaints concerned credit institutions, while four concerned PFS.

By taking account of the 49 files from 2004 in addition to the 152 complaints received in 2005, a total of 201 files have been handled in 2005.

Among the 201 files handled in 2005, 153 have been closed, with the following outcome or reason for closing:

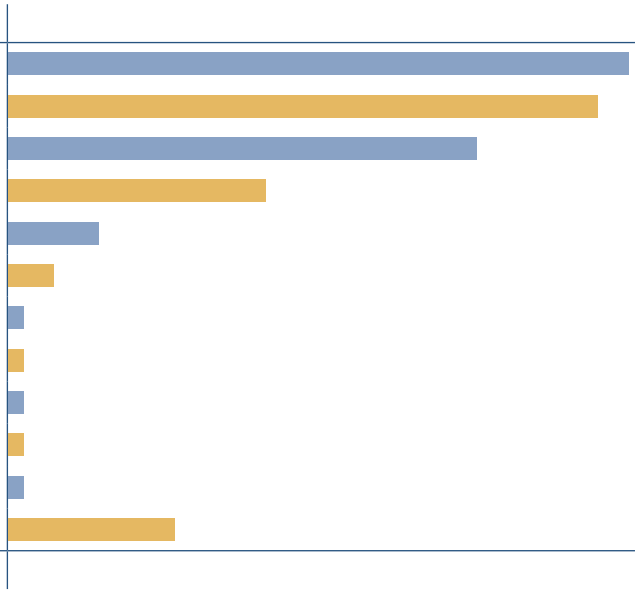
Files closed		**153**
Unjustified complaints	77	
Justified complaints with a reasoned opinion	17	
Amicable settlement without reasoned opinion	22	
Withdrawal by client	35[1]	
Contradictory positions	2	
Open files carried forward into 2006		**48**
Total		**201**

[1] This category not only encompasses the complaints on which the complainant does not follow up, but also those where the client decided to refer his matter directly to the courts, thus putting an end to the CSSF's intervention.

It has to be noted that 20 out of the 48 files carried forward into 2006 have been settled by 1 March 2006.

Breakdown of the 153 complaints closed in 2005 according to the complainants' country of residence

Country	Number
Belgium	41
Germany	39
Luxembourg	31
France	17
United Kingdom	6
Netherlands	3
Sweden	1
Greece	1
Finland	1
Spain	1
Austria	1
Others (non-EU)[2]	11
Total	**153**



In 2005, most of the complaints concerned, just as in 2004, all sorts of banking operations. The cases relating to portfolio management have decreased substantially.

Breakdown of complaints closed in 2005 according to their object

	Number		in %
Banking operations		**94**	**62%**
Fees, commissions, interest rates	32		
Non-execution or incorrect execution of transactions	19		
Criminal offence	9		
Inheritance	7		
Transfers, payments	6		
of which cross-border transfers	*2*		
Deficient client information	9		
Means of payment	3		
Transfer of securities	3		
Non-fulfilment of agreement	1		
Execution deadlines	1		
Various disputes	4		
Portfolio management (advice and discretionary management)		**42**	**27%**
Deficient client information, lack of advice	20		
including cases relating to non-information about risks	*17*		
Non-execution or incorrect execution of orders	14		
Unprofessional management, non-compliance with the profile	10		
Fees and commissions	5		
Non-fulfilment of agreement	3		
Dispute over the existence of a mandate	2		
Execution deadlines	1		
Others[3]		**17**	**11%**
Total		**153**	**100%**

[2] Including Switzerland 4 and Norway 2.

[3] Including freezing of accounts, professional secrecy.

- ***Complaints regarding UCIs***

In 2005, the department Supervision of UCIs has handled nineteen complaints, including five files from 2004. Fourteen files have been closed. One complaint could be settled amicably, while another one was withdrawn by the investor. The vast majority of complaints received in 2005 related to two UCIs that have been withdrawn from the official list during the year.

It should be noted that the complaints relating to UCIs are not included in the 2005 statistics of the General Secretariat.

2.2. Analysis of the complaints handled in 2005

2.2.1. Banking operations

- ***Charges***

A large number of complaints concerned the fees charged by the credit institutions.

Thus, one complaint was lodged by a customer who complained that he had not been informed of the change in charges decided by the credit institution. However, the credit institution had informed all the customers by mail of its new charges in advance. The change introduced an annual lump sum administrative fee for all natural persons, payable at the beginning of the year, as well as a management commission, payable at the beginning of every quarter, applicable to a portfolio of a certain amount. Every change in charges should be duly notified to the customer within a reasonable timeframe. As the customer had not responded to the mail, the credit institution had debited the administrative fee from the account as provided for in the new charges system.

While the CSSF does not interfere, in principle, in pricing policies of institutions, it has however decided in one case that a credit institution could not charge the customer with the investigation costs generated by a search and seizure warrant concerning the customer. According to the CSSF, these expenses were not provided for in the terms and conditions, nor were they made in the interest of the customer. It was rather a legal obligation that the credit institution had to fulfil. Moreover, the credit institution was free to seek advice from a lawyer without passing these costs on to the customer.

Owing to the particular trust relationship that may exist between parties, a credit institution might want to grant advantages such as free custodian fees to a particular customer. One complaint precisely dealt with the fact that a credit institution did not want to uphold this advantage anymore. Indeed, the credit institution considered that this special trust relationship no longer existed, as the customer had requested that his entire portfolio be transferred to another credit institution. Consequently, the credit institution applied the usual charges. Preferential fees and commissions compared to the standard charges list should not be taken for granted by customers. Thus, the credit institution is indeed not obliged to apply a discount conceded for every transaction and forever. Nevertheless, the CSSF considered that the decision to reconsider the preferential fees was questionable insofar as the credit institution had applied the usual fee retroactively to the full year and has therefore invited the credit institution to propose an amicable settlement to the client.

- ***Transfers***

Even though credit institutions are required to perform a certain number of verifications, such as the statement and the accuracy of the mandatory information, before passing on a transfer instruction, they shall pay extra attention when the transfer order is not given by way of a pre-printed form, but on another support, such as on plain paper, sent by post or fax, or even by e-mail, knowing that this is subject to all kinds of fraud.

Thus, in one case submitted to the CSSF, the credit institution had performed a transfer in accordance with an order sent by fax, which had been identified afterwards as a forgery by the complainant. The customer considered that the credit institution should have verified the origin of the transfer order, given notably that it differed considerably from previous orders. The CSSF has concluded that the credit institution should have been alerted by the atypical nature of this fax and contacted the complainant to request a confirmation, even more so as the order concerned almost the whole assets in the account. According to jurisprudence in this matter, the banker of the transferor is at fault if he does not verify with due attention the regularity and genuineness of the order. This examination does not only consist in checking the form and appearance of the order, but also the general circumstances of the transaction. The slightest doubt should prompt the banker to suspend the execution and to request a confirmation from the customer. The CSSF considered that the credit institution was partly liable for the loss sustained by the complainant and invited it to contact the customer so as to reach an amicable settlement.

Another complaint was lodged with the CSSF by a customer who had realised a material error, namely a transfer that had been executed by his credit institution on another account than that stated on his transfer order. The customer wished to transfer the funds to the beneficiary's account with a given credit institution. However, even though the beneficiary was the same, the credit institution took the liberty to transfer the funds to the account that the beneficiary held in its own books. The complainant, who had not immediately realised the change of his funds' destination, had signed the payment receipt, as he had done for every previous transfer in the context of a real estate transaction. Following the CSSF's intervention, the credit institution acceded to the customer's demand and paid back the funds.

The obligation for a credit institution to provide information on the performance and detail of a transaction, such as a transfer, is limited in time. A customer, who had approached the CSSF, claimed that a transaction was fraudulent and that the credit institution had not investigated enough on a transfer executed in the past. However, the credit institution considered that it had made all the investigations it had been able to. Furthermore, it put forward the decennial storage period under article 11 of the Commercial Code, as well as jurisprudence according to which a banker is required to provide the customer with the documents relating to the account management for the ten years preceding the date of the request. As the facts dated back to more than ten years in this particular case, the CSSF did not decide on any misbehaviour of the credit institution which had not been able to trace the contested transfer.

- ***Cheques***

A customer had deposited a cheque with his credit institution and had his account credited on the first subsequent working day with the amount of the cheque minus collection charges. A "credit advice" was sent to the customer on the same day. However, the cheque, upon presentation for payment by the beneficiary's credit institution, was returned by the credit institution of the drawee stating "Cheque stopped - fraudulent use". A registered mail was immediately sent to the customer to inform him of this payment incident, followed by a second registered mail informing him that the credit institution would debit his account for the amount of the cheque, as well as for the return and correspondent charges.

The customer blamed the credit institution for having credited the amount of the cheque without having made preliminary investigations as regards sufficient funds. However, the customer's account was credited with the amount of the cheque "under reserve". The "under reserve" credit of a cheque is considered as an advance granted by the credit institution and, consequently, decided by the account holding bank according to the customer's profile. The customer had been informed thereof through the "credit advice" sent on the same day his account had been credited.

The CSSF has concluded that the expression "under reserve" was sufficiently explicit and included the idea that the credit on the account was made under reserve of a subsequent payment of the cheque by the drawee credit institution. Furthermore, a credit institution is unable to make sure beforehand that cheques are covered. The credit institution could therefore rightfully reverse the entry if the cheque was not paid by the drawee credit institution for whatever reason, as the credit institution does not have to bear the consequences of a fraudulent cheque. It is commonly accepted that depositing a cheque amounts to a collection order; in practice, credit institutions therefore immediately credit the beneficiary's account at the same time as they collect the cheque from the drawee's credit institution. The CSSF could therefore not decide on a misbehaviour of the credit institution.

- ***Loan contracts***

The CSSF has observed a noticeable increase in cases relating to consumer credit and mortgages.

Conclusion of a loan contract

In one case, the customer complained that the refusal of the credit institution to grant a mortgage was not justified, as he claimed to have all the guarantees to be granted the credit sought. The credit institution for its part defended its position by claiming that the repayment burden was out of proportion with the net income of the complainant and of his spouse, and that the guarantees presented were insufficient. The CSSF informed the customer that it does not interfere in the decision of the credit institution to grant a loan or not, as this comes under the commercial policy of the institution.

In another case, a customer complained that the credit institution made him bear the costs for the valuation of real estate in the context of an application for a mortgage, given the fact that the loan had finally been refused. The credit institution had confirmed that the complainant had been explicitly informed on the expert valuation and administration fees he would have to bear at the moment the credit was applied for. The customer had even signed an express statement authorising the credit institution to levy the specific fees relating to the mortgage. However, apparently he did not understand that the expert valuation fees would fall under these specific fees even if the credit was refused. The CSSF could not decide on any misconduct by the credit institution in the context of this dispute.

Interest rates

Customers sometimes approach the CSSF when a credit institution does not automatically adapt the interest rate of a loan contract following a decrease in the rates. The position of credit institutions is that the interest rate of the loan account follows every adaptation of the rates in accordance with their general policy and that variable interest rates are thus adapted to the situation in the market. But interest rates do not necessarily follow the development of the rates decided by the European Central Bank, be it downwards or upwards, as an interest rate takes into account the overall relationship with the customer and its risk profile. No law obliges the credit institutions to follow exactly the variations of the interest rate fixed by the European Central Bank. The loan contract is often silent on this point, even if it provides for the possibility of an increase in the interest

rate.

Payment in advance of the mortgage. Realisation of the mortgage.

In one case submitted to the CSSF, the credit institution had granted a mortgage repayable over a period of twenty years with a fixed interest over a period of ten years. During the fixed rate repayment period, payments in advance were not authorised. On this point, the provisions of the document certifying the credit opening were completed by the letter of credit. However, the parties still had the possibility to exit the credit agreement, notably through a unilateral denunciation of the agreement concerned. In this context, the document certifying the opening of the loan only set down that a "denunciation of the credit would result in the discontinuation of the loan and in all the amounts due by the credited party to the bank becoming payable". In this particular case, the customers had thus not been able to reasonably assess the consequences of an advance payment, knowing that there was no reference to a penalty for breaking mortgage in the credit letter. The CSSF has thus requested the credit institution to reconsider its position *vis-à-vis* the customer. Consequently, the credit institution has not only proposed the customers to settle the dispute on an amicable basis, but has also inserted an explicit statement in its credit letters, which now informs the customers on the existence of a compensation in case of a prepayment, specifying that the latter is based on the refinancing costs of the credit institution.

2.2.2. Portfolio management

A certain number of customers assume that bad investment results are necessarily due to poor management, or even management errors made by the credit institution and therefore lodge a complaint. However, in most cases, the investments have merely undergone the ups and downs of the market that a professional cannot control.

Other complaints were connected with persons under contract with a credit institution as business introducer and who had overstepped their powers, making it appear as actual proxy of the customer.

In one case submitted to the CSSF, the credit institution had left too much latitude to the business introducer. The credit institution left the business provider not only with the task to inquire about the customer's financial information, his investment experience and goals, but did not even object to the fact that the business introducer placed orders on behalf of the customer, which pointed to his being an independent manager of the customer.

- ***Discretionary management***

In one complaint, the customers claimed that they were under discretionary management, whereas the elements of the file suggested the opposite. Indeed, the customers recognised in numerous mails that they had been contacted on a regular basis by their appointed manager to propose investments they decided to follow or not. As regards the customers' claim that their account had not been handled with due attention, the credit institution responded that it had submitted proposals for a certain number of investment possibilities. The credit institution had even proposed to switch to a discretionary management agreement in order to facilitate the management of their assets. However, this proposal had not had any effect. The elements of the file also reveal that the customers had often requested the advice of the credit institution as regards their investments. As an advisory management agreement only entails an obligation of due care and not to achieve a given result, the credit institution could thereby not be responsible for the yield of the recommended investments. The customers had thus been perfectly informed on the nature of their contractual relationship with the credit institution and on the investments made on their behalf and for their account, so that nothing pointed to a misbehaviour of the credit institution.

The CSSF stresses once again the importance to have put down in writing not only the discretionary management agreement, but also all the conditions governing its fulfilment and to ensure that the document is countersigned by both parties.

Within the context of another complaint, a customer invoked the poor fulfilment of the discretionary management agreement he had signed. The credit institution denied having countersigned this contract, which had thus never been executed. The CSSF concluded, in the light of the elements of the file, that the credit institution was partly liable for the inception of this complaint, as the customer could reasonably believe in the execution of the discretionary management contract he had signed. Indeed, the credit institution was not able to prove that the customer had been informed of the fact that the contract had not been fulfilled for lack of sufficient funds. Furthermore, there had been nothing in writing that submitted the fulfilment of the contract to the condition of a defined amount of capital. Moreover, it turned out that the credit institution had charged management fees during several years. The CSSF therefore considered that the credit institution had misbehaved.

- ***Obligation of information***

Customers often complain that they have been insufficiently informed on a given investment or on the products that they envisaged to acquire, which puts the professionals in the delicate situation of having to prove that they have fulfilled their obligation of information.

A customer complained in his complaint letter that the credit institution had not informed him on the risks inherent in an investment in eurobonds. However, the customer had signed every stock market order that the credit institution had executed on his behalf. Furthermore, the customer had not signed any portfolio management agreement with the credit institution, so that the final decision to make a given investment was his. The sole fact that a loss was sustained following a drop in the price of securities does not suffice to conclude that the credit institution is at fault, as the obligation of advice of the credit institution is an obligation of due care. Indeed, the credit institution cannot foresee the ups and downs of the market. Moreover, the customer claimed that he had not understood the meaning of the text written on the securities that had been delivered to him materially. The credit institution stated that it had given all the necessary information and was able to prove that the client had experience with this type of securities. The CSSF could therefore not decide on any misbehaviour. Furthermore, it should be borne in mind that customers should not merely adopt a purely passive attitude, but that they are obliged to make inquiries if necessary. In this particular case, the customer should have asked for the necessary details before taking the decision to invest in eurobonds.

2.2.3. Banking secrecy

The CSSF is regularly approached by persons that had not been able to obtain information as the bank referred to its banking secrecy. In all the cases submitted to the CSSF in 2005, this objection was however justified.

Thus, a complainant blamed the credit institution for not disclosing the identity of a person that had handed in a certificate of an investment fund for collection. The credit institution considered that its secrecy obligation went against the disclosure of this person's identity, as the latter was a third party in relation to the complainant. The CSSF agreed with the position of the credit institution.

In another case, it has been decided that the credit institution could not reveal the identity of the beneficial owner of an account belonging to a company to the heirs of the entitled party of said company whose funds had been transferred on that account, without breaching the banking secrecy.

2.3. FIN-NET network, the cross-border out-of-court complaints network for financial services

A FIN-NET plenary meeting was held on 10 June 2005 in Prague, which also gathered the representatives of some of the ten new Member States of the European Union. They stated their situation and progress as regards out-of-court complaint settlement of complaints on financial matters, in order to fulfil the requirements with respect to their application for full membership of the FIN-NET network.

3. COMMUNICATIONS RELATED TO THE FIGHT AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

The application of the prudential supervisory mission of the CSSF is general and also covers the fight against money laundering and terrorist financing. The law of 12 November 2004 on the fight against money laundering and terrorist financing (hereinafter "the law") confirms that "the Commission is the relevant authority to verify compliance with the professional obligations as regards the fight against money laundering and terrorist financing by all the persons under its supervision, without prejudice to article 5 of the law of 12 November 2004 on the fight against money laundering and terrorist financing."[4]

The obligation of the professionals of the financial sector to communicate to the CSSF a copy of their reports of suspicions filed with the Public Prosecutor is laid down in circular CSSF 05/211 of 13 October 2005, which provides in paragraph 137 that "the professionals of the financial sector shall transmit, separately and at the same time as they transmit information to the Public Prosecutor in accordance with article 5(1), the same information to the CSSF as they transmit to the Public Prosecutor, whatever the origin of the information process and the content of the information concerned".

Communication of information as regards the fight against money laundering and terrorist financing concerns both so-called "spontaneous" reports as provided for in article 5(1)a) of the law in case of a suspicion, and those made at the request of the competent legal authorities as provided for in article 5(1)b) of the law. The CSSF shall also be informed of the subsequent communications insofar as they are of interest for the understanding and follow-up of the file.

Indeed, the analysis of the copies of the reports of suspicions received by the CSSF and of the other reports in this field is an important exercise which allows to assess the concrete implementation and proper application of anti-money laundering procedures by the professionals, including in particular compliance with their obligations as regards KYC (Know Your Customer) and co-operation with the authorities. The assessment of the professional's behaviour allows the CSSF to form a general opinion about the endeavours of the professionals in this field to limit, as far as possible, the legal and reputational risks relating to money laundering or terrorist financing.

Generally speaking, this analysis contributes to the CSSF's overview of the development of the dubious customers' behaviour. The conclusions that can be drawn allow the CSSF to be in tune with the needs of the professionals in this field and to take account thereof in drawing-up its circulars or the stands it takes, as well as within the international bodies or in the expert groups in which the CSSF takes part.

Besides the actual fight against money laundering and terrorist financing, the CSSF issues circulars inviting the professionals to communicate the names of the customers that are mentioned on the lists drawn up by the European Union with respect to the freezing of funds and economic resources.

[4] Indent added by the law to article 2(1) of the law of 23 December 1998 establishing a *commission de surveillance du secteur financier.*

The role played by the CSSF is more than merely being the intermediary between the professionals of the financial sector and the relevant competent ministries.

In this context, it should be borne in mind that a consolidated list, updated by the European Commission and listing the names of the persons and entities concerned by the restrictive financial measures, is available on the official website of the European Union (the relevant link is provided on the CSSF's website under the heading "Links").

Within the CSSF, the General Secretariat handles the files relating to the aforementioned communications.

3.1. The communications in figures

The figures show that the financial sector is still prone to the risk of being used for the purpose of money laundering and terrorist financing despite the fact that at this point in time, the diversification of money-laundering and terrorist-financing techniques involves more sectors, especially when funds are invested.

In 2005, the CSSF dealt with a total of 487 communications relating to the fight against money laundering and terrorist financing, which is a slight decrease as compared to 2004 (514 communications). These communications include reports under article 5 of the law, as well as communications with respect to financial embargoes.

The vast majority of reports are made spontaneously by the professionals, the reason being that certain information about customers came to their knowledge *via* the written press or information published on the Internet, such as the lists of persons that have been previously the object of an investigation.

Indeed, the cases under review reveal that the professionals make increasingly checks at the beginning of the relationship, as well as during the relationship, when they deal with an order of a customer that is not in line with his normal behaviour or when the customer wishes to end the relationship without reasonable explanation. These facts are often only part of a whole set of indications, which can concern the person concerned, the evolution of the customer, the origin of the assets, the nature, the purpose or the terms of the transaction in question.

It is interesting to note that a large part (72) of these reports were made following the request of potential customers to enter into business relations, but to which the professional of the financial sector did not respond favourably due to a suspicion of money laundering or terrorist financing. In these cases, the suspicion was often the result of information on the funds to be deposited or invested, that were not fully satisfying for the professional, i.e. the origin of the funds was not clear, the amount of the deposit was very high, or the nature of the transaction, such as currency exchange or sale of securities, made the professional suspicious and file a report. Certain requests to open an account have been refused by the professionals because the documents submitted in this context appeared to be fraudulent or were fakes.

Around sixty reports were due to decisions or regulations issued in the context of restrictive financial measures decided at European level. This category comprises the communications that have either been transmitted to the CSSF as copies following a circular issued by the Luxembourg Financial Intelligence Unit (FIU) in the context of the fight against money laundering or terrorist financing, or following the CSSF circulars on the freeze of funds and economic resources decided at European level.

Twenty-nine cases are related to a communication to the CSSF that has been made following a notification of a seizure and search warrant issued either in the context of a national investigation in the context of the fight against money laundering and terrorist financing, or in the context of an international investigation following an international letters rogatory.

As regards the data on the professionals that have filed a communication in 2005, 67 out of the 155 credit institutions registered on the official list as at 31 December 2005 have made a communication; three communications have been filed by two banks that were not active anymore at 31 December 2005.

As regards the other professionals of the financial sector (PFS), sixteen of the total 185 PFS registered on the official list as at 31 December 2005 have filed a communication with the CSSF.

Moreover, two management companies out of the 72 management companies registered on the list as at 31 December 2005 have made communications in this field.

It should be stressed that the professionals that have filed more that ten reports – i.e. twelve banks and one PFS – have become even more diligent as in 2004, as the communications of these professionals represent more than half of the total number of communications received by the CSSF (about 61% in 2005 against 46% in 2004).

3.2. General crime

In the context of communications regarding the fight against money laundering and terrorist financing, the CSSF also dealt with a certain number of files relating rather to general crime, but that can however present a certain risk for the professional, as well as for the customer.

A technique that stood out regularly in the context of distance selling is that persons guilty of fraud use the possibilities to conclude deals *via* the Internet to possibly launder money. In this particular case, the customers that wish to sell objects through the Internet are informed by the relevant buyers that the selling price is paid by cheque sent to them and which they have to hand in for collection. However, these cheques are often altered and/or forged, or issued for an amount that largely exceeds the agreed selling price. In the latter case, the seller is requested to transfer part of the extra amount to a third party, the goal which consists in circulating and laundering money being thereby achieved.

Furthermore, several cases of fraud relating to transfer orders have been reported by banks. The mechanism was always the same: the banks had received transfer orders that had been duly signed by customers residing in African countries, requesting the transfer of the funds from accounts opened on behalf of these customers to banks in Asia. When the customers noticed the transfers, they informed the bank that they had never initiated the transfers concerned. Investigations revealed that the orders had been falsified in a professional manner, by means of information that had been stolen from the customers. The accounts in Asia had been opened by means of falsified passports and the money had been withdrawn immediately.

The CSSF therefore advises banks to strengthen their transfer procedures for customers residing in high-risk countries, notably by having written orders confirmed orally.

GENERAL SECRETARIAT

Left to right: Iwona MASTALSKA, Steve HUMBERT, Christiane TRAUSCH, Benoît JUNCKER, Danièle BERNA-OST, Jean-François HEIN, Nadine HOLTZMER, Natasha DELOGE, Anne WAGENER, Danielle MANDER

Absent: Carine CONTE

CHAPTER XI

GENERAL SUPERVISION AND CSSF INVOLVEMENT IN INTERNATIONAL GROUPS

1. General Supervision

2. Co-operation within European institutions

3. Multilateral co-operation

1. GENERAL SUPERVISION

1.1. Setting up of General Supervision: reasons and objective

Given the challenges of a complex regulatory environment, the development of more and more sophisticated risk management techniques and the continuous innovation in the structure of financial products, the support and assistance of the CSSF's agents that are directly in charge of the supervision of the professionals of the financial sector with respect to specific subjects is of utmost importance within a supervisory authority of a financial centre such as that of Luxembourg.

The CSSF has therefore created a transversal function "General Supervision" (SGE) as from 1 January 2005, which deals on a horizontal basis with prudential supervisory, accounting and auditing issues common to the CSSF's departments directly involved in the supervision of the professionals of the financial sector.

The objective of this "think tank", which proposes approaches and instruments for analysis and assessment, is thus to develop competence fields that require specific knowledge and experience, provide methodological support for the performance of prudential supervision on a daily basis, transmit and communicate the knowledge acquired at internal training sessions and accompany agents to on-site inspections that deal with more complex subjects, such as the validation of risk management models.

In particular, the SGE function is responsible for:

- all the files of the international groups in which the CSSF takes part, i.e. those established under the aegis of the EU Commission and EU Council, CEBS, CESR, CEIOPS, IOSCO, OECD, Basel Committee, European Central Bank and FATF;
- the development and the interpretation of the national and international regulations;
- general issues regarding the approach and methodology concerning prudential supervision, rules of conduct and professional obligations in the financial sector;
- dealing with issues relating to accounting, preparation of balance sheets, reporting, publication of financial information, and audit of global macro-prudential studies on professionals of the financial sector, as well as on financial markets and products;
- lending assistance in the field of risk management methods and risk modelling.

1.2. Activities in 2005

During its first year of existence, the SGE function, currently composed of nineteen agents, has sent 536 letters stating the CSSF's views as regards prudential supervisory, accounting and auditing issues.

In 2005, the agents of the SGE function took part in 42 meetings that were held with representatives of the banking industry at the CSSF's premises.

During the year under review, the CSSF participated in 219 meetings of international groups (among others CEBS, CESR, CEIOPS, Basel Committee, ECB, OECD, IOSCO, various groups at European level), including 170 which have been handled directly by the SGE function. In addition, eleven multilateral meetings, in which agents of the SGE function took part, were held with foreign supervisory authorities in the context of the implementation of the new capital adequacy provisions (Basel II) in certain cross-border banking groups with subsidiaries in Luxembourg.

The SGE function carried out nineteen on-site inspections at the premises of Luxembourg credit institutions in order to gather the necessary information for its meeting with the International Monetary Fund, as well as 52 other controls and on-site inspections. They mainly related to CSSF's monitoring of the future implementation of the new capital adequacy framework (Basel II) by Luxembourg banks and of the validation of market models.

1.3. Implementation of the new capital adequacy framework

In 2005, the SGE function continued its fact-finding missions concerning the implementation of the New Basel Accord and of the European Directive on capital requirements in close co-operation with the department in charge of the supervision of banks. The CSSF agents visited credit institutions more than twenty times in this context.

These specific fact-finding missions were either initiated by the credit institutions themselves or by the CSSF, or have been undertaken in the context of the coordination efforts made with foreign supervisory authorities within the scope of the home-host co-operation, as provided in the tenth consultative paper (CP10) of CEBS for the European framework, respectively by the co-operation principles drawn up by the Accord Implementation Group of the Basel Committee on banking supervision. They are also carried out in the context of case studies performed at European level as well as in the USA.

The main objectives of the fact-finding missions are:

- for the CSSF to learn about the progress of the credit institutions' implementation of the IRB approach (Internal Ratings Based Approach);
- the management of the project (budget, implementation and development plan, self-assessment analysis, including a gap analysis compared to regulatory requirements, etc.);

taking account notably of corporate governance (role of the authorised management, risk management and internal audit, development and validation process, stress testing, etc.) and concepts (philosophy of internal ratings, Masterscale, etc.), the methods chosen (expert, statistical, neural or causal models, etc.), as well as the use (use tests) and the operational and supervisory framework. The content and the intensity of the various elements of the control plan are adapted according to the role of the Luxembourg entity and its involvement in the development, maintenance, validation and use of the models considering the importance of the different activities and portfolios. The scope of these on-site missions is being extended to other areas, such as operational risk, and the first contacts in this respect have already been made.

In order to be able to prepare the on-site missions and to allow a structured dialogue, the CSSF invites banks to provide it with the documents relating to a standard agenda beforehand (kick-off meeting). Furthermore, other elements, such as the responses to specific letters or to different circular letters, the results and questionnaires relating to the Quantitative Impact Studies, the templates submitted in the context of informal files (pre-application packages), as well as the information gathered on the occasion of previous exchanges of opinion can be used for these missions.

In a proactive effort, the CSSF reserves the right to voice comments if it observes cases of non-compliance with specific points. However, it is important to note that considering the progress of regulatory texts, the CSSF's responses shall not be interpreted as a formal review and that the fact that some points have not been raised does not mean that there is compliance.

The CSSF's assessment is based to a large extent on the text of the future Directive, on the last version of CEBS CP10, as well as on numerous contributions of the Accord Implementation Group (AIG) and of the Sub-group on Validation (AIGV). All the important decisions likely to impact the CSSF's policy, the recommendations and questions are discussed within the Committee for Internal Validation (CoVa) of the CSSF, which gathers agents involved in the permanent supervision of banks, as well as agents dealing with risk management and prudential policy. The Committee for Internal Validation also adopts the standardised documents such as the control plans and the different documentation templates relating to applications for authorisation filed by credit institutions.

Qualitative impact study QIS 5

In March 2005, the Basel Committee decided to review the calibration of the revised framework in spring 2006. In order to evaluate the impact of the new proposals and to ensure that this study is based on the most recent and high-quality data, a fifth quantitative impact study (QIS 5) was launched in October 2005.

The CSSF had contacted the Luxembourg credit institutions and recommended them to perform this test computation on a voluntary basis. The interest of such an application for participating credit institutions is obvious as it will provide a realistic view of the means to be allocated for the implementation of the new rules and will allow to assess the consequences in terms of capital requirements. The protected workbooks integrating the various national parameters, as well as the relating documents have been sent by the CSSF to all institutions participating in this impact study.

The response of the Luxembourg credit institutions was absolutely satisfactory, as about twenty banks intended to perform the test computation. Several responses have been sent on an anonymous basis to the Basel Committee in order to take part in the overall evaluation which has not yet been completed.

2. CO-OPERATION WITHIN EUROPEAN INSTITUTIONS

Article 3 of the law of 23 December 1998 creating a *Commission de Surveillance du Secteur Financier* as amended appoints it, *inter alia*, to deal with and participate in the negotiations concerning problems relating to the financial sector, at both Community and international level. The CSSF therefore participates in the work of the following forums.

2.1. Groups attached to the European Commission

2.1.1. The Committee of European Banking Supervisors (CEBS)

The Committee of European Banking Supervisors (CEBS) was established by Commission Decision 2004/5/EC of 5 November 2003. Its duties encompass reflecting, discussing and giving advice to the European Commission in the fields of banking regulation and supervision. The Committee also co-operates with the other competent committees in banking matters, notably with the European Banking Committee established by Commission Decision 2004/10/EC. CEBS was chaired by Mr José-María Roldan (Banco de España, Spain) until January 2006. In February 2006, Mrs Danièle Nouy (Commission Bancaire, France), who was Vice-Chairman until that date, took the chair. She is assisted by Mr Helmut Bauer (Bundesanstalt für Finanzdienstleistungsaufsicht, Germany) as Vice-President. Mr Andrea Enria (Banca d'Italia, Italy) has been appointed General Secretary. The Chair is supported by a "Bureau", comprising Mr Andreas Ittner (Oesterreichische Nationalbank, Austria), Mrs Kerstin af Jochnick (Finansinspektionen, Sweden) and Mr Andrzej Reich (National Bank of Poland, Poland). CEBS' Secretariat is based in London.

CEBS took up its duties in January 2004 by holding its first meeting in Barcelona on 29 January 2004. Its objective is to fulfil the functions of a Level 3 committee for the banking sector in the application of the Lamfalussy process:

- advise the European Commission either at the Commission's request, within the time limit which the Commission may lay down according to the urgency of the matter, or on the Committee's own initiative, in particular as regards the preparation of draft implementing measures in the field of banking activities;
- contribute to the consistent application of European Directives and to the convergence of Member States' supervisory practices throughout the Community;
- enhance prudential supervisory co-operation, including the exchange of information.

During 2005, CEBS continued its work relating to the future Directive on capital adequacy, which will transpose the New Basel Accord into European law.

CEBS finalised three documents in this context. The first document relates to the common reporting framework to be used by credit institutions and investment firms when they report their solvency ratio to supervisory authorities under the Capital Requirements Directive (known as COREP). The second document relates to a standardised financial reporting framework based on IAS standards for credit institutions and investment firms operating within the European Union (known as FINREP). Finally, the third document relates to the information falling within the scope of the disclosure to be made by the supervisory authorities of the European Union in accordance with article 144 of the future Directive on capital adequacy.

Furthermore, following calls for advice from the European Commission, CEBS presented its technical advice, within the allotted time, on the following topics:

- The review of article 16[1] of Directive 2000/12/EC of 20 March 2000 on the taking-up and pursuit of the business of credit institutions in order to make sure that prudential controls do not hamper cross-border mergers and acquisitions. This advice was provided on 31 May 2005.
- The review of article 8 of Directive 2000/46/EC of 18 September 2000 on the taking-up, pursuit of and prudential supervision of the business of electronic money institutions, relating to the waivers from the application of this Directive and of Directive 2000/12/EC for hybrid issuers. This advice was provided on 1 July 2005.
- The review of certain aspects of Directive 94/19/EC of 16 May 1994 on deposit guarantee schemes, such as the level of coverage, the division of the responsibilities between the home and host country authorities, information sharing between the local supervisory authority and the deposit guarantee system, as well as crisis management procedures. This advice was provided on 30 September 2005.

The above-mentioned topics were submitted to public consultation by CEBS and the European Commission.

Moreover, CEBS has published the following consultation papers:

CEBS consultation

The final document explaining the public consultation practices, as well as the timelines that CEBS is to follow in its consultation processes, was published on 11 March 2005.

Role and tasks of CEBS

On 5 July 2005, CEBS has published a consultation paper on its role and tasks. This document takes stock of the experience gained by CEBS over the first year of its existence. The paper explains CEBS' overall approach to meeting its main objectives, as well as the tools at its disposal. The consultation period closed on 28 November 2005.

Recognition of External Credit Assessment Institutions (ECAIs)

Based on the work achieved by its working group CEBS-EGCRD, CEBS published, on 29 June 2005, a consultation paper on the guidelines for a common approach to the recognition of external credit assessment institutions. The future Directive on capital adequacy provides for the use of these institutions to determine the risk weight of certain exposures of credit institutions and investment firms, under the condition that these institutions are recognised by the supervisory authorities concerned as eligible to perform this activity. The consultation closed on 30 September 2005.

On 1 November 2005, CEBS published a supplementary note to the above-mentioned consultation paper. This note sets out further details on the mapping of securitisation credit assessments and of credit assessments of undertakings for collective investment. The consultation closed on 30 November 2005.

The final document, published on 20 January 2006, takes to a large extent account of the industry's feedback on this subject (please refer to www.c-ebs.org).

[1] Article 16 deals with the qualifying holding in a credit institution.

Co-operation between consolidating supervisors and host supervisors

On 8 July 2005, CEBS published a consultation paper on guidelines for establishing an enhanced co-operation between the supervisory authorities with respect to European banking groups and investment firms. These guidelines reflect the requirements of the future capital adequacy Directive. The consultation closed on 8 November 2005 and the final guidelines, which take account of the industry's feedback, were published on 25 January 2006.

Application of the Supervisory Review Process under Pillar 2

On 20 June 2005, CEBS published a second consultation paper on the Supervisory Review Process, which is a revised and expanded version of the first consultation paper of 2004. The Supervisory Review Process is an essential component of the future capital adequacy Directive. The objective of this process is that banks develop internal capital adequacy assessment processes and a strategy to maintain this adequacy. Furthermore, supervisory authorities should review and evaluate, in dialogue with the banks, the internal capital adequacy assessment and the strategies developed by the banks to require them to take corrective measures, where applicable.

This consultation closed on 21 October 2005 and the industry's feedback has been taken into account to a large extent in the final document published on 25 January 2006.

Joint Protocol between CEBS, CEIOPS and CESR

On 24 November 2005, CEBS, CESR (Committee of European Securities Regulators) and CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) signed a joint protocol to foster co-operation and coordination in the areas of regulation, information exchange and other tasks with a common interest to the three committees.

As the three committees are already closely co-operating on a regular basis, this joint protocol formalises this co-operation in a transparent manner.

Co-operation between CESR, CEBS and CEIOPS has become increasingly important with the sectoral market integration and cross-sector business activity within the European Union. The members of the three committees emphasise the importance of the consistency of the work done in the three sectors at Level 3 of the Lamfalussy procedure. With the joint protocol, the three committees will be able to align their work where necessary.

The practical objectives of the joint protocol are the following:

- share information in order to have compatible approaches;
- exchange experiences which can facilitate supervisors' ability to co-operate;
- produce work or reports that are common to the relevant EU committees and institutions;
- reduce supervisory burdens and streamline processes; and
- ensure that the basic functioning of the three committees develops along parallel lines.

Coordination and co-operation will be based on practical arrangements included in the joint protocol to support consistency in the works of these committees. The protocol defines the basic procedures for meetings and contacts to be made to gain access to information, and indicates the areas of joint work anticipated. Last but not least, the protocol defines the way in which the dialogue between the committees will take place to ensure that new developments are taken into consideration in a consistent manner by the three committees.

- ***CEBS – Groupe de contact***

Created in 1972, the *Groupe de Contact* has been used from the outset as forum for informal co-operation between banking supervisory authorities on EU level. Following the enlargement of the European Union, it now also comprises the representatives of the authorities of the ten new Member States. The Groupe is chaired by Mr Fernand Naert of the Commission bancaire, financière et des assurances (Belgium) since the end of 2004.

Within the new European structure of banking supervision, the *Groupe* henceforth acts as main working group of the Committee of European Banking Supervisors. In that capacity, it assists CEBS with a view to achieve convergence of the prudential supervisory practices in the European Union. The *Groupe* also continues to be a body appreciated for informal co-operation concerning the situation of individual credit institutions, particularly in the event of problems. It follows the development of national regulations, discusses practical aspects of prudential supervision of credit institutions and conducts general comparative studies.

In 2005, the *Groupe* has welcomed two new observers within the context of the EU enlargement process, namely representatives of the supervisory authorities of Bulgaria and Romania.

The *Groupe* continued to focus on the implementation of the prudential supervisory review process, Pillar 2 of the new capital adequacy framework which is being adopted at Community level.

In this field, the *Groupe* notably continued to work on the different risk categories under Pillar 2. These works took shape with the publication of the document dealing with the relation between the internal capital adequacy assessment process of the credit institutions and the supervisory review process of the supervisory authorities. The works regarding the drawing up of best practice guidelines for internal governance of credit institutions and the relevant supervision to be carried out by the authorities, as well as the drawing up of approaches to solve issues relating to the distribution of responsibilities and duties between home and host authorities as regards banking groups operating across Europe, have also progressed.

Furthermore, the *Groupe* continues, following the public consultation that closed in July 2004, to polish up the high-level principles regarding outsourcing of banking functions. However, the outcome of these works depends on the implementation measures of MiFID (Directive concerning markets in financial instruments) that the European Commission intends to introduce (please refer to http://www.europa.eu.int/comm/internal_market/securities/isd/mifid2_en.htm). These measures, which also concern the provisions with respect to outsourcing, have been based on the work of the European Securities Committee.

Another important part of the *Groupe*'s responsibilities concerns the exchange of information on particular problems encountered by one or several authorities and topical issues. This exchange of information between members, as well as between the *Groupe* and CEBS, continued during 2005.

- ***CEBS – Joint EGCRD/Gdc Working group on Validation of the Advanced Approaches***

This joint EGCRD[2] and *Groupe de contact* working group, established in 2004, gathers experts of the banking supervisory authorities of CEBS member countries in the field of validation of advanced credit risk and operational risk approaches. The group's mandate is in line with the efforts of EGCRD to achieve convergence in the technical fields concerning validation of eligible models in the proposed amendment of Directives 2000/12/EC and 93/6/EEC.

[2] Expert Group on the Capital Requirements Directive.

The works of the group notably resulted in a first publication of the tenth CEBS consultative paper entitled "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and International Ratings Based (IRB) Approaches" in July 2005 for a three-month consultation period, and a second publication in January 2006 with a consultation period closing on 15 February 2006. This document can be downloaded from http://www.c-ebs.org/Consultation_papers/consultationpapers.htm.

- ***CEBS – Working Group on Common Reporting (COREP)***

In order to meet the requirements of the industry and European institutions to reduce the administrative burden and harmonise the reporting requirements for credit institutions, CEBS mandated the Working Group on Common Reporting to develop a common reporting framework for the supervision of capital adequacy within the scope of the new regulatory framework, which is being endorsed.

This decision reflects CEBS' conviction that the introduction of this new regulatory framework, as well as the adoption of the accounting standards IAS/IFRS (FINREP), present unique opportunities to achieve these objectives.

The proposed framework, which was subject to a public consultation launched in January 2005, was finalised in January 2006 (please refer to www.c-ebs.org). Following this consultation and in order to reduce the burden on banks and investment firms, CEBS divided the prudential reporting scheme into two parts, the first one representing "basic information" and the second one "detailed information". Thus, the framework aims at achieving an enhanced convergence of basic information, while leaving enough flexibility for national authorities to fix the scope of the detailed information they request for prudential reporting needs.

It should also be stressed in this context that the final "product" does not only comprise a harmonised framework, but also an IT solution to support the framework, based on the XBRL protocol that each State is free to adopt.

- ***CEBS - Supervisory Disclosure Task Force (SDTF)***

The task force, established in 2004 by CEBS, is responsible for the definition of elements falling within the scope of the disclosure made by supervisory authorities of the European Union in accordance with article 144 of the re-cast Directive 2000/12/EC.

In 2005, the group published its proposals for the concrete setting-up of the publication infrastructure of these elements and the definition of CEBS' role in this implementation. This future transparency obligation requires supervisory authorities to set up a permanent infrastructure allowing the European financial sector and the public to consult and compare the different legislative and regulatory environments of the banking supervisory authorities. These elements include laws, prudential regulations, national options and discretions exercised by national authorities, supervisory methodologies and statistical data relating to banks and investment firms.

The proposals of the task force were submitted to public consultation. As the response to the consultation had been overall positive, the task force has finalised the new disclosure framework, which has been published on the CEBS website on 1 November 2005. The information referred to under the new article 144 of the amended Directive 2000/12/EC should in principle be published for the first time as from 2007. The first statistical data should be published according to this framework in 2008.

- ***CEBS - Expert Group on Accounting and Auditing (EGAA)***

The main activities of the working group established in 2004 are exposed hereinafter according to three sub-working groups.

CEBS - EGAA Sub-Working Group on Prudential and Accounting

At the end of 2004, CEBS had published "Guidelines on prudential filters for regulatory capital" to be made by the banks applying the IAS standards, in order to eliminate the potentially undesirable effects of the application of the IAS standards on the quality, level and stability of regulatory capital. In the course of 2005, the sub-group has conducted a survey on the implementation of these guidelines by Member States. The results of the survey revealed that CEBS' recommendations were followed to a large extent, which had promoted a consistent application of prudential filters among the European States. However, a variety of prudential treatments has been noted in the fields where the CEBS recommendations provide for alternative approaches or none at all.

During 2005, the sub-working group has developed and carried out a quantitative survey to measure the impact of the application of the IAS/IFRS accounting standards on prudential own funds, as well as to assess the prudential filters' efficiency. The main conclusions of the study show that the prudential filters recommended by CEBS, which are in line with the recommendations published by the Basel Committee on banking supervision, adequately address the undesired effects of the transition to the IAS/IFRS standards on regulatory capital of credit institutions.

CEBS - EGAA Sub-Working Group on Standards & Accounting

In March 2005, the sub-group submitted comments to the International Accounting Standards Committee Foundation (IASCF) concerning the consultation paper "Review of the Constitution, Proposals for change" in relation with the IASCF's reorganisation. The documents are available on the IASCF's website http://www.iasb.org/current/iascf.asp.

Moreover, at the beginning of 2005, the members have analysed the results of a survey on the provisions relating to macrohedging. This survey, which was conducted in October 2004, aimed at assessing how the carving-out of certain provisions relating to macrohedging by the European Commission will be implemented by the Member States. The survey reveals that the majority of the Member States will leave it at the regulated entities' discretion to use the full IAS 39 standard of the IASB or the carved-out version of the standard as adopted by the European Commission.

CEBS - EGAA Sub-Working Group Financial Reporting (FINREP)

The sub-working group continued in 2005 to develop a consolidated financial reporting framework for the prudential supervision under the IAS/IFRS accounting framework. In April 2005, this framework was submitted to public consultation for a period of three months. A final amended version, which takes account of the feedback received, was adopted and published by CEBS in December 2005 (please refer to www.c-ebs.org).

The common financial reporting framework, commonly referred to as FINREP, is designed for EU credit institutions that have to submit financial information using the accounting standards IAS/IFRS for prudential reporting to their supervisory authority. FINREP has been developed on the basis of the International Financial Reporting Standards, including the International Accounting Standards and Interpretations as at 1 January 2005 of the IASB, as endorsed by the European Commission. The framework also takes into account certain elements of the standard IFRS 7 "Financial Instruments: Disclosures".

With the standardisation in terms of definition and content, FINREP will contribute at European level both to a better comparability of financial information submitted to the supervisory authorities and to reducing the reporting burden for banking groups that operate in several EU Member States. CEBS considers that the transfer format XBRL can be a helpful tool in constructing a harmonised European reporting system. In this context, CEBS will develop a XBRL FINREP taxonomy that will be made available to the supervisory authorities and the supervised credit institutions.

2.1.2. Committee of European Securities Regulators (CESR)

Established by the European Commission Decision of 6 June 2001, CESR (Committee of European Securities Regulators) took over from FESCO (Forum of European Securities Commissions) in September 2001. CESR is one of the two committees proposed in the Committee of Wise Men's report, which was endorsed by the Stockholm resolution of 23 March 2001. Composed of representatives of 27 supervisory authorities of securities markets in the European Economic Area (Member States of the European Union, Norway and Iceland), CESR is an independent body, which assists the European Commission in preparing technical measures relating to Community legislation on transferable securities, and is entrusted with ensuring harmonised and continued application of Community legislation in Member States. CESR also works towards strengthening co-operation between the supervisory authorities. CESR is chaired by Mr Arthur Docters van Leeuwen (Autoriteit Financiële Markten, Netherlands). He is assisted by Mr Kaarlo Jännäri (Financial Supervision Authority, Finland) as Vice-President.

CESR carried on with its work related to the initiatives concerning the Financial Services Action Plan (FSAP) by notably continuing its works on the mandates concerning the drafting of implementing measures within the scope of the Directive on the harmonisation of transparency requirements concerning the information on issuers whose securities are admitted to trading on a regulated market and Directives 2001/107/EC and 2001/108/EC (UCITS III Directives) that amend Directive 85/611/EEC (UCITS I Directive).

CESR closed its work on the mandates concerning the drafting of implementing measures within the scope of the Directive concerning markets in financial instruments and the Prospectus Directive.

In addition to the work carried out at Level 2 of the Lamfalussy process under the mandates received by the European Commission within the scope of the Directives, CESR continued Level 3 work by drawing up recommendations, standards, common interpretations and procedures to implement co-operation within different areas in order to strengthen regulatory convergence within the EU.

At its meeting on 28 and 29 January 2005, CESR decided to establish a Mediation Task Force intended to develop proposals on the introduction and the functioning of a CESR mediation mechanism. The decision to establish a mediation mechanism follows the request received by CESR of, among others, the Inter-Institutional Monitoring Group for securities markets, the European Securities Committee and the European Parliament, to consider establishing an internal mediation mechanism which goes beyond the requirements provided for the Market Abuse Directive. The consultation paper on the establishment of such a mechanism was published on 8 September 2005 and an open hearing was held on 21 November 2005.

The objective of the mechanism is to resolve disputes between supervisory authorities that are members of CESR and should promote convergence of supervisory practices at European level.

After four years of existence, CESR gradually begins to focus its work on the implementation of FSAP Directives. Its members have therefore decided in October 2005 to create a Task Force in order to define CESR's medium-term priorities as well as any adaptation of its functioning.

Considering the sectoral market integration and the interdependence of financial activities within the European Union, CESR signed, on 24 November 2005, a joint protocol with CEBS and CEIOPS to foster co-operation and coordination in the areas of regulation, information exchange and other tasks with a common interest to the three committees. More detailed information is available under point 2.1.1. above.

Moreover, owing to the growing interdependence of the European and American markets, CESR held discussions with the American regulatory authorities, i.e. the SEC (Securities and Exchange Commission) and CFTC (Commodities and Futures Trading Commission) in the various areas. A joint working programme between CESR and CFTC aiming at facilitating the performance and supervision of transatlantic activities as regards derivatives was published in June 2005.

The Market Participants Consultative Panel, a committee comprised of fifteen market participants appointed in a personal capacity, established in June 2002 following a suggestion of the European Parliament and the Committee of Wise Men, is charged with assisting CESR in carrying out its tasks. The three meetings in 2005 of this committee focused mainly on the major trends and evolutions in financial markets, on EU and US regulatory and supervisory issues, on the listing of EU companies on US exchanges, on the exercise of corporate rights in investment management, as well as on the supervisory convergence role of CESR.

Groups established within CESR

- ***Expert group related to the Directive concerning markets in financial instruments (MIFID)***

Under a **Steering Group** and assisted by a consultative group composed of 23 external experts (including a representative of a Luxembourg professional of the financial sector), three CESR expert groups cover the mandates for the Directive on markets in financial instruments (commonly referred to as ISD 2 or MIFID). It has to be noted that the transposition deadline of MIFID was extended to 1 February 2007. The Directive will be applicable as from 1 November 2007.

The mandates[3] cover three major subjects handled by three working groups within CESR:

- the requirements for financial intermediaries and investor protection – the Group Intermediaries;
- the rules governing financial markets and market transparency – the Group Markets;
- the requirements for transaction reporting and co-operation – the Group Co-operation and Enforcement.

A first technical advice, submitted to the European Commission on 3 February 2005, covers organisational issues of the financial intermediaries and investor protection (compliance function, organisation regarding procedures, internal systems and resources, outsourcing, record keeping, safeguarding of clients' assets, management of conflicts of interest within an entity to which MIFID applies, rules of conduct for the provision of investment services in relation to the information to provide to customers and the relationships that should be established with customers on services provided by the investment firm, minimum content in the contract signed with the retail client), reporting requirement regarding transactions on financial instruments and co-operation and exchange of information between competent authorities.

[3] The mandates have been described more explicitly in the CSSF's Annual Report 2004.

Based on past standards drawn up by CESR relating to investor protection and having considered the informed comments of the industry and the participants in the open hearings, the **expert group Intermediaries** presented, on 29 April 2005, technical measures to the European Commission concerning the best practice rules by defining the criteria to be taken into account for the definition of the importance of the different elements of best practice (such as price, cost, swiftness, security and probability of execution and delivery), as well as the rules governing the handling of eligible counterparties. These technical measures also cover the definition of investment advice, the list of financial instruments, certain rules of conduct (requirement to act honestly, fairly and professionally in the best interest of the clients, suitability test, execution only), the conflicts of interest inherent in investment research, the agreement with the professional client and the handling of eligible counterparties.

Both advices have been discussed within the European Securities Committee and will be used by the European Commission to establish implementing measures complementing the MIFID framework.

CESR attaches increasingly attention to the involvement of private investors and consumers in its works and to their feedback. CESR had therefore organised a MIFID Consumer Day on 22 March 2005. Twelve representatives of national and European consumer organisations exchanged their views with CESR notably as regards the technical measures drawn up by the expert group Intermediaries. The importance of investor education and the need to have it high on the political agenda, as well as the need to organise such consumer days more often have been the essential conclusions that were drawn at the MIFID Consumer Day.

The **expert group Co-operation and Enforcement**, which submitted its technical advice to the European Commission on 31 January 2005, continued discussions on the technical aspects relating to the modalities for on and off stock exchange transaction reporting on financial instruments admitted on a regulated market. CESR-Pol (please refer to "CESR's operational groups" hereunder) has been put in charge of drawing up the technical modalities regarding co-operation in this field.

Considering the complexity of the technical aspects and the implementation deadline of MIFID, CESR's chairmen have decided to set up a **Technical Task Force** (TTF) comprising, among others, IT experts. The mandate given to TTF prioritised the establishment of common data formats and common file formats. At medium term, TTF will work on setting up common quality standards, determining the infrastructure and the setting up of the means to exchange information between competent authorities. TTF made concrete operational proposals for both categories of formats and stressed how important it is to create and maintain certain reference databases for adequate data identification (for example financial instruments). Furthermore, TTF prepared recommendations relating to qualitative subjects concerning the frequency and appropriateness of transaction reports on financial assets, as well as to safety and error correction. TTF considers that exchanges of financial assets transaction reports between competent authorities can be done (1) on a centralised basis, (2) on a decentralised basis, (3) on a mixed basis or (4) through a European database. The future work of TTF relating to the application and financing, as well as to the concrete modalities to implement with respect to transaction reports on financial instruments depends on the final technical measures adopted at Level 2 by the European Commission.

- ***Transparency expert group***

In the first half-year of 2005, the expert group continued its work under the mandate received in 2004 under the Directive on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive). These first mandates addressed certain issues related to the notification of reports of major stockholdings, the standards for the dissemination of regulated information and questions on semi-annual reports, the equivalence of transparency requirements provided by third countries and procedures whereby an issuer may elect its home Member State. CESR submitted its technical advice on these issues to the European Commission on 30 June 2005.

In March 2005, CESR took stock of the different options concerning the setting up of a future electronic network of central storage mechanisms for regulated information at European level. This report also addresses the issue of the electronic sending of regulated information by issuers to the competent authorities. Following this report, the European Commission requested CESR in July 2005 to provide:

- by June 2006, its opinion on possible implementing measures concerning the interoperability agreement necessary to allow the interconnection of national central storage mechanisms in a European network and the costs resulting from the creation of such network;
- by June 2006, technical advice on the minimum quality standards that should apply to central storage mechanisms. Moreover, CESR is invited to advise on the role of the competent authorities (notably with regard to their supervisory powers concerning central storage mechanisms), as well as on the minimum quality standards applicable to the transmission of regulated information to the competent authorities;
- by April 2006, an intermediary report on the impact in terms of costs related to the implementation and compliance with the above-mentioned standards by central storage mechanisms.

The working group is assisted by a consultative group gathering eleven external experts (including a representative of a Luxembourg professional of the financial sector) in its work under this new mandate. This work resulted in the publication of a first paper that is submitted to public consultation for a period of two months as from 31 January 2006. It covers the whole mandate, save for the cost-related aspect, which will be dealt with separately.

- ***Expert group Credit Rating Agencies***

The European Commission published a mandate on 27 July 2004 requesting CESR to draw up a technical advice in order for the Commission to assess the need for introducing European legislation concerning rating agencies. The deadline to submit technical advice was 1 April 2005.

On 30 March 2005, CESR presented to the European Commission its technical advice that included feedback of the professionals. CESR proposes not to regulate the credit rating agencies for the time being and to adopt a more pragmatic approach, which consists in keeping under review how credit rating agencies implement the standards set out in the IOSCO Code of Conduct. CESR intends to develop this strategy on the basis of voluntary co-operation of credit rating agencies. In addition, CESR will continue to monitor developments related to credit rating agencies, as well as issues impacting issuers and investors.

Within the context of the voluntary co-operation between CESR and credit rating agencies, every credit rating agency will send an annual letter to CESR outlining how it has complied with the IOSCO Code of Conduct standards and indicating any deviations from the Code. An annual meeting will be held between CESR and credit rating agencies in order to discuss any issues relating to the implementation of the IOSCO code. The credit rating agency will provide an explanation to the national CESR member where any substantial incident occurs with a particular issuer in its market.

CESR published its correspondence with credit rating agencies on 13 December 2005.

- ***Investment Management expert group***

In 2005, the expert group, chaired by the Chairman of the Italian Commissione Nazionale per le Societá e la Borsa (Consob), has notably overseen three sub-working groups, two of them dealing with the clarification of definitions concerning eligible assets for UCITS and the third one with the guidelines for supervisory authorities regarding the notification procedure of UCITS.

The CSSF took part in the work of the expert group as well as in that of the three sub-working groups. Overall, these groups met sixteen times in 2005.

The expert group is assisted by a consultative group consisting of sixteen industry experts, including one representative of the Luxembourg investment fund sector. In 2005, three meetings were held between the expert group and the consultative group. The CSSF took part in all the meetings.

The two sub-working groups dealing with the clarification of the definitions concerning eligible assets for UCITS

The works of both sub-working groups led to the adoption, in January 2006, of the technical advice of CESR on the clarification of the definitions concerning eligible assets for investments of UCITS. This Lamfalussy Level 2 and 3 advice can be downloaded from CESR's website (www.cesr-eu.org), reference 06-005.

To prepare its technical advice, CESR had held two consultations and two open hearings in order to gather the comments of the persons and entities concerned. Around hundred persons and entities submitted their comments in writing within the scope of both consultation periods.

On the basis of CESR's technical advice, which aims at a common interpretation of the UCITS Directive, the European Commission will adopt, in spring/summer 2006, a Directive or a Regulation concerning the eligible assets for UCITS.

The following can be underlined in the context of CESR's technical advice:

- The technical advice lists the conditions to be fulfilled by securities under articles 19(1) and 19(2) of the UCITS Directive in order to constitute eligible assets.
- The technical advice specifies that the closed-end UCIs can constitute eligible assets under certain conditions. In this respect, the supervisory member authorities of CESR had developed divergent approaches. The approach adopted in the technical advice of CESR is more stringent than the current approach of the CSSF, but less restrictive than that of many other supervisory member authorities.

- As regards investment in financial derivative instruments on financial indices under the terms of article 19(1)g of the Directive, the technical advice sets down that hedge fund indices cannot be considered as financial indices. However, CESR added that it will reconsider its position by October 2006. It should be noted in this context that the CSSF had adopted a different approach and that it had authorised a small number of UCITS whose investment policy allows to invest in derivative instruments on a hedge fund index. Until that date, the CSSF and the other CESR members committed not to authorise UCITS anymore whose investment policy allows to invest in derivative instruments on a hedge fund index. The technical advice does not rule out investments in derivative instruments on financial indices based on non-eligible assets, such as commodities, and specifies that investments in derivative instruments on indices on commodities can be considered as eligible. The text specifies the conditions that financial indices must fulfil to be considered as eligible as underlying of derivative instruments.
- The technical advice also broaches the money market instruments, credit derivatives, securities and money market instruments that contain embedded derivatives, the other UCIs and UCITS tracking an index.

The sub-working group on guidelines for supervisory authorities as regards the notification procedure of UCITS

The sub-working group has finalised a consultation document on the notification procedure of UCITS which deals notably with the following subjects:

- the notification procedure: this point concerns the two-months period provided for by the Directive, the certification of documents, the translations and the issues concerning sub-funds of umbrella UCITS;
- the content of the notification file: CESR's guidelines contain a model attestation to be drawn up by the home Member State authority and a model notification letter to be submitted by the UCITS to the host supervisory authority;
- the arrangements concerning the marketing of units in the host Member State: the guidelines provide that the website of the supervisory authorities shall mention the marketing rules for units by UCITS.

Following a first three-month consultation period and an open hearing to gather the responses of the persons and entities concerned, a second consultation period of one month is currently envisaged. The final document on the notification procedure of UCITS will be at Level 3 of the Lamfalussy procedure.

- ***Joint CESR-ECB working group on compensation and securities settlement systems***

On 27 September 2001, the European Central Bank (ECB) and CESR drafted the framework for co-operation between the European System of Central Banks (ESCB) and CESR as regards compensation and securities settlement systems in order to study issues of common interest.

Until September 2005, the group worked on a methodology to assess compliance with the standards referred to in the report "Standards for clearing and settlement systems in the European Union" which had been approved in October 2004.

The group has also drawn up a new consultative report entitled "Standards for central counterparties in the European Union" which has not yet been published for consultation.

As regards the open issues identified in paragraph 27 of the October 2004 report, the group was confronted with more political issues, which led to many debates and opinions that diverge more frequently. Given this situation, CESR and the Governing Council of the ECB decided in October 2005 to suspend the work of the working group and to wait for the decision of the European Commission with respect to a proposal for a Directive on securities clearing and settlement. The European Commission announced a possible decision for the end of the first half-year of 2006.

- ***Review Panel***

Established following the decision of CESR chairmen in December 2002, the Review Panel is responsible for assisting CESR in its task to ensure consistent and harmonised implementation of EU legislation in the Member States.

In April 2005, the Review Panel published a document describing the methodology to be used and the procedure to be followed for the assessment of the level of transposition and application of CESR measures.

The European Commission requested CESR to assess the transposition of two recommendations it had published on 30 April 2004 and which deal with the use of derivative instruments by UCIs and the simplified prospectuses of UCIs. Based on the assessment methodology, the Review Panel published its assessment report on 7 July 2005. Moreover, the Review Panel was mandated by the chairmen of CESR to assess the transposition of guidelines concerning the transitional provisions of the UCITS III Directive that have been published by CESR on 3 February 2005.

The Review Panel assessed the implementation of CESR standards on cold calling and published its review on 3 January 2006. It has also started to assess the implementation of CESR principles concerning financial information to be provided by issuers and the competences and powers of the authorities in this respect (Standard no. 1), as well as an impact study on Standard no. 1 of 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.

These reports are available on the CESR website www.cesr-eu.org.

- ***Prospectus expert group***

In 2005, the expert group continued its work on issues related to the complex historical financial information in order to determine common practice in this field. As a conclusion to the year under review, CESR noted that Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC (Prospectus Directive) did not allow anymore, in principle, to require the inclusion in a prospectus of certain historical financial information considered by the competent authorities as representing the information necessary for the proper assessment of the financial situation of a company issuing securities and which was previously required by the majority of competent authorities.

Following this observation, the European Commission considered that it would be preferable to rule out any uncertainty with respect to the information required in these events and to provide for a level of historical financial information that allows to ensure adequate investor protection. The European Commission published a formal mandate in this respect on 2 June 2005.

In its technical advice submitted to the European Commission at the end of October 2005, the expert group has:

- clarified the difference between the nature of the *pro forma* financial information and the complex historical financial information and the period covered;
- proposed to restrict the requests concerning complex historical financial information to the cases where the shares registration document a pplies;

- proposed a flexible approach allowing the competent authorities to take their decisions in this field in accordance with the situation, in light of the economic reality, the significance of the events and the costs related to the drawing-up of the requested information.

The expert group closely co-operated with a consultative group comprised of ten external experts, including one representative of the *Bourse de Luxembourg* (Luxembourg Stock Exchange) to draw up its technical advice.

Following the implementation of the Prospectus Directive in the different Member States, experts of the different competent authorities met twice in 2005 in order to ensure a coherent and consistent implementation of the European provisions relating to prospectuses for securities and to promote the proper operation of the European passport granted to issuers. Urgent practical questions concerning the co-operation and the procedures to apply in the context of this co-operation have been discussed. The experts have notably drawn up a contact list between authorities and a model notification certificate in order to simplify the procedures relating to the European passport for prospectuses. During these meetings, the experts started discussions concerning the practical implementation of the provisions of the Prospectus Directive and of the Regulation (EC) 809/2004 and were able to agree on a certain number of common positions.

Operational groups established within CESR

- ***CESR-Fin***

The purpose of the permanent operational committee CESR-Fin is to coordinate CESR's works as regards financial information standards in Europe.

CESR-Fin allows CESR to play an effective role in the implementation and enforcement of the IAS/IFRS standards in the European Union within the context of the new compulsory accounting framework for all European listed companies since 2005. CESR-Fin also helps CESR to ensure a coordinated and effective application of the IAS/IFRS standards by EU listed companies by developing standards and guidelines as regards supervision and control of financial information in Europe.

Moreover, CESR-Fin has been put in charge of monitoring developments in Europe in the area of audit.

In 2005, CESR-Fin dedicated the majority of its activities to two main projects:

- the implementation of the coordination mechanism as envisaged by CESR's Standard no. 2 on the monitoring of the enforcement of financial information, with, among others, the organisation of the first meetings of the competent authorities in order to discuss practical cases linked to financial information and the creation of a CESR database of decisions in this field;
- the development and the finalisation of CESR's advice to the European Commission on the equivalence of accounting standards of certain third country GAAP and IAS/IFRS standards.

Moreover, CESR-Fin has continued to follow the endorsement process of IFRS standards in the European Union and prepared a consultation paper on the Alternative Performance Measures.

Enforcement of the IFRS standards

The Prospectus and Transparency Directives introduced considerable changes in the European institutional landscape of financial information by requiring the designation in each Member State of a competent administrative authority responsible for the supervision of financial information provided to the markets by means of prospectuses or on a periodic basis.

CESR anticipated the new institutional framework by developing Standard no. 1 whose implementation at national level is currently under review by the Review Panel.

The coordination mechanism developed by Standard no. 2 on the enforcement of financial information was further implemented by the European Enforcers Coordination Sessions (EECS). EECS started its activities in January 2005 and met seven times during the year. Its meetings have been entirely dedicated to discussing practical and technical issues that arose from the day-to-day supervisory practice of financial information in each jurisdiction and represent an efficient means for experts in accounting and financial information to exchange their views and experience.

Simultaneously, CESR completed its IT project by creating a database for decisions taken by the competent supervisory authorities, members of CESR. Operational since August 2005, the database is a useful source of information for EECS members that are required to look up the existing decisions before taking new ones.

CESR-Fin also took part in discussions led by the European Commission within the Accounting Regulatory Committee (ARC) in order to set up a temporary round table, supposed to act as informal forum of European accounting professionals and experts to rapidly identify the emerging accounting aspects and potential issues and requiring the intervention of the Regulator (IASB/IFRIC). CESR was invited to participate in the round table which supplements the existing European infrastructure.

Given the importance within the European context, the continuation of EECS meetings and the efficient use and development of the database has priority in the CESR-Fin agenda for the coming months and years.

Equivalence of accounting standards of certain third country GAAP and IFRS

On 29 June 2004, CESR received the mandate from the European Commission to provide technical advice on the equivalence of Canadian, Japanese and US GAAP and IFRS standards. The mandate also requested the description of the enforcement mechanisms of the financial information which are in place in the three countries concerned. The mandate related to the requirements laid down in the Prospectus and Transparency Directives concerning financial information issued by third country issuers.

The technical assessment of equivalence of accounting standards and the description of the enforcement mechanisms have been undertaken by the relevant CESR-Fin sub-committees assisted by a Consultative working group of high-level accounting and financial information experts.

In its final advice submitted to the European Commission on 30 June 2005, CESR confirms the premise of its initial technical assessment of equivalence and concludes, after having considered the needs of the investors in the EU financial markets, that the GAAP of the three countries, each of them taken as a whole, can be considered as equivalent to the IFRS standards subject to certain remedies (mainly relating to the publication of information; please refer to www.cesr-eu.org).

A key element of CESR's conclusion is the fact that issuers under the Canadian, Japanese or US GAAP are not at all required to provide full reconciliation to IFRS. The description of enforcement mechanisms of financial information is based on the information provided by Canada, Japan and the USA.

The European Commission has however pointed out that it would not take any decision on equivalence before 2009.

CESR's recommendation concerning Alternative Performance Measures and endorsement activities of CESR-Fin

The final recommendation on the use by the listed companies of the Alternative Performance Measures was published by CESR on 3 November 2005. Its purpose is to provide guidelines to the listed companies in order to make sure that the information they provide to investors is not misleading.

Moreover, CESR-Fin has continued to follow the developments as regards the new standards or adjusted financial information standards. In particular, the Committee analysed the project published by IASB proposing adjustments to the standards.

CESR-Fin voiced its concerns that IASB introduces major and much debated technical amendments without addressing some fundamental aspects that have been identified by CESR's advice on equivalence, such as the consolidation of special purpose entities (SPEs). According to CESR, it is important that the IASB (and IFRIC) first deals with the aspects identified by the regulators and other players as being of immediate practical importance, rather than with larger-scale ones.

CESR-Fin activities in the area of audit

CESR's audit activities focused on the developments regarding the 8th Directive and on the audit issues arising from the implementation of the new European Directives.

CESR-Fin has thus held discussions which resulted in the approval by the European Parliament of certain amendments to the 8th Directive (Audit Directive) on 28 September 2005. These amendments will introduce a system for the public oversight of the audit profession and for the co-operation between Member State authorities, require the application of international standards on auditing in the European audit and the rotation, every seven years, of the key audit partner / statutory auditor.

CESR-Fin also carried out a survey on the role of securities regulators in auditor oversight and on the relationship with auditors of public listed companies.

- ***CESR-Pol***

CESR-Pol's purpose is to enhance sharing of information, co-operation and coordination of supervision and enforcement activities between CESR members.

A major priority of CESR-Pol is to ensure the effective day-to-day implementation of the Market Abuse Directive at Level 3 of the Lamfalussy process. As a result of the mandate received by CESR's chairmen, CESR-Pol published, on 11 May 2005, a document containing detailed guidance on the following subjects:

- accepted market practices (procedure to abide by, format and accepted practices proposed by certain members);
- a description of certain types of price manipulation;
- indication of insider dealing and price manipulation;
- format for reporting suspicious transactions to the relevant authority.

In the same context, CESR-Pol started to work on the preparation of measures covering the following subjects:

- the definition of "inside information" and the moment as of which an information becomes an inside information;
- legitimate reasons to delay the publication of an inside information;

- questions on insider dealings relating to book-building and pre-marketing mechanisms;
- the moment as of which large customer orders may become an inside information;
- assessment criteria of a rather illiquid market;
- the establishment and keeping of insider lists, notably where financial instruments of an issuer are admitted to several regulated markets of different countries and where the registered office of the issuer is located in a country different from that of the person acting for the account of the issuer.

Similarly, in order to ensure harmonised implementation of the provisions concerning co-operation under MIFID, CESR's Chairmen requested CESR-Pol to draw up measures covering co-operation issues under this Directive. CESR-Pol will actively start its work once the European Commission has endorsed its implementing measures of MIFID.

In order to better achieve its goal to enhance co-operation, CESR-Pol had drawn up a paper describing the procedure to follow as regards requests to open an investigation by a competent authority to the authority of another CESR Member States, as well as requests for joint investigations between several authorities of Member States. Moreover, CESR-Pol has categorised the information that has to be exchanged between competent authorities (automatic information, information that has to be exchanged in consultation procedures and information to be exchanged on request).

One of the major decisions of CESR-Pol in 2005 was to establish a more operational structure. Thus, its members will deal, during plenary meetings, with subjects concerning political strategy and general principles of co-operation and will adopt proposals for more technical measures under the mandates received by CESR-Pol from CESR's Chairmen. A new permanent working group **Surveillance and Intelligence Group** (S & I Group) will focus on the exchange of practical experience in co-operation, daily supervision of investment firms and financial markets and unauthorised offers of financial services by persons and investment firms that do not hold adequate authorisation. CESR-Pol has also adopted the principle to establish an **Urgent Issues Group** every time that several authorities of different Member States are involved in an investigation and it is necessary to ensure swift co-operation and to take prompt measures in cases of threats to one or several securities markets.

Furthermore, CESR-Pol developed its network for the dissemination of warnings relating to illicit offers of financial services by investment firms or individuals that have not been granted the required authorisations thereto. Warnings are also transmitted to CEBS members.

CESR-Pol has also continued to enhance dialogue with IOSCO in order to improve co-operation and exchange of information with non-co-operative countries and to coordinate the measures to be taken in this respect. Moreover, CESR-Pol continued discussions with Liechtenstein and provided assistance for the transposition of the Market Abuse Directive.

2.1.3. Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) is comprised of high-level representatives from the insurance and occupational pensions supervisory authorities from EU Member States. The Committee's objectives are to advise the European Commission, either at the European Commission's request or on the Committee's own initiative, as regards the preparation of implementing measures in the fields of insurance, reinsurance and occupational pensions, to contribute to the consistent implementation of EU Directives and to the convergence of Member States' supervisory practices and to constitute a forum for supervisory co-operation, including the exchange of information on supervised institutions.

The CSSF participates in the works of CEIOPS concerning occupational pensions in its capacity as member.

CEIOPS has created several working groups among which the Occupational pensions committee. This permanent working group deals with all the aspects relating to the activities of institutions for occupational retirement provision under the terms of Directive 2003/41/EC concerning the activities and supervision of institutions for occupational retirement provision (IORP Directive).

Its tasks include:

- developing a common understanding of the IORP Directive;
- facilitating the co-operation, coordination and exchange of information between supervisory authorities on cross-border membership and related issues;
- carrying out the preparatory work for dealing with issues related to pension funds.

These functions notably comprise the following tasks:

- preparation of a protocol organising the co-operation, coordination and regular information exchange between occupational pensions supervisors in view of the implementation of the IORP Directive;
- analyses of the current status of the pension savings institutions from the EU legislation point of view;
- monitoring of the practices adopted by the Member States to calculate technical provisions;
- monitoring of the progress achieved in the adaptation of investment rules and the use of depositaries in the national supervisory systems.

On 22 February 2006, the plenary meeting of CEIOPS members adopted a protocol ("Budapest Protocol") relating to the collaboration of the relevant supervisory authorities in the application of the IORP Directive, which is available on the CEIOPS website (www.ceiops.org).

2.1.4. Capital Requirements Directive Transposition Group

Established in December 2005, the objective of the group is to provide all interested parties with responses as regards the implementation and interpretation of the recasted Directives 2000/12/EC and 93/6/EEC that transpose Basel II into European legislation, as the different linguistic versions of the final texts of these Directives will not be published before the end of the first half-year of 2006. To this end, the European Commission and its working group co-operate closely with CEBS. Further information on the operation of the process, which aims at ensuring a certain consistence in the transposition of both Directives, is available on CEBS' website at www.c-ebs.org/crdtg.htm.

2.1.5. Contact comittee on money laundering

The Contact committee on money laundering, established by Directive 91/308/EEC on the prevention of the use of the financial system for the purpose of money laundering, is entrusted with facilitating the harmonised implementation of the Directive through regular consultation on concrete issues regarding implementation. The committee also deals with questions discussed within the Financial Action Task Force on money laundering (FATF). Luxembourg is represented within this committee by representatives of the CSSF, the Ministry of Finance and the Ministry of Justice.

In 2005, the committee met on six occasions. Its works mainly concerned the implementing measures of the anti-money laundering Directive and FATF works.

2.1.6. Expert group on payment systems

The *ad hoc* group, which met twice in 2005, continued its work on the introduction of a new legal framework for payments within the internal market. The European Commission has published a proposal for a Directive in this context which is being discussed by the EU Council.

2.1.7. Accounting Regulatory Committee / Contact committee on accounting directives

The objective of the Accounting Regulatory Committee, established by the European Commission in accordance with Article 6 of the IAS Regulation, is to provide advice on the proposals of the European Commission in order to adopt one or several international accounting standards.

In 2005, the Accounting Regulatory Committee met five times jointly with the Contact committee on accounting directives, instituted under Article 52 of the fourth Company Law Directive (Directive 78/660/EEC). These meetings mainly concerned the adoption of the standards of the International Accounting Standards Board (IASB), the draft IASB standards in progress, the draft implementation of a Roundtable on consistent application, as well as the convergence and equivalence between the IFRS standards and third country GAAP, in particular US GAAP.

During the meeting of 8 July 2005, the Committee endorsed the international standard IAS 39 "Financial instruments: Recognition and measurement", introducing into this standard a new version of the fair value option, based on principles and allowing the use of this option solely in the cases that are listed in this standard. The adoption of this amendment entailed the elimination of the carve-out of November 2004, which excluded the use of the fair value option for liabilities. Consequently, only the carve-out of certain provisions on hedge accounting remains.[4]

The current situation of the approval process of the international accounting standards in the European Union, as well as the works of the Accounting Regulatory Committee are available on the website of the European Commission at http://europa.eu.int/comm/internal_market/accounting/ias_en.htm.

2.2. Groups operating at European Union Council level

The CSSF is a member of the groups working on proposals for Directives concerning financial services. The groups of government experts meeting at Council level play an important role in the Community legislative process, since they format the consensus texts, referring only political difficulties to the Permanent Representatives Committee and the Council of Finance Ministers. The groups are chaired by a representative of the Member State that presides over the Council. Luxembourg chaired in the first half of 2005 followed by the United Kingdom in the second half. The list of Directives under negotiation at Council level and a brief description thereof is available in Chapter XII.

[4] Please also refer to the CSSF's Annual Report 2004.

2.3. Banking Supervision Committee of the European Central Bank

The Banking Supervision Committee (BSC) of the European Central Bank is a committee made up of high-level representatives of the banking supervisory authorities and the central banks of Member States. It is chaired by Mr Meister, member of the Board of Directors of Deutsche Bundesbank. The missions concerning prudential supervision conferred by the Treaty and the statutes of the European Central Bank on the ESCB (European System of Central Banks) are carried out by the Banking Supervision Committee on behalf of the ESCB. The Committee is a forum for the exchange of opinions on the supervisory policies and practices in Member States. It should also be consulted on proposals for Directives and bills tabled by Member States on matters within its competence.

Two working groups comprising members of the central banks and national supervisory authorities, i.e. the Working group on macro-prudential analysis and the Working group on developments in banking, mainly assisted the Banking Supervision Committee in carrying out its mandate in 2005.

In order to systematise the analysis of macro-economic data with a view to identifying, as far as possible in time, the factors likely to weaken the financial institutions as a whole and therefore the financial system, the Working group on macro-prudential analysis monitors the macro-economic environment and reports to the Committee on trends and facts likely to be relevant to the prudential supervision of the financial sector.

Every year, the working group draws up a report on the stability of the financial sector. This report is discussed by the Executive board of the European Central Bank. It has been published under the aegis of the Banking Supervision Committee for four years now (please refer to www.ecb.int). In 2005, the group has analysed in particular the potential risks for the stability of the banking sector resulting from direct positions, mainly investments and credit lines, and indirect exposure on the alternative fund sector. A specific study was dedicated to the changing relations between banks and large companies. The development of the price policy, as well as the diversification and impact of the condition of the corporate sector and of certain of its major players on the asset quality of banks have been studied.

As in the previous years, the Working group on developments in banking focused on the drawing up of its structural report during the first half of 2005. This annual report aims to identify and monitor the structural trends marking the European banking sector as a whole. The 2005 report focuses in particular on the market of syndicated lending, consumer credits, as well as the structure of large European banking groups. During the second half of the year, the group analysed the future of the European banking market by the end of the decade. This work consisted in particular in analysing the areas of financial intermediation and corporate governance.

The joint working group on crisis management established together with CEBS at the end of 2004 published a preliminary version of a document on the guidelines for prudential supervisory authorities and central banks to manage financial crises within the banking sector or the securities markets. An exemplifying list of information to exchange between authorities in case of a crisis has also been set up and transmitted to the founding committees.

3. MULTILATERAL CO-OPERATION

3.1. Basel Committee on banking supervision

The Basel Committee continued to follow the implementation of the new capital adequacy framework, commonly known as "New Basel Accord" or "Basel II", in its different work groups.

Furthermore, the Basel Committee has revised the Core principles for effective banking supervision published in September 1997. These Core principles, along with the Core principles methodology, have been used by countries for assessing the quality of their supervisory systems and for identifying future work to be done to achieve a baseline level of sound supervisory practices. In conducting this review of the Core Principles and their Methodology, the Committee was motivated by a desire to ensure continuity and comparability with the 1997 framework, which has functioned well and is seen to have withstood the test of time.

Thus, the intention was not to radically rewrite the Core Principles, but rather to focus on those areas where adjustments to the existing framework were required to ensure their continued relevance. The publication of the document, which is currently under consultation with other international bodies, is planned for 2006.

The Committee also participated in the works of the Joint Forum established in 1996 under the aegis of the Basel Committee, the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), to deal with issues common to the banking, securities and insurance sectors. In 2005, the work of the Joint Forum resulted in the publication of the following documents, which are available on the website of the Basel Committee at www.bis.org/dcms/fl.jsp?aid=4&pmdid=3&smdid=14&tmdid=14&fmdid=0&dtid=1&y=now:

- the document "Outsourcing in Financial Services", published in February 2005;
- the document "Credit Risk Transfer", released in March 2005, which deals with the credit risk transfer in the context of transactions linked to credit derivatives. This market has developed rapidly over the last few years and the report includes a set of recommendations for market players and supervisory authorities in the areas of risk management, disclosure and supervisory approaches;
- the consultation document "High-level principles for business continuity", published in December 2005.

3.1.1. Capital Task Force

The Capital Task Force (CTF) is the ultimate technical work group of the Basel Committee on banking supervision as regards regulatory aspects relating to the reforms of the capital adequacy framework. It met on a regular basis in 2005 and has notably adopted the technical part of the document "The Application of Basel II to Trading Activities and the Treatment of Double Default Effects", published for consultation in April 2005 and finalised in July 2005.

This document, which has been drawn up jointly by the Basel Committee on banking supervision and IOSCO and which addresses explicitly credit institutions and investment firms, includes proposals on subjects whose works have already been announced in the preamble of the final text of the New Basel Accord in June 2004, namely:

- the treatment of counterparty risk for over-the-counter derivatives, repo-style and securities financing transactions;
- the treatment of cross-product netting arrangements;
- the treatment of double-default effects;
- the short-term maturity adjustment in the IRB approach;

- the new provisions relating to specific market risks for trading book positions;
- the review of the treatment for non-settled transactions.

The CTF has also been charged with consolidating this document with the documents "International Convergence of Capital Measurements and Capital Standards: A Revised Framework", commonly known as New Basel Accord, and "Amendment to the Capital Accord to incorporate market risks" of 1996. The consolidated versions have been published on 15 November 2005 and are available at http://www.bis.org/publ/bcbsca.htm.

3.1.2. Accord Implementation Group

The Accord Implementation Group has been created to promote the consistent implementation of the new capital adequacy framework at international level. It operates as multilateral discussion forum that allows national supervisory authorities that are members of the Basel Committee, to share their experience in the field of validation of advanced approaches under Basel II. The group endeavours in particular to find a common solution to the concrete questions arising from the practical implementation of the Basel II standards. The Accord Implementation Group includes the Working Group on Capital of the Core Principles Liaison Group in this endeavour in order to extend the discussions to the States that are not members of the Basel Committee. In this context, the Basel Committee published a set of guidelines for the co-operation between home and host authorities under the title "Home-host information sharing for effective Basel II implementation" in November 2005.

During its three meetings in 2005, the Accord Implementation Group has closely followed the implementation works of the Basel II standards by the main banking groups that operate cross-border. It also endeavoured to consider the opinions of the different professional associations and their concrete questions concerning the practical implementation of Basel II. The specific subjects treated in 2005 concerned the elements left at national discretion, the estimation of LGD (Loss Given Default), risk concentration measure, simulations in crisis situations, as well as prudential supervisory process (pillar 2). The work on LGD led to a first publication "Guidance on the estimation of loss given default (Paragraph 468 of the Framework Document)" in July 2005.

3.1.3. Accord Implementation Group - Sub-group on Validation (AIGV)

The working group focused its efforts in 2005 on the methods that banks, whose low-default portfolio does not allow them to quantify their probability of default, should adopt. Other subjects included the criteria to fulfil for the adoption of vendor models, the requirements as regards governance and internal control and the use of internal ratings systems (use test).

In order to promote the exchange of knowledge between authorities, the AIGV proposes to regroup the documents produced by the group in relation with the validation of internal ratings systems in a compendium, which will be available to a larger community of banking supervisory authorities.

3.1.4. Risk Management and Modelling Group

In the introduction of the new Basel II framework, the Basel Committee stipulates that it "understands that the IRB approach represents a point on the continuum between purely regulatory measures of credit risk and an approach that builds more fully on internal credit risk models". In order to achieve a prudential regulation that is more in line with internal models, the Basel Committee "seeks to continue to engage the banking industry". To this end, it created the Risk Management and Modelling group, which met for the first time in 2005. The group's objective is to interact with industry in order to propose in the long run and if necessary, a realignment of requirements regarding regulatory capital with internal risk measures.

3.1.5. Accounting Task Force

The Accounting Task Force is in charge of monitoring the works in the areas of accounting and audit and the development of the principles and guidelines in these areas.

In April 2005, the group finalised a document on "Compliance and the compliance function in banks" dealing in particular with best practice concerning compliance within credit institutions.

In the field of provisioning, which preoccupies the prudential supervisory authorities, the group has published a consultative document entitled "Sound credit risk assessment and valuation for loans" that replaces the paper "Sound practices for Loan Accounting and Disclosure" of July 1999. This document explains how common data and processes may be used for credit risk assessment, accounting and capital adequacy purposes. It also highlights the provisioning concepts that are intended to be consistent with prudential and accounting frameworks. The consultation period ended on 28 February 2006.

Another area of concern for the prudential authorities relates to the fair value option. It should be noted that the International Accounting Standards Board (IASB) published an amended version of the fair value option in June 2005, which limits its use to only those cases that are listed in the new provisions. The Accounting Task Force has been in contact with IASB representatives and submitted its view on IASB's proposal in April 2005.

The consultative document "Supervisory guidance on the use of the fair value option by banks under International Financial Reporting Standards" was published in July 2005. The first part of the document informs banks that use the fair value option on the appropriate and sound processes as regards risk management and control. The second part provides guidance for prudential supervisory authorities regarding the manner in which they should consider the level and the nature of the use of the fair value option when assessing the adequacy of risk management and regulatory capital of a credit institution. The CSSF will thus assess if banks utilise the fair value option appropriately and may take, where necessary, corrective measures as provided for in the document. The consultation period ended on 31 October 2005. The document will be revised soon in the light of the comments received during the public consultation. A final version will be published subsequently.

As regards audit, the group sent its comments on various exposure drafts of the International Federation of Accountants (IFAC) and of the International Auditing and Assurance Standards Board (IAASB), i.e. the "IFAC Exposure Draft on the Proposed Revised Code of Ethics", the "IAASB Exposure Drafts on group audits, auditor communications, modified audit opinions and the use of emphasis of matter or other matter paragraphs in the independent auditor's report", the "IAASB Exposure Drafts on Materiality and Auditing Estimates" and the "IAASB Exposure Drafts on Clarity and Documentation".

3.1.6. Working Group on corporate governance

Established in 2004 at the initiative of the Basel Committee on banking supervision, the group has updated the guidelines on corporate governance for banking organisations. Insofar as they apply to the banking sector, the group incorporated the revised principles on corporate governance as published by the OECD in 2004. The prudential lessons drawn from recent breakdowns in corporate governance also helped to enrich the text. Finally, the Know Your Structure issue has been dealt with more specifically to extract best practice principles as regards the use and implementation, for own account or on behalf of third parties, of legal means, as well as complex financing structures.

Representatives of the OECD and of the World Bank participated in these works. Discussions and dialogue took place with other international bodies, notably with the representatives of the International Association of Insurance Supervisors (IAIS), to share experience as regards the implementation of the "Insurance Core Principles on Corporate Governance" published in January 2004, as well as with regional associations of representatives of the financial sector.

The document "Enhancing Corporate Governance for Banking Organisations" was submitted to public consultation during the summer of 2005. The working group reviewed the comments collected during this consultation and incorporated them into the document insofar as they were useful for the implementation of certain principles and as they made the text clearer, more visible and coherent. The text was published on 13 February 2006 on the website www.bis.org.

3.2. International Organisation of Securities Commissions (IOSCO) and IOSCO groups

3.2.1. XXXth Annual Conference of IOSCO

The securities and futures regulators and other members of the international financial community met in Colombo, Sri Lanka, from 4 to 7 April 2005, on the occasion of the XXXth Annual Conference of IOSCO.

During this conference, IOSCO adopted a new strategic direction that will allow to fully play its role as international standard setter for securities regulation and to strengthen its effectiveness. The means that will be employed to reach these objectives include notably the improvement of enforcement related cross-border co-operation and the implementation of the IOSCO objectives and principles of securities regulation (IOSCO Principles). In addition, a new public consultation policy was endorsed.

Greater emphasis will be laid on the Multilateral Memorandum Concerning Consultation and Cooperation and the Exchange of Information (MMOU). IOSCO has also adopted a timetable by which all member regulators of IOSCO, which are not already signatories to the MMOU will be asked to meet this benchmark by 1 January 2010. By this date, all member regulators should have applied for and been accepted as signatories (under Appendix A) of the MMOU or have expressed a commitment to seek legal authority to enable them to become signatories (*via* Appendix B). In order to achieve these objectives, IOSCO will provide resources to members including technical assistance. Twenty-nine candidates have signed this MMOU and nine candidates have committed themselves to undertake the necessary reforms to become a full signatory. Similarly, IOSCO also endeavours to promote international co-operation by continuing to strengthen the ability of the members to obtain swift and effective co-operation with respect to aspects relating to cross-border investigations on potential infringements of the regulations on securities. Moreover, IOSCO tries to identify the countries that appear to be unable to co-operate or unwilling to co-operate and to enter into a dialogue with them in order to resolve related issues.

IOSCO continued its work as regards the fight against financial fraud and its collaboration with the Basel Committee on banking supervision and the International Association of Insurance Supervisors in order to coordinate actions in combating money laundering and terrorist financing.

IOSCO also continues its endeavours aiming to promote compliance with the IOSCO Principles by its members and the adoption of the principles of a Code of Conduct by credit rating agencies. Moreover, IOSCO reiterated its support for the work of the International Accounting Standards Board (IASB) and encouraged its members to accept financial statements prepared under the International Financial Reporting Standards (IFRS). IOSCO developed its work as regards boiler rooms, cold calling and the broad principles for undertakings for collective investment (UCITS) governance.

IOSCO also started an analysis of organised securities and derivatives markets and of their supervisory authorities, of market timing, hedge funds and the development of a model code of ethics for self-regulating organisations.

3.2.2. IOSCO groups

The CSSF is a member of two IOSCO groups, i.e. the Standing Committee n° 1, dealing with subjects concerning accounting, and the Standing Committee n° 5 concerning UCIs and collective management.

- ***Standing Committee n° 1 (SC1)***

The CSSF is member of the permanent committee SC1 and takes also part, as far as possible, in the meetings of the sub-committees on disclosure, accounting, auditing, as well as the implementation of the IAS/IFRS standards.

In 2005, the sub-committee Disclosure finished its work on the International Debt Disclosure Principles. This project, published on the IOSCO website (www.iosco.org), had been submitted to public consultation. The document will be completed at the beginning of 2006 and will take into account the comments received during the consultation period. The committee, in the meantime, resumed its work on the principles for periodic disclosure by issuers and believes being able to submit draft principles to the SC1 by the end of 2006.

Among the various projects initiated in 2005 by the SC1 is the survey on the internal control requirements for issuers. A questionnaire has been prepared which should provide an overview of the existing regulations and practices. The results of this survey will be included in a report that will probably be presented at the annual conference 2006.

Another SC1 project concerns the information disclosed by issuers where special purpose entities (SPEs) are used. In this context, SC1 takes stock of the current requirements applicable in the different jurisdictions as regards accounting and non-financial information and, where applicable, the level of assurance given by an auditor. SC1 will present a report to the Technical Committee that includes its recommendations, if, in its opinion, the use of SPEs by issuers justifies the disclosure of additional information.

As far as accounting is concerned, SC1 continued to follow the work of IASB and IFRIC concerning accounting regulation. Its sub-committee Accounting participates in the IASB working groups, including those on reporting of financial performance of issuers, accounting of financial instruments, insurance contracts and extraction of natural resources. In 2005, the SC1 sent several comment letters to the IASB, notably on the proposed amendment of the accounting for business combinations.

In the field of auditing, SC1 continued its analysis of the activities of IAASB, international standard-setter in auditing, and notably of the "Clarity" project, which aims at indicating how the International Standards on Auditing (ISAs) will be written in the future.

The results of the survey on the audit profession, performed by the sub-committee Auditing, were published on the IOSCO website in April 2005. It should be noted, among the consequences of the survey, the particular concentration of SC1 on the services other than auditing.

The sub-committee IFRS Regulatory Interpretation and Enforcement continued its work on the supervision of the implementation of financial information. Thus, the terms of the arrangements under which regulatory authorities may share their experience and decisions on the implementation of IFRS standards have been developed. The future work will mainly concern the development of a database, in close co-operation with CESR, in order to build an IOSCO database that is compatible with that of CESR.

- ***Standing Committee n° 5 (SC5)***

In 2005, the Committee worked on the following topics: Examination of governance for CIS, Anti-money laundering guidance for CIS, Market timing and associated issues, Hedge funds and related issues, Distribution costs and fee structure, Soft commissions and Risk based approach of the future SC5 working program.

In October 2005, IOSCO published the documents "Final Report: Best practices standards on anti market timing and associated issues for CIS" and "Final Report: Anti-money laundering guidance for collective investment schemes". Both documents are available on the IOSCO website.

At the end of January 2006, the committee submitted to the Technical Committee of IOSCO the report prepared in 2005 on hedge funds offered to the public.

3.3. Informal groups

Extended contact group "Undertakings for collective investment"

The group is entrusted with establishing multinational dialogue on issues that arise within the scope of regulation and supervision of UCIs.

The CSSF participated in the annual meeting of the group, which was held from 28 to 30 September 2005 in Dublin. During this meeting, the following topics have been tackled: questions relating to prudential supervision, conflicts of interest / code of conduct, legal issues, financial issues, reporting, management and administration, UCITS and special UCIs.

3.4. Institut Francophone de la Régulation Financière (IFREFI)

The *Institut Francophone de la Régulation Financière* (IFREFI, Francophone institute for financial regulation), gathering the financial markets regulatory authorities of fourteen French-speaking countries (Algeria, Belgium, France, Guinea, Luxembourg, Quebec, Morocco, Switzerland, the West African Monetary Union, Monaco, Tunisia, the Economic and Monetary Community of Central Africa, Cameroon and Romania) was created in 2002 by a charter. IFREFI is a flexible structure of co-operation and dialogue and aims at furthering the exchange of knowledge and experience, drawing up studies and exchanging essential information relating to the financial markets between the Member States of the Institute. According to the charter, IFREFI also aims at promoting professional training by organising training seminars on specific topics.

During the annual meeting of chairmen that has been held in Brussels in June 2005, recent works of IOSCO relating to fraudulent bankruptcies, as well as rating agencies have been discussed. Following this meeting, a training seminar on the authorisation and supervision of investment service providers has been organised. The seminar dealt with the following subjects:

- minimum requirements for authorisation (material means, own funds, competence, professional repute and ethics of managers and main shareholders);
- supervisory means and techniques (documents, place and organisation);
- relief and administrative sanctions;
- rules of conduct (presentation of CESR's rules of conduct);
- irregular offer of investment services;
- close collaboration between supervisory authorities;
- compensation schemes.

As the participants showed a strong interest in the subject of administrative sanctions, it has been decided to look into this subject during one of the next meetings of IFREFI. In the context of this seminar, one CSSF agent gave an account of the Luxembourg professional experience as regards rules of conduct.

3.5. Groupe des superviseurs bancaires francophones

Following the kick-off meeting of the *Groupe des superviseurs bancaires francophones* (GSBF, Group of Francophone banking supervisors) within the context of the International Conference of Banking Supervisors in Madrid on 21 September 2004, a second meeting of the group took place in Morocco in March 2005 during which the GSBF charter has been signed. The GSBF gathers the banking supervisory authorities of the following French-speaking countries: Central Africa, Algeria, Canada, Congo, Belgium, Burundi, France, Guinea, Lebanon, Luxembourg, Madagascar, Morocco, Mauritania, Romania, Rwanda, Switzerland, Tunisia and the West African Monetary Union.

The objective of the GSBF is to develop a high-level co-operation between its members so that the exchange of experience and information promotes the generalisation of best practices and the convergence of the prudential approaches *vis-à-vis* common problems. Furthermore, it proposes to provide comments, following examination, on the work that has been circularised by the Basel Committee and to regularly inform the latter on the activities of the Group and on the specific work or research undertaken occasionally. Finally, the GSBF intends to strengthen the contacts and exchanges between regional supervisory groups and to rely on the Institute for Financial Stability (IFS) of the Bank for International Settlements to develop a set of appropriate training actions.

GENERAL SUPERVISION

First row, left to right: Marguy MEHLING, Diane SEIL, Danièle KAMPHAUS-GOEDERT, Claude SIMON, Jean-Marc GOY

Second row, left to right: Claude WAMPACH, Ronald KIRSCH, Martine WAGNER, Alain HOSCHEID, Nadia MANZARI, Manuel NEU

Third row, left to right: Pierrot RASQUE, Davy REINARD, Vincent THURMES, Didier BERGAMO, Edouard REIMEN

Absent: Guy HAAS, Ngoc Dinh LUU, Joëlle MARTINY, Romain STROCK, Claudine WANDERSCHEID

CHAPTER XII

BANKING AND FINANCIAL LEGISLATION AND REGULATIONS

1. Directives under discussion at Council level
2. Directives adopted by the Council and the European Parliament but not yet implemented under national law
3. Laws passed in 2005
4. Circulars issued in 2005
5. Circulars in force

1. DIRECTIVES UNDER DISCUSSION AT COUNCIL LEVEL

The CSSF participates in the groups examining the following proposals for Directives:

1.1. Proposed Directives to recast Directive 2000/12/EC of 20 March 2000 on the taking-up and pursuit of the business of credit institutions, and Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions

The proposed Directives aim to establish a new capital adequacy regime for credit institutions and investment firms, in parallel to the works carried out by the Basel Committee on banking supervision (Basel II).

The proposals apply the "re-casting technique" (interinstitutional agreement 2002/7777/01) allowing to make substantive amendments to existing legislation without any distinct amending Directive. This technique reduces the complexity of the European legislation making it more accessible and comprehensible. Amendments of a non-substantive nature are made to many provisions to improve the structure, drafting and readability of the Directives.

The proposed Directives have been discussed in detail in the CSSF's Annual Report 2004.

1.2. Proposal for a Directive on statutory audit of annual accounts and consolidated accounts and amending Directives 78/660/EEC and 83/349/EEC

The purpose of the proposal for a Directive is to replace the eighth Directive 84/253/EEC on the approval of persons responsible for carrying out the statutory audit of accounting documents (auditors). It maintains the basic requirements regarding registration and professional integrity of the auditors while considerably extending its scope.

The Directive thus proposes to clarify the duties of statutory auditors, notably by introducing the application of international standards to all statutory audits carried out in the European Union. It sets out certain ethical principles to ensure their objectivity and independence. Furthermore, it introduces a requirement for external quality assurance as well as rigorous public oversight. It improves co-operation between supervisory authorities in the EU and provides a basis for international regulatory co-operation with third country supervisors. Finally, it introduces two specific provisions to respond to frauds, namely the liability of the group auditor and the establishment of an independent audit committee in all public interest entities.

The proposed Directive has been adopted by the European Parliament on 28 September 2005 and endorsed by the Council. It will enter into force 20 days following its publication in the Official Journal of the European Union and must be transposed into national law within two years as from this date.

1.3. Proposal for a Directive on the new legal framework for payment services

In December 2005, the European Commission presented a proposal for a Directive on payment services in the internal market and amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC. This new initiative of the European Commission aims at achieving an integrated and efficient EU payments market and is one of the key actions of the Lisbon programme.

The proposal's objective is to eliminate the current legal obstacles to the development of a Single Payment Market in the European Union. Thus, cross-border payments through credit cards, debit cards, electronic payments, direct debit or any other means should be as safe and easy to use and reach the same cost level as national payments.

The proposed Directive, called "new legal framework", is based on three main building blocks:

- the right to provide payment services to the public

  The objective of the proposal is to harmonise market access requirements of payment services providers other than credit institutions or electronic money institutions in order to create a level-playing field and to instil more competition in national markets, by triggering market entry of a new generation of providers. The new framework for payment institutions will also reflect market developments in recent years and the Special Recommendation VI of the OECD Financial Action Task Force.

- transparency and information requirements

  The proposal aims to harmonise horizontally, i.e. irrespective of the provider's quality, the transparency rules that apply to payment services in order to improve consumer protection. It introduces clear and concise rules that will replace existing national rules.

- rights and obligations of users and providers of payment services

  The new legal framework will improve legal certainty, by specifying horizontally the core rights and obligations of users and providers of payment services. This legal certainty is essential for the development of modern and efficient electronic payment systems that will allow to strengthen the trust of users.

2. DIRECTIVES ADOPTED BY THE COUNCIL AND THE EUROPEAN PARLIAMENT BUT NOT YET IMPLEMENTED UNDER NATIONAL LAW

This section presents the Directives adopted by the Council and the European Parliament for which a draft law has been submitted to the Luxembourg *Chambre des Députés* or for which a preliminary draft law is under discussion in the committees operating within the CSSF or which are being implemented by the CSSF.

2.1. Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services and amending Directives 90/619/EEC, 97/7/EC and 98/27/EC

The Directive, whose purpose is to define a harmonised legal framework covering the conclusion of financial service contracts at a distance so as to establish an appropriate level of consumer protection in all Member States and thereby promote cross-border marketing of financial services and products, has been covered in detail in the CSSF's Annual Report 2002. A draft law aiming to transpose the Directive into Luxembourg law has been submitted to the *Chambre des Députés.*

2.2. Directive 2002/87/EC of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC, 93/22/EEC, 98/78/EC and 2000/12/EC

The Directive, the purpose of which is to supplement the legislation on sectoral prudential supervision with a set of measures governing the supervision of financial conglomerates, has been covered in detail in the CSSF's Annual Report 2002. A draft law aiming to transpose the Directive into Luxembourg law has been submitted to the *Chambre des Députés.*

2.3. Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (Market Abuse Directive)

The purpose of the Directive is to ensure the integrity of the EU financial markets and to strengthen investor confidence in these markets. The Directive has been covered more explicitly in the CSSF's Annual Report 2001.

In accordance with the final report of the Committee of Wise Men on the regulation of European securities markets, a first set of implementing measures, detailed in the CSSF's Annual Report 2003, has been endorsed.

Furthermore, on 17 November 2003, the European Commission's services published a working paper on a second set of implementing measures, which are based on the technical advice delivered by CESR in September 2003. The working paper led to the publication of Directive 2004/72/EC of 29 April 2004 on the implementing Directive 2003/6/EC as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions.

A draft law aiming to transpose the Directive into Luxembourg law has been submitted to the *Chambre des Députés.*

2.4. Directive 2004/25/EC of 21 April 2004 on takeover bids (Takeover Directive)

The Directive, which introduces common EU provisions as regards takeover bids, was published on 30 April 2004. It will come into force on 20 May 2006 at the latest. More detailed information is provided in the CSSF's Annual Report 2003.

A draft law aiming to transpose the Directive into Luxembourg law has been submitted to the *Chambre des Députés.*

2.5. Directive 2004/39/EC of 21 April 2004 on markets in financial instruments, amending Directives 85/611/EEC, 93/6/EEC and 2000/12/EC and repealing Directive 93/22/EEC (MIFID Directive)

The Directive enhances harmonisation of national rules and gives investment firms an effective single passport, which will allow them to operate throughout the European Union on the basis of authorisation in their home Member State. It also ensures that investors enjoy a high level of protection when making use of investment firms, wherever they are located in Europe. Finally, it establishes a comprehensive regulatory framework governing the organised execution of investor transactions by exchanges, other trading systems and investment firms. The objectives of the Directive are detailed in the CSSF's Annual Report 2003.

In accordance with the Committee of Wise Men on the regulation of European securities markets, the European Commission gave several mandates to CESR to develop technical measures concerning the rules of conduct for investment firms, rules governing their internal organisation, investor protection, rules of pre- and post trade transparency, conditions for admission, definition of investment advice, publication of limit orders, treatment of eligible counterparties, systematic internalisation, rules governing reporting of transactions on financial instruments and rules governing co-operation between relevant authorities. The mandates and relating works in progress have been described in detail in the CSSF's Annual Report 2004, Chapter X, point 1.1.2.

Under the scope of these mandates, CESR submitted its technical advices to the European Commission on 31 January 2005 and 30 April 2005. In February 2006, the European Commission has published draft implementing measures in the form of a working paper, which presents a proposal for a Directive on organisational requirements and operating conditions for investment firms and a proposal for a Regulation as regards record-keeping obligations for investment firms, transaction reporting, market transparency and admission of financial instruments to trading.

A draft law aiming to transpose the Directive into Luxembourg law is currently under discussion within the CSSF's committees.

2.6. Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (Transparency Directive)

The Directive introduces requirements that strengthen the transparency requirements for companies whose securities are admitted to trading on a regulated market. The disclosure of accurate, comprehensive and timely information about security issuers builds sustained investor confidence and allows an informed assessment of their business performance and assets. This enhances both investor protection and market efficiency. More detailed information is provided in the CSSF's Annual Report 2004.

In accordance with the procedure decided upon in the Stockholm Resolution adopted by the European Council in March 2001, which aims at improving the decision process as regards securities, the European Commission gave two mandates for the preparation of technical advice under the Transparency Directive to CESR in June 2004.

The first mandate related to the drawing up of technical measures related to the notification of major holdings of voting rights, the standards for the dissemination of regulated information, the half-yearly reports, the equivalence of transparency requirements of third countries and procedures whereby an issuer may elect its home Member State. Following the submission of CESR's technical advice in June 2005, the DG Internal Market Services published a working paper presenting level 2 measures in the form of a procedural arrangement for the choice of the home Member State, the content of the half-yearly report, the procedures for notification of major holdings of voting rights, the dissemination of regulated information and the equivalence of the transparency requirements of third country issuers and in the form of a recommendation for standardised formats of notification of major holdings of voting rights.

The second mandate, which relates to the equivalence between US GAAP, Canadian GAAP and Japanese GAAP and the IAS/IFRS standards, has also led to the publication of a technical advice by CESR in June 2005. The European Commission's work in this field is still in progress. CESR's work on both mandates has been covered in detail in the CSSF's Annual Report 2004, Chapter X, point 1.1.2.

A third mandate on storage of regulated information and electronic filing of such information with the authorities was given to CESR in July 2005 calling for a technical advice by June 2006. The work in this field is covered in detail in Chapter XI (cf. point 2.1.2. relating to CESR) in this Annual Report.

2.7. 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

Following its adoption, under Luxembourg presidency, by the Council of Economic and Finance Ministers on 7 June 2005, the third Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing was published in the Official Journal of the European Union on 25 November 2005.

The new Directive, which replaces that of 1991, as amended in 2001, aims to incorporate into EU law the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF). It should be noted that the professional obligations of the players concerned, notably those relating to customer identification, are specified and fine-tuned, without being amended in their principles. Thus, the Directive introduces a definition of the beneficial owner, as well as detailed rules as regards customer due diligence. The Directive provides for enhanced customer due diligence rules with respect to customers that present a high risk of money laundering or terrorist financing, notably those considered as politically exposed persons or those that are not physically present for identification purposes.

In order to be able to take account of the technical progress in the field of combating money-laundering and terrorist financing and to ensure a uniform implementation of the new rules, the Directive uses the comitology procedure. This procedure allows to set down implementing measures for the Directive in specific areas.

Member States shall transpose this new Directive by 15 December 2007.

3. LAWS PASSED IN 2005

3.1. Law of 10 July 2005 on prospectuses for securities

The law on prospectuses for securities sets up a new framework for the drawing-up, approval and distribution of prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market. It transposes into Luxembourg law, among others, Directive 2003/71/EC of 4 November 2003 concerning the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Prospectus Directive).

As a result of the transposition of the Prospectus Directive, the provisions relating to the prospectus to be published when securities are offered to the public and/or admitted to trading laid down in the law of 23 December 1998 as amended on the supervision of securities markets (implemented by Grand-Ducal regulation of 28 December 1990 on the conditions governing the drawing-up, the control and the distribution of the prospectus to be published when securities are offered to the public or admitted to trading) are repealed.

Moreover, certain provisions related to the prospectuses and other terms governing an offer referred to in the law of 30 March 1988 as amended on undertakings for collective investment, the law of 20 December 2002 as amended on undertakings for collective investment, the law of 15 June 2004 on the investment company in risk capital and the law of 10 August 1915 concerning commercial companies, are amended.

Concurrently, Regulation (EC) no. 809/2004 of 29 April 2004 implementing the Prospectus Directive as regards information contained in prospectuses, as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements becomes directly applicable in Luxembourg as from 1 July 2005.

This European Regulation plays an important role with respect to the implementation of the law on prospectuses for securities, as it mainly sets down the detailed information to include in a prospectus and also contains many provisions governing the drawing-up of prospectuses for programmes of securities other than equity, a market segment in which the Luxembourg Stock Exchange has been specialising for the last twenty years.

The purpose of the Prospectus Directive is to allow companies to raise capital across the European Union more easily and at lower costs, based on a single approval granted by the authority of the home Member State, as well as to strengthen investor protection by ensuring that all prospectuses, wherever they are issued and approved in the European Union, provide investors with the clear and comprehensive information they need to take their investment decision.

A detailed analysis of the law on prospectuses for securities is available in Chapter VII "Supervision of securities markets".

3.2. 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)

A detailed analysis of the law is available in Chapter III "Supervision of pension funds".

3.3. Law of 5 August 2005 on financial collateral arrangements

The law of 5 August 2005 on financial collateral arrangements transposes Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements into Luxembourg law. The law notably aims at improving the legal certainty of financial collateral arrangements by removing certain "inequalities" between the different types of arrangements that stem from the fact that they have been introduced at different periods of time. Under the generic term "financial collateral arrangement", it refers both to traditional security as well as to new forms of security. One of the objectives of the law is to consolidate all the legislation on financial collateral arrangements into a single law and to improve transparency and accessibility of this part of Luxembourg legislation.

3.4. Law of 16 March 2006 relating to the introduction of the international accounting standards for credit institutions

The law of 16 March 2006 transposes into the law of 17 June 1992 on the accounts of credit institutions as amended the Community regulations on international accounting standards[1], namely:

- Directive 2001/65/EC of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions;
- articles 5 and 9 of Regulation (EC) no. 1606/2002 of 19 July 2002 on the application of international accounting rules;
- Directive 2003/51/EC of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions as well as insurance undertakings.

In accordance with the compulsory regime of the IAS Regulation, solely the banks whose securities (shares or bonds) are listed are compelled to publish their consolidated accounts under the IAS framework. The law gives the option to banks other than those subject to the compulsory regime of the IAS Regulation to publish their consolidated accounts and/or annual accounts under the IAS framework. The banks may thus prepare only one set of statements and use the IAS standards as their basic standards.

[1] International Accounting Standards "IAS" or International Financial Reporting Standards "IFRS" following the denomination of the new international accounting standards adopted by the International Accounting Standards Board "IASB".

Moreover, the law allows the banks (mixed regime), that do not use the IAS standards, to apply certain provisions of the IAS standards. The banks may thus migrate progressively to the IAS standards.

In order to improve the comparability of financial information and ensure a level playing field among Luxembourg banks, all the law's options for banks shall be submitted for prior approval to the CSSF. The CSSF's approval can be given on a case-by-case basis or by means of general instructions containing implementation rules for the use of the IAS standards.

It should also be noted that the banks that apply the IAS standards, namely those that are required to do so under the IAS Regulation, as well as those that are authorised thereto under the law on bank accounts, remain submitted to certain provisions of the law concerned which are not covered by the IAS standards (provisions relating to the management report and the report of the statutory auditor and the requirement to append certain items of information).

Finally, the law implements the transitional provisions of the IAS Regulation and postpones the implementation of its compulsory regime in certain cases (banks of which only the bonds are listed) until the end of 2007.

4. CIRCULARS ISSUED IN 2005

In 2005, the CSSF issued 62 circulars, 43 of which dealing with the fight against money laundering and terrorist financing.

The following circulars are the most important, some of which being covered more specifically in the relevant Chapters of the Annual Report:

- Circular CSSF 05/176 concerning the rules of conduct to be adopted by undertakings for collective investment in transferable securities in relation to the use of financial derivative instruments;
- Circular CSSF 05/211 on combating money laundering and terrorist financing and the prevention of the use of the financial sector for the purpose of money laundering and terrorist financing;
- Circular CSSF 05/226 concerning the general presentation of the law on prospectuses for securities and the technical specifications regarding communications to the CSSF of documents for the approval or for filing and of notices for offers of securities to the public and admissions of securities to trading on a regulated market;
- Circular CSSF 05/227 on the introduction of a new prudential reporting in 2008.

5. CIRCULARS IN FORCE (AS AT 1 MARCH 2006)

5.1. Circulars issued by the *Commissariat au Contrôle des Banques*

B 79/2	07.05.1979	European Code of Conduct on securities transactions
B 83/6	16.03.1983	Participating interest held by credit institutions

5.2. Circulars issued by the *Institut Monétaire Luxembourgeois*

84/18	19.07.1984	Futures markets (law of 21 June 1984)
86/32	18.03.1986	Control of the annual accounts of credit institutions
88/49	08.06.1988	New legal provisions concerning controls carried out by auditors
91/75	21.01.1991	Revision and recasting of rules governing Luxembourg undertakings covered by the law of 30 March 1988 on undertakings for collective investment

91/78	17.09.1991	Terms of application of Article 60 of the amended law of 27 November 1984 regulating private portfolio managers
91/80	05.12.1991	Staff numbers (PFS)
92/86	03.07.1992	Law of 17 June 1992 concerning the accounts of credit institutions
93/92	03.03.1993	Computerised transmission of periodic data
93/94	30.04.1993	Entry into force for banks of the law of 5 April 1993 on the financial sector
93/95	04.05.1993	Entry into force for other professionals of the financial sector of the law of 5 April 1993 on the financial sector
93/99	21.07.1993	Provisions for Luxembourg credit institutions wishing to exercise banking activities in other EEC countries through the establishment of branches or under the freedom to provide services
93/100	21.07.1993	Provisions for credit institutions of Community origin exercising banking activities in Luxembourg through branches or under the freedom to provide services
93/101	15.10.1993	Rules concerning the organisation and internal control of the market activity of credit institutions
93/102	15.10.1993	Rules concerning the organisation and internal control of the activities of brokers or commission agents exercised by other financial sector professionals
93/104	13.12.1993	Definition of a liquidity ratio to be observed by credit institutions
94/109	08.03.1994	Allocation of responsibilities for the establishment of equipment for transmitting computerised data to the IML
95/116	20.02.1995	Entry into force of: - the law of 21 December 1994 amending certain legal provisions concerning the transfer of claims and pledging; - the law of 21 December 1994 concerning repurchase agreements transacted by credit institutions
95/118	05.04.1995	Customer complaint handling
95/119	21.06.1995	Rules for the management of risks linked to derivatives transactions
95/120	28.07.1995	Central administration
96/123	10.01.1996	Staff numbers (new table S 2.9.)
96/124	10.01.1996	Staff numbers (new table S 2.9. for PFS)
96/125	30.01.1996	Supervision of credit institutions on a consolidated basis
96/126	11.04.1996	Administrative and accounting organisation
96/129	19.07.1996	Law of 9 May 1996 on the netting of claims in the financial sector
96/130	29.11.1996	Calculation of a simplified ratio in application of IML Circular 96/127
97/135	12.06.1997	Transmission of supervisory data and statistics by telecommunications media
97/136	13.06.1997	Financial information for the IML and Statec
98/143	01.04.1998	Internal control
98/147	14.05.1998	Provisions for EC investment firms exercising their activities in Luxembourg through branches or under the freedom to provide services
98/148	14.05.1998	Provisions for Luxembourg investment firms wishing to exercise their activities in other EC countries through the establishment of branches or under the freedom to provide services

5.3. Circulars issued by the *Commissariat aux Bourses*

91/2	01.07.1991	Law of 3 May 1991 on insider dealing
93/4	04.01.1993	Law of 4 December 1992 on reporting requirements concerning the acquisition or disposal of major holdings in a listed company

5.4. Circulars issued by the *Commission de surveillance du secteur financier*

99/1	12.01.1999	Creation of the Commission de Surveillance du Secteur Financier
99/2	20.05.1999	Entry into force of three new laws dated 29 April 1999
99/4	29.07.1999	Entry into force of the law of 8 June 1999 creating pension funds in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep)
99/7	27.12.1999	Declarations to be sent to the CSSF in accordance with articles 5 and 6 of the law of 23 December 1998 on the supervision of the securities markets
00/10	23.03.2000	Definition of capital ratios pursuant to article 56 of the amended law of 5 April 1993 on the financial sector (application to credit institutions)
00/12	31.03.2000	Definition of capital ratios pursuant to article 56 of the amended law of 5 April 1993 on the financial sector (application to investment firms)
00/13	06.06.2000	Sanctions against the Federal Republic of Yugoslavia and the Taliban in Afghanistan
00/14	27.07.2000	Adoption of the law of 17 July 2000 amending certain provisions of the law of 30 March 1988 on undertakings for collective investment
00/15	02.08.2000	Rules of conduct for the financial sector
00/17	13.09.2000	Entry into force of the law of 27 July 2000 bringing into force the provisions of Directive 97/9/EC concerning investor compensation schemes under the amended law of 5 April 1993 on the financial sector
00/18	20.10.2000	Bank accounts of the State of Luxembourg
00/22	20.12.2000	Supervision of investment firms on a consolidated basis carried out by the Commission de Surveillance du Secteur Financier
01/26	21.03.2001	Law of 12 January 2001 implementing the provisions of Directive 98/26/EC on settlement finality in payment and securities settlement systems under the amended law of 5 April 1993 and supplementing the law of 23 December 1998 creating a supervisory commission for the financial sector
01/27	23.03.2001	Practical rules on the role of external auditors
01/28	06.06.2001	Verification by banks and PFS that the legal requirements on domiciliation are satisfied
01/29	07.06.2001	Minimum content required for an agreement on the domiciliation of companies
01/32	11.07.2001	Publication of information on financial instruments
01/34	24.09.2001	Entry into force of a series of laws concerning the financial sector
01/42	19.11.2001	Mortgage bond banks: rules on real estate valuation
01/46	19.12.2001	Repeal of Circular CSSF 01/35
01/47	21.12.2001	Professional obligations of domiciliation agents of companies and general recommendations Amendment of Circular CSSF 01/28
02/61	04.06.2002	Identification and declaration of business relations with terrorist circles
02/63	01.07.2002	Cross-border payments in euros
02/65	08.07.2002	Law of 31 May 1999 governing the domiciliation of companies; precisions as regards the concept of "seat"

02/71	01.10.2002	Law of 3 September 1996 concerning the involuntary dispossession of bearer securities
02/77	27.11.2002	Protection of investors in case of miscalculation of NAV and the compensation following non-compliance with investment rules applicable to undertakings for collective investment
02/80	05.12.2002	Specific rules applicable to Luxembourg undertakings for collective investment (UCIs) which adopt alternative investment strategies
02/81	06.12.2002	Practical rules regarding the tasks of external auditors of undertakings for collective investment
03/87	21.01.2003	Coming into force of the law of 20 December 2002 regarding undertakings for collective investment
03/88	22.01.2003	Classification of undertakings for collective investment governed by the provisions of the law of 20 December 2002 regarding UCIs
03/95	26.02.2003	Mortgage bond banks: applicable minimum requirements regarding management and control of mortgage register, cover assets and limit of circulating mortgage bonds
03/97	28.02.2003	Publication of the simplified and complete prospectuses as well as annual and half-yearly reports of UCIs in the database of the financial centre
03/100	01.04.2003	Publication on the Internet of CSSF instructions: - *Recueil des instructions aux banques* of the CSSF - Schedule of Conditions for the technical implementation of the CSSF reporting requirements – SOC/CSSF
03/108	30.07.2003	Luxembourg management companies subject to Chapter 13 of the law of 20 December 2002 concerning undertakings for collective investment, as well as Luxembourg self-managed investment companies subject to article 27 or article 40 of the law of 20 December 2002 concerning undertakings for collective investment
03/113	21.10.2003	Practical rules concerning the mission of external auditors of investment firms
03/122	19.12.2003	Clarifications on the simplified prospectus
04/132	24.03.2004	Abrogation of circular CaB 91/3
04/140	13.05.2004	Amendment of circular CSSF 2000/12 applicable to investment firms incorporated under Luxembourg law and to branches of non-EU investment firms to transpose Directive 2004/69/EC of the European Commission of 27 April 2004 amending Directive 2000/12/EC of the European Parliament and of the Council as regards the definition of "multilateral development banks"; Amendment of the list of zone A countries
04/143	24.05.2004	Abrogation of circulars IML 90/67, 90/68 and 91/77
04/144	26.05.2004	Amendment of circular CSSF 2000/10 applicable to banks incorporated under Luxembourg law and to branches of non-EU banks to transpose Directive 2004/69/EC of the European Commission of 27 April 2004 amending Directive 2000/12/EC of the European Parliament and of the Council as regards the definition of "multilateral development banks"; Amendment of the list of zone A countries
04/146	17.06.2004	Protection of undertakings for collective investment and their investors against Late Trading and Market Timing practices
04/154	24.08.2004	New capital requirements regime
04/155	27.09.2004	Compliance function

04/156	01.10.2004	Circular CSSF 2000/10 - Abrogation of the communication of the detailed calculation of the capital requirement (tables B 3.2 and B 7.3) - List of currencies of EU Member States not participating in the Euro
05/176	05.04.2005	Rules of conduct to be adopted by undertakings for collective investment in transferable securities in relation to the use of financial derivative instruments
05/177	06.04.2005	Abolition of any prior control by the CSSF of advertising material used by persons and companies supervised by the CSSF; abrogation of point II. of Chapter L. of IML circular 91/75; abrogation of the two last sentences of point IV. 5.11 of circular CSSF 2000/15
05/178	11.04.2005	Administrative and accounting organisation; outsourcing of IT services; abrogation of point 4.5.2. of circular IML 96/126 and replacement by point 4.5.2. of this circular
05/185	24.05.2005	Luxembourg management companies subject to Chapter 13 of the law of 20 December 2002 concerning undertakings for collective investment, as well as Luxembourg self-managed investment companies subject to article 27 or article 40 of the law of 20 December 2002 concerning undertakings for collective investment
05/186	25.05.2005	Guidelines of the Committee of European Securities Regulators (CESR) relating to the implementation of the transitional provisions of Directives 2001/107/EC and 2001/108/EC (UCITS III) amending Directive 85/611/EEC (UCITS I)
05/187	26.05.2005	Financial information to be submitted to the CSSF by the "other professionals of the financial sector" (PFS) on a periodic basis
05/197	19.07.2005	Reporting of periodic financial information to the CSSF by the "other professionals of the financial sector" (PFS) by electronic means
05/201	29.07.2005	Coming into force of the law of 13 July 2005 on institutions for occupational retirement provision in the form of pension savings companies with variable capital (sepcav) and pension savings associations (assep)
05/210	10.10.2005	Drawing-up of a simplified prospectus within the scope of Chapter 1 of Part III of the law on prospectuses for securities
05/211	13.10.2005	Combating money laundering and terrorist financing and the prevention of the use of the financial sector for the purpose of money laundering and terrorist financing
05/219	09.12.2005	Update of table B 4.6 *Responsables de certaines fonctions*
05/221	13.12.2005	Statistics on guaranteed deposits and instruments
05/222	13.12.2005	Breakdown of value corrections made by the credit institutions at 31 December 2005
05/224	15.12.2005	Choice of the home Member State for third country issuers whose securities are admitted to trading on 1 July 2005 and notification by these issuers of their choice by 31 December 2005
05/225	16.12.2005	Notion "offer to the public of securities" as defined in the law on prospectuses for securities and the "obligation to publish a prospectus" that may ensue
05/226	16.12.2005	General overview of the law on prospectuses for securities and technical specifications regarding communications to the CSSF of documents for the approval or for filing and of notices for offers of securities to the public and admissions of securities to trading on a regulated market
05/227	16.12.2005	Introduction of a new prudential reporting in 2008
05/228	16.12.2005	Impact of the international accounting standards IAS/IFRS on the determination of the capital requirements

The circulars listing the persons and entities to which restrictive measures apply within the scope of the fight against terrorism and money laundering, are mentioned hereunder, and do not appear in the table above.

The changes to the list of countries and territories considered as non co-operative by the Financial Action Task Force (FATF) are the subject of circular CSSF 05/212.

The amendments to Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban published on 4 June 2002 in Circular CSSF 02/61 are the subject of circulars CSSF 02/62, 02/68, 02/70, 02/72, 02/74, 02/75, 02/79, 03/89, 03/91, 03/92, 03/96, 03/98, 03/99, 03/101, 03/102, 03/103, 03/105, 03/109, 03/110, 03/111, 03/112, 03/116, 03/117, 03/119, 04/125, 04/126, 04/127, 04/130, 04/131, 04/134, 04/138, 04/141, 04/148, 04/150, 04/152, 04/157, 04/160, 04/164, 04/166, 05/169, 05/170, 05/173, 05/183, 05/184, 05/190, 05/198, 05/202, 05/204, 05/206, 05/207, 05/209, 05/213, 05/215, 05/216, 05/220, 05/229, 06/232, 06/234 and 06/235.

The specific restrictive measures against certain persons and entities within the scope of the fight against terrorism are the subject of circulars CSSF 02/59, 02/75, 03/111 and 05/230.

The freeze of funds in relation to Mr Milosevic and those persons associated with him is the subject of circulars CSSF 00/20 and 03/102.

The measures against UNITA (União Nacional para a Independência Total de Angola) are the subject of circular CSSF 03/90.

The restrictive measures concerning certain Iraqi assets are the subject of circulars CSSF 03/110, 03/114, 03/118, 04/136, 04/142, 04/145, 05/194 and 05/205.

The restrictive measures in relation to the persons indicted by the ICTY are the subject of circulars CSSF 04/159, 04/163, 04/168, 05/172, 05/180, 05/181, 05/189, 05/208 and 06/231.

The restrictive measures in respect of Burma / Myanmar are the subject of circulars CSSF 04/135, 04/161, 05/174 and 05/182.

The restrictive measures in relation to Liberia are the subject of circulars CSSF 04/137, 04/147, 04/153, 04/158, 05/193 and 05/223.

The restrictive measures in respect of Zimbabwe are the subject of circulars CSSF 04/128, 05/192 and 05/203.

The restrictive measures in view of the situation in Côte d'Ivoire are the subject of circulars CSSF 05/179 and 06/236.

The restrictive measures against Sudan are the subject of circular CSSF 05/199.

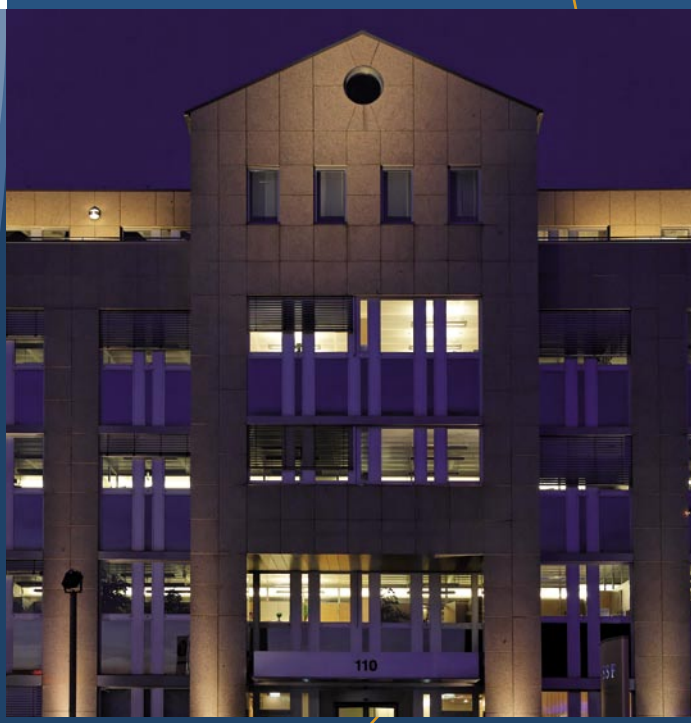
The restrictive measures against the Democratic Republic of Congo are the subject of circulars CSSF 05/200, 05/218 and 06/233.

The restrictive measures in connection with the assassination of former Lebanese Prime Minister Rafiq Hariri are the subject of circular CSSF 06/237.

CHAPTER XIII

INTERNAL ORGANISATION OF THE CSSF

1. Functioning of the CSSF
2. Human resources
3. Information Technology
4. Staff members
5. Internal committees



1. FUNCTIONING OF THE CSSF

The CSSF's administrative and management organisation is described in detail in the sub-section "Corporate governance and functioning" of the CSSF website (www.cssf.lu, section "About the CSSF").

2. HUMAN RESOURCES

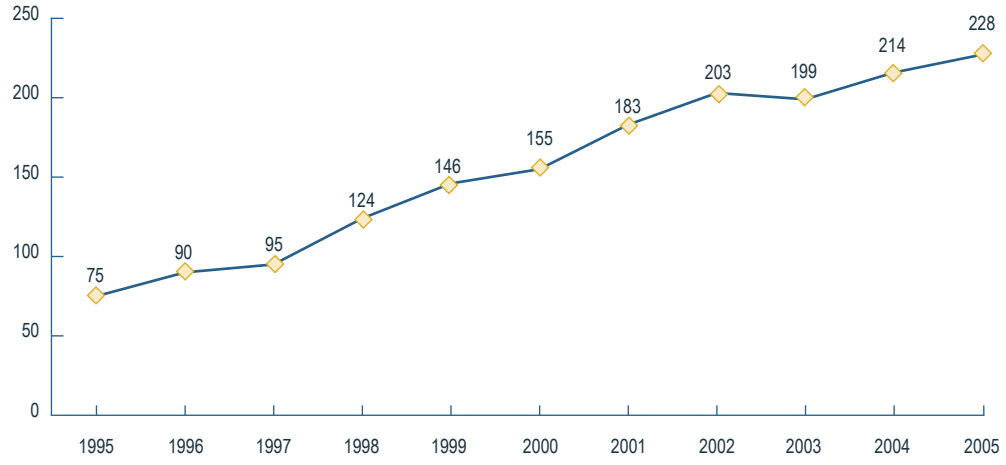
The year 2005 was characterised by the recruitment of a considerable number of new agents. Indeed, in the context of the transposition into national law of Directive 2003/71/EC on prospectuses to be published when securities are offered to the public or admitted to trading (Prospectus Directive), the CSSF launched a first recruitment campaign in spring 2005 which resulted in the engagement of fifteen agents, among whom ten have been appointed to the department supervising securities markets.

Owing to the needs in personnel of the department supervising UCIs, due to the sustained growth of the investment fund industry, the CSSF had organised two competitive exams in October 2005, which allowed to engage at the beginning of 2006 eight agents in the *carrière supérieure*, i.e. six economists and two legal experts, and seven agents in the *carrière moyenne*.

Two agents left the CSSF during the year, one agent having retired as of 1 February 2005 and the other agent, on unpaid leave since 2003, having resigned on 1 June 2005.

Following the transfer of fourteen Luxembourg Stock Exchange employees to the CSSF on 1 January 2006, total staff increased to 254 as at 1 January 2006, against 214 as at 1 January 2005, which represents 232 full-time jobs.

Movements in staff numbers



Within the scope of continuing training, 98 trainings, including 19 abroad, were held for the CSSF staff in 2005, against 51 in 2004. The majority of these trainings were held in the fields of economics and finance. The other trainings in 2005 concerned subjects as varied as information technology, law, accounting, management, human resources management and personal development. Attendance to the different training sessions rose from 428 in 2004 and 196 in 2003 to 565 in 2005. In total, 183 agents attended at least one training in 2005.

3. INFORMATION TECHNOLOGY

The most important project that the department "Information technology" dealt with in 2005 concerns the re-implementation of the processing and analysis tool for the prudential reporting of banks and UCIs. The new reporting tables that are in the process of being standardised at European level under the Directive on capital adequacy (CAD III) and the new international accounting standards (IFRS) will be integrated therein. The new application is planned to be implemented as of 1 January 2007. Moreover, the CSSF prepared for the XBRL (eXtensible Business Reporting Language) data exchange format, devised to facilitate the exchange of reporting data.

A computer-aided management system for the reporting of the other professionals of the financial sector has been introduced. The PFS shall thus file their reports with the CSSF on a monthly basis, either *via* an electronic medium or *via* direct transmission.

In order to facilitate the exchange of UCI prospectus documents that are being approved by the CSSF, the internal Electronic Document Management System (DMS) has been interfaced with the Luxembourg Stock Exchange's "e-file" system, thereby allowing a secure transfer and a continuous follow-up of the documents exchanged between the "*Déposants*" of prospectuses connected to "e-file" and the CSSF.

Within short time frames, the CSSF's tools have been adapted to the processing of prospectuses for securities, introduced by the law of 10 July 2005 on prospectuses for securities and entirely under the control of the CSSF since 1 January 2006.

The CSSF's IT development team was joined by a developer, whose activities focus on the development and maintenance of the DMS.

As regards the IT infrastructure, the implementation of the storage area network (SAN) on the backup site, re-using the equipment that was replaced in the previous year by a new installation, needs to be stressed. The CSSF now has the same architecture on both sites, which facilitates business recovery if necessary.

The team responsible for the operating systems has set up the agents engaged in 2005, which includes the configuration of the PCs, network and phones, as well as the necessary adaptations on the servers.

A personal e-mail address has been set up for every agent. The division "Dataflow management" was charged with the centralised processing of e-mails that are likely to pose a security threat. Similarly, encrypted e-mails are put into quarantine as they cannot be automatically analysed, notably so as to detect viruses. It should also be noted that e-mails exceeding 10 MB are blocked as they are not accepted by all mail servers.

DEPARTMENT ADMINISTRATION AND FINANCE

Left to right: Raul DOMINGUES, Paul CLEMENT, Milena CALZETTONI, Georges BECHTOLD, Jean-Paul WEBER, Marco VALENTE, Alain KIRSCH

Absent: Tom EWEN, Edmond JUNGERS, Vic MARBACH, Carlo PLETSCHETTE

DEPARTMENT INFORMATION TECHNOLOGY

First row, left to right: Guy WAGENER, Nadine ESCHETTE, Carine SCHILTZ, Karin PROTH, Steve KETTMANN

Second row, left to right: Edouard LAUER, Guy FRANTZEN, Luc PROMMENSCHENKEL, Jean-Luc FRANCK, Jean-Jacques DUHR, Joao Pedro ALMEIDA, Marc KOHL, Paul HERLING

Absent: Jean-François BURNOTTE, Sandra WAGNER

4. STAFF MEMBERS (AS AT 1 MARCH 2006)

EXECUTIVE BOARD

Director General	Jean-Nicolas Schaus
Directors	Arthur Philippe, Simone Delcourt
Executive Secretaries	Marcelle Michels, Monique Reisdorffer, Joëlle Deloos, Karin Frantz
IT audit	David Hagen, Claude Bernard, Pascal Ducarn
Internal audit	Marie-Anne Voltaire
Director General's advisors	Marc Weitzel, Geneviève Pescatore
IT coordination	Pascale Damschen
Systems security	Constant Backes

GENERAL SUPERVISION

Head of function	Claude Simon
Deputy head	Romain Strock

Division 1 – International files

Head of division	Romain Strock
	Guy Haas, Jean-Marc Goy, Ngoc Dinh Luu, Nadia Manzari, Vincent Thurmes

Division 2 – Issues regarding accounting, tax system and external audit

Head of division	Danièle Kamphaus-Goedert
	Marguy Mehling, Martine Wagner, Diane Seil, Ana Bela Ferreira

Division 3 – Special functions

Joëlle Martiny, Davy Reinard, Didier Bergamo, Alain Hoscheid, Ronald Kirsch, Manuel Neu, Edouard Reimen, Claude Wampach, Pierrot Rasqué

DEPARTMENT SUPERVISION OF BANKS

Head of department	Frank Bisdorff
Deputy head of department	Ed. Englaro

Division 1 – Supervision of credit institutions 1

Head of division	Ed. Englaro
	Jean Ley, Isabelle Lahr, Claudine Tock, Anouk Dondelinger, Jacques Streweler

Division 2 – Supervision of credit institutions 2

Head of division Jean-Paul Steffen

Joan De Ron, Jean Mersch, Michèle Trierweiler, Alain Weis, Jean-Louis Duarte, Carlos Azevedo Pereira

Division 3 – Supervision of credit institutions 3

Head of division Nico Gaspard

Marco Bausch, Jean-Louis Beckers, Claude Moes, Monica Ceccarelli

Division 4 – Supervision of credit institutions 4

Head of division Patrick Wagner

Françoise Daleiden, Christina Pinto, Marc Bordet, Steve Polfer, Marina Sarmento, Gilles Jank, Yves Simon

General studies and issues Marc Wilhelmus

Statistics and IT issues Claude Reiser, Romain De Bortoli

Secretaries Michèle Delagardelle, Claudine Wanderscheid, Steve Humbert

DEPARTMENT SUPERVISION OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT

Head of department Irmine Greischer

Deputy heads of department Claude Steinbach, André Schroeder, Jean-Paul Heger

Practical studies and specific aspects

Pierre Bodry, Francis Koepp

IT systems Nico Barthels, Danièle Christophory

Management and operation of databases

Claude Steinbach

Jolanda Bos, Marie-Louise Baritussio, Géraldine Olivera, Adrienne André-Zimmer, Danielle Neumann, Nicole Grosbusch Suzanne Wagner, Claude Krier, Claudine Thielen, Christiane Cazzaro, Sabine Schiavo

Authorisation and supervision of UCIs and management companies

Coordination of Divisions 1 to 6 Jean-Paul Heger

Division 1

Head of division Anica Giel-Markovinovic

Nathalie Reisdorff, Alain Strock, Diane Reuter, Pascale Schmit, Claude Wagner, Patricia Jost, Nathalie Wald, Paul Hansen, Alex Weber

Division 2

Head of division Charles Thilges

Francis Lippert, Joël Goffinet, Marc Siebenaler, Dominique Herr, Yolanda Alonso, Dave Reuter, Carole Lis, Sophie Leboulanger, Christel Tana

Division 3

Head of division Ralph Gillen

Carine Peller, Michèle Wilhelm, Isabelle Dosbourg, Martin Mannes, Daniel Schmitz, Roberta Tumiotto, Michel Friob, Florence Winandy, David Philipps

Division 4

Head of division Francis Gasché

Evelyne Pierrard-Holzem, Martine Kerger, Marc Racké, Marie-Rose Colombo, Thierry Quaring, Serge Eicher, Robert Köller, Nicole Gengler

Division 5

Head of division Guy Morlak

Pierre Reding, Nathalie Cubric, Damien Houel, Géraldine Appenzeller, Marc Decker, Jean-Claude Fraiture, Jean-Marc Lehnert, Thierry Stoffel, Gilles Oth

Division 6 – Authorisation and supervision of management companies

Head of division Pascal Berchem

Anne Conrath, Pascale Felten-Enders, Roberto Montebrusco, Eric Tanson, Anne-Marie Hoffeld

Legal and economic aspects André Schroeder

François Hentgen, Angela De Cillia, Fabio Ontano, Joëlle Hertges, Christiane Streef, Christian Schaack, Alain Bressaglia, Stéphanie Bonifas

Secretaries Carole Eicher, Sandy Bettinelli, Carla Dos Santos, Simone Kuehler

DEPARTMENT SUPERVISION OF THE OTHER PROFESSIONALS OF THE FINANCIAL SECTOR

Head of department Sonny Bisdorff-Letsch

Deputy head of department Denise Losch

Carlo Felicetti, Simone Gloesener, Nicole Lahire, Carole Ney, Luc Pletschette, Claudia Miotto, Sylvie Mamer, Anne Marson, Gérard Brimeyer, Elisabeth Demuth

Secretary Emilie Lauterbour

GENERAL SECRETARIAT

Head of department	Danièle Berna-Ost
Deputy head of department	Danielle Mander
	Benoît Juncker, Carine Conté, Natasha Deloge, Jean-François Hein, Nadine Holtzmer, Iwona Mastalska, Christiane Trausch, Anne Wagener
Secretary	Steve Humbert

DEPARTMENT SUPERVISION OF SECURITIES MARKETS

Head of department	Françoise Kauthen
Deputy head of department	Annick Zimmer

Legal issues — Marc Limpach

Division 1 – Approval of prospectuses

Head of division	Jean-Christian Meyer
Group 1	Andrea Haris, Cornelia Bernhardt, Frédéric Dehalu, Olivier Ferry, Julien May
Group 2	Jerry Oswald, Fanny Breuskin, Patrick Fricke, Stéphanie Jamotte, Manuel Roda

Division 2 – Approval of prospectuses

Head of division	Gilles Hauben
Group 1	Olivier Weins, Daniel Jeitz, Marc Reuter, Cyrille Uwukuli
Group 2	David Schmitz, Estelle Bottemer, Michèle Debouché, Claude Fridrici, Joëlle Paulus

Aspects relating to accounting and supervision of listed companies

Pierre van de Berg

Inquiries and other functions of supervision of securities transactions

Karin Weirich, Eric Fritz, Maureen Wiwinius, Laurent Charnaut, Malou Hoffmann, Sylvie Nicolay-Hoffmann, Maggy Wampach

Supervision of persons performing stock exchange activities and other supervisory aspects relating to securities markets

Mylène Hengen, Martine Simon

Secretary — Marie-Josée Pulcini

DEPARTMENT SUPERVISION OF PENSION FUNDS, SICARS AND SECURITISATION UNDERTAKINGS

Head of department	Christiane Campill
Deputy head of department	Marc Pauly
	Josiane Laux, Isabelle Maryline Schmit, Natalia Radichevskaia, Daniel Ciccarelli, René Schott, Son Backes
Secretary	Carla Dos Santos

DEPARTMENT ADMINISTRATION AND FINANCE

Head of department Edmond Jungers

Deputy head of department Georges Bechtold

Division 1 - Human resources and day-to-day management

Head of division Georges Bechtold

Vic Marbach, Alain Kirsch, Raul Domingues, Marco Valente, Paul Clement

Division 2 - Financial management

Head of division Jean-Paul Weber

Carlo Pletschette, Tom Ewen

Secretary Milena Calzettoni

DEPARTMENT INFORMATION TECHNOLOGY

Head of department Jean-Luc Franck

Deputy head of department Sandra Wagner

Division 1 - Analysis and development

Head of division Paul Herling

Guy Wagener, Luc Prommenschenkel, Marc Kohl

Division 2 - Management of databases

Sandra Wagner

Division 3 - Operating systems

Head of division Guy Frantzen

Jean-Jacques Duhr, Nadine Eschette, Steve Kettmann, Edouard Lauer, Jean-François Burnotte

Division 4 - Dataflow management

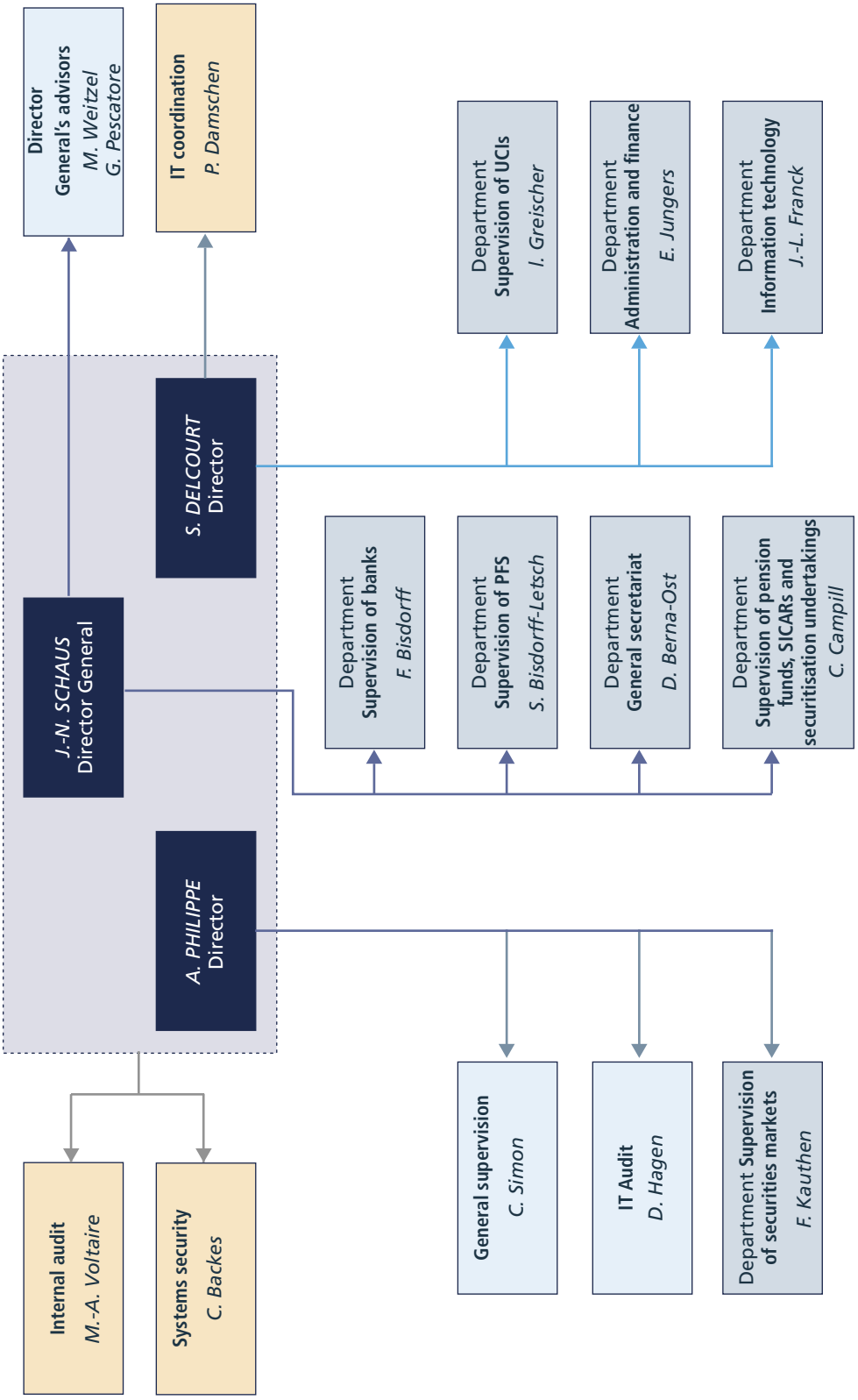
Head of division Joao Pedro Almeida

Karin Proth, Carine Schiltz

FINANCIAL CONTROLLER

KPMG

ORGANISATION CHART



5. INTERNAL COMMITTEES

Consultative committee for prudential regulation

Chairman Jean-Nicolas SCHAUS

Members Rafik FISCHER, Jean FUCHS, Jean GUILL, Robert HOFFMANN, Michel MAQUIL, Jean MEYER, Arthur PHILIPPE, Jean-Jacques ROMMES

Secretary Danielle MANDER

Consultative committee Anti-Money Laundering

Chairman Jean-Nicolas SCHAUS

Members Claude BIRNBAUM, Bernard COUCKE, Pia HAAS, Charles HAMER, Roger HARTMANN, Jean-François HEIN, Jean-Luc KAMPHAUS, Pierre KRIER, Jean-Marie LEGENDRE, François PAULY, Marc PECQUET, Arthur PHILIPPE, Jean-Jacques ROMMES, Thomas SEALE, Claude SIMON, Romain STROCK, Lucien THIEL, Marc WEITZEL, André WILWERT

Secretary Geneviève PESCATORE

Committee Other Professionals of the Financial Sector

Chairman Jean-Nicolas SCHAUS

Members Pierre-Yves AUGSBURGER, Sonny BISDORFF-LETSCH, Freddy BRAUSCH, Jean BRUCHER, Henri DE CROUY-CHANEL, Alain FEIS, Jean FUCHS, Irmine GREISCHER, Antoine HYE DE CROM, Didier MOUGET, Jean-Michel PACAUD, Geneviève PESCATORE, Arthur PHILIPPE

Secretary Denise LOSCH

Committee Banks

Chairman Arthur PHILIPPE

Members Stéphane BOSI, Ernest CRAVATTE, Serge DE CILLIA, Jean-Claude FINCK, Charles HAMER, Roger H. HARTMANN, Pierre KRIER, André MARC, Jean MEYER, Paul MOUSEL, Frédéric OTTO, Philippe PAQUAY, Guy ROMMES, Jean-Nicolas SCHAUS, Claude SIMON, Romain STROCK, Klaus-Michael VOGEL, Ernst-Dieter WIESNER

Secretary Martine WAGNER

Committee Compliance

Chairman Arthur PHILIPPE

Members Patrick CHILLET, Alain HONDEQUIN, Jean-Marie LEGENDRE, Jean-Noël LEQUEUE, Thierry LOPEZ, Vafa MOAYED, Didier MOUGET, Marc OLINGER, Jean-Jacques ROMMES, Jean-Nicolas SCHAUS, Claude SIMON, Jean STEFFEN, Romain STROCK, Marie-Anne VOLTAIRE, Marco ZWICK

Secretary Ronald KIRSCH

Committee Banking Accounting

Chairman	Arthur PHILIPPE
Members	Volkert BEHR, André-Marie CRELOT, Eric DAMOTTE, Serge DE CILLIA, Doris ENGEL, Jean-Paul ISEKIN, Carlo LESSEL, Bernard LHOEST, Vafa MOAYED, Carole ROEDER, Daniel RUPPERT, Jean-Nicolas SCHAUS, Thomas SCHIFFLER, Claude SIMON, Romain STROCK, Alain WEBER
Secretary	Danièle KAMPHAUS-GOEDERT

Committee Company domiciliation

Chairman	Jean-Nicolas SCHAUS
Members	Gérard BECQUER, Carlo DAMGE, Johan DEJANS, Lucy DUPONG, Victor ELVINGER, Guy HARLES, Rüdiger JUNG, Jean LAMBERT, Carlo SCHLESSER, Christiane SCHMIT, André WILWERT, François WINANDY
Secretary	Luc PLETSCHETTE

Committee Pension funds

Chairman	Jean-Nicolas SCHAUS
Members	Freddy BRAUSCH, Christiane CAMPILL, Simone DELCOURT, Jacques ELVINGER, Rafik FISCHER, Fernand GRULMS, Robert HOFFMANN, Claude KREMER, Anne-Christine LUSSIE, Jacques MAHAUX, Olivier MORTELMANS, Geneviève PESCATORE, Arthur PHILIPPE, Jean-Jacques ROMMES, Jean-Paul WICTOR, Claude WIRION
Secretary	Marc PAULY

Committee Information Technology

Chairman	Simone DELCOURT
Members	Nico BARTHELS, Walter B. FIEDLER, Jean-Luc FRANCK, David HAGEN, Marc HEMMERLING, Bruno LEMOINE, Claude MELDE, Alain PICQUET, Olivier PEMMERS, François SCHWARTZ, Bernard SIMON, Alain TAYENNE, Dominique VALSCHAERTS
Secretary	Pascale DAMSCHEN

Committee Legal experts

Chairman	Jean-Nicolas SCHAUS
Members	Philippe BOURIN, Maria DENNEWALD, Philippe DUPONT, Irmine GREISCHER, André HOFFMANN, Jean-Luc KAMPHAUS, Christian KREMER, Jacques LOESCH, André LUTGEN, Yves PRUSSEN, Jean-Jacques ROMMES, Jean STEFFEN, Romain STROCK, Marc WEITZEL
Secretary	Geneviève PESCATORE

Committee Mortgage Bonds

Chairman	Arthur PHILIPPE
Members	Alain BAUSTERT, Heiko BECK, Janine BIVER, Reinolf DIBUS, Thomas FELD, Jean-François HEIN, Hans-Dieter KEMLER, Jean-Jacques ROMMES, Raymond SCHADECK, Jean-Nicolas SCHAUS, Thomas SCHIFFLER, Martin SCHULTE, Claude SIMON, Romain STROCK, Dirk VORMBERGE
Secretary	Michèle TRIERWEILER

Committee Securities Markets

Chairman	Arthur PHILIPPE
Members	Danièle BERNA-OST, André BIRGET, Daniel DAX, Serge DE CILLIA, Jean-Paul DEKERK, Axel FORSTER, Patrick GEORTAY, Robert HOFFMANN, Philippe HOSS, Françoise KAUTHEN, Claude KREMER, Albert LE DIRAC'H, Jean-Nicolas SCHAUS, Richard SCHNEIDER, Jean-Marie SCHOLLER, Christiane SCHON, Claude SIMON, Henri WAGNER, Marco ZWICK
Secretary	Annick ZIMMER

Committee Undertakings for Collective Investment

Chairman	Jean-Nicolas SCHAUS
Members	Jacques BOFFERDING, Freddy BRAUSCH, Simone DELCOURT, Jacques DELVAUX, Jacques ELVINGER, Rafik FISCHER, Jean-Michel GELHAY, Irmine GREISCHER, Joëlle HAUSER, Robert HOFFMANN, Rüdiger JUNG, Claude KREMER, Michel MALPAS, Julian PRESBER, Marc SALUZZI, Gilbert SCHINTGEN, Alex SCHMITT, Thomas SEALE, Claude SIMON, Camille THOMMES, Dominique VALSCHAERTS, Eric VAN DE KERKHOVE, Julien ZIMMER, Patrick ZURSTRASSEN
Secretary	Jean-Marc GOY

Committee Support PFS

Chairman	Jean-Nicolas SCHAUS
Members	Sonny BISDORFF-LETSCH, Jean-Marc FANDEL, Ulla FRANZ, David HAGEN, Gérard HOFFMANN, Renaud JAMAR DE BOLSEE, Patrick JOST, Charles MANDICA, Marcel ORIGER, Geneviève PESCATORE, Yves REDING, Gérard B. RIVOLLIER
Secretary	Claude BERNARD

Committee SICAR

Chairman	Jean-Nicolas SCHAUS
Members	Freddy BRAUSCH, Christiane CAMPILL, Simone DELCOURT, Jacques ELVINGER, Amaury EVRARD, Alain KINSCH, Claude KREMER, Charles MULLER, Arthur PHILIPPE, Mark TLUSZCZ
Secretary	Joëlle HERTGES

APPENDICES

APPENDICES

1. The CSSF in figures
2. The financial centre in figures
3. Contact telephone numbers

1. THE CSSF IN FIGURES

		Prudential supervision						IT matters		Matters of general interest			
	General supervision	Supervision of banks	Supervision of UCIs	Supervision of PFS	Supervision of securities markets	Supervision of pension funds, SICARs and securitisation undertakings	Administation and Finance	Information technology	IT audit	Management	Director General's Advisors	General Secretariat	TOTAL
Letters	536	2,086	19,672	1,047	1,673	345	1,148	260	62	97	225	2,470	29,621
Meetings	42	179	125	125*	48	47	32	70	127*		120*	6	781
On-site inspections	71	46	2	2	1								122
Internal committee meetings													
> Committee Anti-Money Laundering											2		2
> Committee Banks		1											1
> Committee Banking accounting	3												3
> Committee Compliance	2												2
> Committee UCIs			5										5
> Committee SICAR						3							3
> Committee Other professionals of the financial sector				3									3
> Committee Securities markets					4								4
> Committee Pension funds						1							1
> Committee Support PFS									1				1
> Committee Legal experts											20		20
> Consultative committee for prudential regulation												5	5
National meetings					19	2			16				37
International meetings	170	9	5	4	28	16		2	1	14		12	261
Meetings with homologous authorities	20*	33*	6										39
Speeches at conferences	2				3	1			2	6	11		25

* Joint meetings of the departments and functions concerned.

2. THE FINANCIAL CENTRE IN FIGURES

Situation as at 31 December 2005

BANKS

Number	155
Balance sheet total	EUR 792.422 billion
Net profit	EUR 3.548 billion
Employment	23,227 people

UNDERTAKINGS FOR COLLECTIVE INVESTMENT

Number	2,060
Number of units	8,497
Total assets	EUR 1,525.208 billion

MANAGEMENT COMPANIES

Number	72
Employment	1,572 people

PENSION FUNDS

Number	15

SICAR

Number	47
Balance sheet total	EUR 2,695.6 million

SECURITISATION UNDERTAKINGS

Number	6

PROFESSIONALS OF THE FINANCIAL SECTOR (PFS)

Number	185
Balance sheet total	EUR 51.981 billion
Net profit	EUR 433.944 million
Employment	6,547 people

Total employment in supervised entities	31,346 people

3. CONTACT TELEPHONE NUMBERS

Commission de Surveillance du Secteur Financier

Address	110, route d'Arlon, L-1150 Luxembourg	
Postal address	L-2991 Luxembourg	
Switchboard	26 25 1	- 1
Fax	26 25 1	- 601 (executive board)
		- 603 (general supervision / banks)
		- 604 (pension funds, SICARs and securitisation undertakings)
		- 605 (UCI)
		- 606 (securities markets)
		- 607 (PFS)
		- 608 (administration / IT)

The full directory of the CSSF is available on the website www.cssf.lu under the heading "Contact"