

**In case of discrepancies between the French and the English texts, the  
French text shall prevail**

Luxembourg, 2 August 2000

To all credit institutions and other  
professionals of the financial  
sector

**CIRCULAR CSSF 2000/15  
as amended by CIRCULAR CSSF 05/177**

**Subject: Rules of Conduct in the financial sector**

Dear Sir, Madam,

The main purpose of this Circular is to specify the principles laid down in Article 37 of the Law of 5 April 1993 on the financial sector as amended. For each principle prescribed by Law, the Circular establishes precise rules of conduct adapted to the real business practice in the financial sector.

The compliance with these rules is supervised by the Commission de Surveillance du Secteur Financier (the “Commission”).

Each professional of the financial sector (the “professional”) is to take the appropriate measures so as to implement these rules of conduct as set forth below. The practical application modes of these rules depend on the envisaged type of operation, product or service, means of distribution, the market type as well as the nature and the volume of the professional’s activities and organisation.

This Circular is in line with the principles established by the European Investment Services Directive and with initiatives on rules of conduct currently under way in other international forums.

Without prejudice to the applicability of the rules of conduct stipulated in article 37 of the Law of 5 April 1993 on the financial sector as amended, the professionals are to set up procedures within six months in order to comply with this Circular and shall inform the Commission thereof in a detailed manner.

The rules of conduct mentioned below do not affect those rules of conduct the professionals may have imposed upon themselves within the scope of their professional organisations or the markets they are working in.

## **I. Scope**

The Circular applies to all professionals authorised in Luxembourg and subject to the supervision of the Commission, as well as to the activities carried out in Luxembourg by professionals established in other Community Member States. It also applies to the free provision of services by foreign professionals active in Luxembourg. The professionals whose registered office is located in a state signatory of the Agreement on the European Economic Area are to be given, within the limits defined by the Agreement and by relevant acts, the same status as professionals originating from the European Community.

The rules of conduct shall also be incorporated in the systems of branches and subsidiaries established by Luxembourg professionals abroad. In addition, these establishments must observe the standards of their host country. If there are provisions in this host country that prevent the professional from complying with the Luxembourg standards, the Luxembourg professional is to inform the Commission thereof so as to find a solution to this conflict.

The rules of conduct mentioned below apply when intermediaries intervene between the client and the professional. If the intermediary is a professional himself, the rules of conduct apply while considering the specific role of the intermediary.

As regards the persons to whom the professional provides a service, the rules of conduct apply while taking into account the professional status of these persons, in accordance with the criteria and procedures established by FESCO (Forum of European Securities Commission) in March 2000 and appended to this Circular. Pursuant to Article 37 (2) of the Law of 5 April 1993 as amended, the professionals apply the rules of conduct by distinguishing between professional clients and those treated as professionals upon request (see Annex).

## **II. Responsibility of the management**

The executive management of the professional designates one of its members to be in charge of implementing the policy and rules it has established in this context and who oversees the compliance with the rules of conduct. This member can be the same as the one designated in accordance with IML Circulars 93/101 and 93/102. The professionals are to notify the identity of this person to the Commission by 31 December 2000 and, subsequently, any changes as they arise.

The executive management is in charge of communicating this procedure and any change thereof to the personnel concerned.

It will regularly organise internal audits so as to verify the compliance with the rules of conduct in accordance with IML Circular 98/143 relating to internal audit.

## **III. Control by the external auditor**

As regards credit institutions, the analytical report to be drawn up by the external auditor according to IML Circular 89/60 must contain an assessment of the established rules in accordance with this Circular and the compliance herewith. The report must also mention the identity of the member of the executive management in charge of this area and her/his subsequent replacement.

As far as other professionals are concerned, the external auditor shall establish a report within the context of his annual audit containing an assessment of the established rules in accordance with this Circular and the compliance herewith. The report must also mention the identity of the member of the management in charge of this area and her/his subsequent replacement.

## **IV. Rules of conduct**

### **1. The professional shall act honestly and fairly in conducting his business activities in the best interests of his clients and the integrity of the market**

1.1. The professional shall effect the transactions of his clients based on clear and precise contractual provisions.

- 1.2. The professional shall do his utmost to ensure that the orders received and accepted are executed in the best possible way, considering for instance the type of requests, the situation in the concerned market(s) and the object of the orders received.
- 1.3. The professional shall ensure that the orders received and accepted are effected within a reasonable timeframe while following the chronological order of reception of these orders. The execution of an order may be delayed if the professional considers the delay to be in the best interest of the originator of the order; the professional shall inform the client as soon as possible should the latter have fixed a specific execution date.
- 1.4. As regards the discretionary portfolio management, the professional shall refrain from initiating transactions for his clients' account that are unnecessary or against the interest of his clients. Neither shall he effect transactions that, given their frequency and volume, must be considered as solely in his own interest. The professional shall therefore refrain from moving his clients' portfolios in an excessive and economically unjustified manner with the sole aim of increasing his commissions.
- 1.5. Should the professional forward an order to another professional on behalf of a client and be remunerated by a retrocession of commission from the establishment to which the order has been forwarded, the professional shall inform the client thereof as from the start of their business relationship, or at the latest upon receipt of such an order.
- 1.6. The professional shall identify at the time of their execution those transactions effected for the account of his clients and those executed for his own account. When the professional places a block order for the account of several parties, he shall prior to his commitment define the rules of allocation.
- 1.7. The professional shall refrain from any act liable to impair the market transparency and the proper operation of market activities. At no time shall he manipulate the market, alone or in concert with others, to his advantage or to the advantage of a third party, by means of any single or a series of acts, silences, spreading of false information or rumours, through misleading practices or any other means, without prejudice to the professionals' right to intervene in order to ensure the success of securities issues or to stabilise a market price.

1.8. When a professional is to execute a client's order liable to influence a market price, he shall not, directly or indirectly, intervene in the market before executing the order with the aim of benefiting from this intervention. The professional shall ensure that his employees also abide by this rule.

**2. The professional shall act with due skill, care and diligence in the best interests of his clients and the integrity of the market**

2.1. The professional shall manage his clients' accounts and assets in such a way as to ensure they are at all times clearly separated from his own accounts and assets.

2.2. The professional shall act with due diligence as regards the services he provides and shall execute transactions in accordance with the specific rules and practices of each market.

2.3. In order to ensure optimal discretionary management of portfolios, the professional shall monitor the performance of the client's portfolio according to its inherent nature of risks.

2.4. Unless assisted by an expert, the professional shall refrain from executing a specific transaction for which he considers his information or knowledge insufficient to guarantee adequate client service.

2.5. When a client lodges a complaint with the professional regarding a service provided by him, the professional shall handle this complaint in an appropriate manner and within a reasonable lapse of time commensurate with the nature of the problem, in accordance with IML Circular 95/118.

**3. The professional shall have and employ effectively the resources and procedures necessary for the proper performance of his business activities.**

3.1. The professional shall have at his disposal adequate resources and capabilities of analysis. He shall in particular employ at every level of responsibility a sufficient number of qualified staff, possess sufficient technical resources, an adequate internal organisation as well as an appropriate separation of duties for the proper performance of his

business activities. He shall set up systems ensuring an adequate security with regard to the powers delegated to the portfolio managers in the context of their dealings with clients.

- 3.2. The professional shall be able at all times to produce detailed documentation concerning individual transactions. With regard to the discretionary portfolio management, he shall at all times be able to produce detailed information on the origin, transmission and execution of orders, as well as the composition of the portfolio.
- 3.3. When a professional executes leveraged transactions, he must have adequate resources at his disposal, in particular to be able to monitor the positions.
- 3.4. The professional shall ensure that the client is not dependent on the employee in charge of his affairs and particularly that the client relationship does not become the sole responsibility of a single employee.

**4. The professional shall seek from his clients information regarding their financial situation, investment experience and their objectives as regards the services requested.**

- 4.1. When entering a business relationship, the professional shall obtain from the client information concerning his identity, domicile or registered office, legal status, legal capacity and any restrictions due to his functions.
- 4.2. In order to provide an adequate service to the client considering his situation, the professional shall obtain from the client any useful information regarding his financial situation, investment objectives (short/long-term investments, regular income requirement or none, risk profile), and his investment experience and expertise.
- 4.3. The professional shall assess the client's expertise as regards the envisaged transactions and his knowledge of the inherent risk.
- 4.4. The professional shall update the aforementioned information on a regular basis.

**5. The Professional shall make adequate disclosure of relevant material information in his dealings with his clients.**

- 5.1. This obligation aims at protecting non-professional clients as defined in this Circular, enabling them to take a considered and informed investment decision.
- 5.2. Upon entering a business relationship, the professional shall inform the client of the following: identity, address of his registered office, legal status, activities, as well as the expenses chargeable to the client, the identity of the prudential supervisory authority which controls his activities, and the information stipulated in Article 37bis of the Law of 5 April 1993 as amended.
- 5.3. If the service provided consists in portfolio management, the contract between parties shall at least mention the objective, the categories of securities and instruments the portfolio may contain, the modes of communicating investment developments to the client, the duration of the contract, the terms of renewal and termination as well as the basis on which the professional will be remunerated. If the professional delegates the management of the portfolio to another professional, this must be mentioned in the contract, together with the identity of the other professional to whom the management is delegated.
- 5.4. The professional shall inform the client about the available products and services and the inherent risks. The professional shall warn the client that he can make losses and that previous good results are no guarantee for future results.
- 5.5. If the client wishes to invest in products which may imply high risks, such as derivatives or other leveraged instruments, the professional shall find out the client's objectives and provide him, where applicable and prior to the execution of the transactions, with any information useful to the understanding of the envisaged transaction. The professional shall inform the client of the risks inherent in the transactions by obtaining his signature on a written warning notice. The same shall apply when, during their business relationship, the client plans to invest in financial instruments, that by their nature, type or amounts concerned, lie outside the scope of the usual transactions. The professional shall inform the client that he can be liable, where applicable, for margin calls and the closure of any open positions.
- 5.6. All information provided to the client must be clear, truthful, accurate, complete and formulated comprehensibly, in an adequate form and reflecting the assessment the professional made of the knowledge and the experience of his client.

- 5.7. The professional shall in any cases inform the client of the capacity (counterparty or representative) in which he intervened.
- 5.8. The professional shall be able upon simple request to provide the client with complete and clear information regarding the commitments taken on behalf of the client.
- 5.9. The professional shall provide the client with any confirmations and other information relating to the transactions effected and the situation of the portfolio within reasonable timeframe and at reasonable intervals according to the nature of the investments.
- 5.10. In the event of a significant loss arising from investments made for the account of the client within the scope of the discretionary management of his portfolio, the professional shall inform the client without delay on the status of his portfolio. When a client signed a “hold mail” agreement with the professional, the latter shall provide for a contact address in the event of a major loss incurred in the context of a discretionary portfolio management.
- 5.11. The professional shall at no time engage in misleading advertising of the services offered by him. Where applicable, he shall mention the specific inherent risks of these services and draw the clients’ attention to their personal liability. [...]\*

**6. The professional shall try to avoid conflicts of interests and, when they cannot be avoided, ensure that his clients are treated fairly**

- 6.1. The professional shall adopt the necessary internal measures and procedures so as to prevent conflicts of interest. He must therefore specifically ensure that business functions and activities liable to entail conflicts of interest are strictly separated so as to avoid any unnecessary flow of information that could give rise to conflicts of interest.
- 6.2. The professional shall also set up procedures to prevent the members of his staff from accepting or soliciting benefits of any kind which, considering his business activities, are liable to give rise to conflicts of interest with respect to the professional’s obligations towards his clients. The professional shall therefore take the necessary steps so that receiving and offering gifts and benefits, of whatever form, by the members of staff in the course of their business activities is kept to a minimum. Gifts and benefits to members of staff the value of which

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\* As amended by Circular CSSF 05/177.

exceed a reasonable limit set by the professional must be reported to the latter.

- 6.3. The professional shall ensure that he does not, in the scope of his business relationships, unfairly place his own interests ahead of those of his client.
- 6.4. The professional shall not recommend the purchase or sale of a security to the client should this give rise to a conflict of interests, unless, according to the circumstances, he informs the client in due form about his own interest before executing the transaction or he takes measures ensuring that the client is treated fairly.
- 6.5. If the conflict of interests cannot be avoided, the professional shall take the necessary steps to avoid any personal gain arising out of this situation and any loss for his client or other parties with whom he has a business relationship. Depending on the circumstances, the professional shall refrain from intervening.

**7. The professional shall comply with all regulatory requirements governing the conduct of his business activities so as to promote the best interests of his clients and the market integrity**

- 7.1. In order to allow compliance with the laws and regulations, the professional shall ensure in particular that the members of his staff directly concerned are continuously kept up to date on applicable laws and regulations.
- 7.2. The professional shall comply with the rules governing the regulated markets on which he intervenes.
- 7.3. When the professional notices that one of his agents infringes or attempts to infringe the regulations, he shall immediately take the adequate steps according to the seriousness of the offence and where appropriate, inform the Commission.

**V. Rules governing specific competitive situations**

The professional shall refrain from luring away or attempting to lure away clients from a competitor using unfair means. He shall not seek to obtain and use confidential information on the clients of a competitor and at the disposal of a member of his staff previously employed by this competitor. He shall also make sure that his staff does not actively use this information for the same purpose.

The professional shall refrain from any such practice, notably if an account manager changes the employer, in which case and depending on the circumstances, the professional and the employee concerned might be held responsible in many aspects under criminal and civil law.

The Commission might challenge the professional reputation of persons referred to under Articles 7 and 19 of the Law of 5 April 1993 on the financial sector in case it becomes aware of such behaviour.

**VI. Repealing provision**

Circular 5/75 of the *Commisariat au Contrôle des Banques* is hereby repealed.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Charles KIEFFER  
Directeur

Jean-Nicolas SCHAUS  
Directeur Général

Annex

## ANNEX

### Extract from “Implementation of Article 11 of the ISD: Categorisation of Investors for the Purpose of Conduct of Business Rules” published by the Forum of European Securities Commissions (FESCO) in March 2000

#### **Criteria for defining professional investors**

9. Professional investors are those who may be deemed to possess the experience, knowledge and expertise to make their own investment decisions and properly assess the risks they incur.

#### **I. Categories of investors who are considered to be professionals**

10. The members of FESCO agree, subject to what is said below in §11, that the following should all be regarded as professionals in all investment services and instruments described in the Annex of the ISD.
- a) Entities which are required to be authorised or regulated to operate in the financial markets.

The list below should be understood as including all authorised entities carrying out the characteristic activities of the entities mentioned: entities authorised by a Member State under a European Directive, entities authorised or regulated by a Member State without reference to a European Directive, and entities authorised or regulated by a non-Member State:

- credit institutions<sup>1</sup>,
- investment firms<sup>2</sup>,
- other authorised or regulated financial institutions<sup>3</sup>,
- insurance companies<sup>4</sup>,

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<sup>1</sup> Within the meaning of the first indent of Article 1 of Directive 77/780: “*Credit Institution*” means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own accounts.

<sup>2</sup> Within the meaning of point 2 of article 1 of Directive 93/22: “*Investment firm*” shall mean any legal person the regular occupation or business of which is the provision of investment services for third parties on a professional basis. For the purpose of this Directive, Member States may include as investment firms undertakings which are not legal persons if:

- their legal status ensures a level of protection for third parties’ interests equivalent to that afforded by legal persons, and
- they are subject to equivalent prudential supervision appropriate to their legal form.

<sup>3</sup> Within the meaning of article 1 (6) of Directive 89/646/EEC.

<sup>4</sup> Within the meaning of article 1 of Directive 73/239/EEC or article 1 of Directive 79/267/EEC or undertaking carrying on reinsurance and retrocession activities referred to in Directive 64/225/EEC.

- collective investment schemes and management companies of such schemes,
  - pension funds and management companies of such funds.
- b) National governments, Central Banks, international and supranational institutions such as the World Banks, the IMF, the ECB, the EIB and other similar international organisations.
11. The entities mentioned in §10 are considered to be professionals. They must however be allowed to request non-professional treatment and investment firms may agree to provide a higher level of protection.

It is the responsibility of the client considered to be a professional investor to ask for a higher level of protection when it deems it is unable to properly assess or manage the risks involved.

This higher level of protection will be provided when an investor who is considered to be a professional enters into a written agreement with the investment firm to the effect that it shall not be treated as a professional for the purposes of the applicable conduct of business regime. Such agreement should specify whether this applies to one or more particular services or transactions, or to one or more types of product or transaction.

## **II. Investors who may be treated as professionals on request**

### **II.1 Identification criteria**

#### **a) Large and institutional investors**

12. The members of FESCO consider that the following investors will often not require the full protection of Conduct of Business Rules:
- a) financial institutions other than those mentioned in §10,
  - b) large companies and partnerships,
  - c) institutional investors other than those mentioned in §10 whose corporate purpose is to invest in financial instruments,
  - d) commodity dealers,
  - e) public sector bodies<sup>5</sup>,
  - f) issuers of listed financial instruments, i.e. entities whose securities (equity instruments or other) are traded on a regulated market<sup>6</sup>.

Investment firms should therefore be allowed to treat any of the above investors as professionals provided the relevant criteria and procedure mentioned below are

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<sup>5</sup> It should be noted that public sector bodies are subject to specific regulations that might prevent them from entering into certain types of transactions or opting for the professional conduct of business regime.

<sup>6</sup> Within the meaning of article 1.13 of the ISD.

fulfilled. These investors should not, however, be presumed to possess market knowledge and experience comparable to that of the authorised, regulated financial entities listed in §10.

13. The large companies and partnerships referred to in §12. b) may be allowed to waive some of the protections afforded by the conduct of business rules subject to meeting two of the following size requirements<sup>7</sup>:

- balance sheet total: EUR 12,500,000;
- net turnover: EUR 25,000,000;
- average number of employees during the financial year: 250.

**b) Other investors**

14. The members of FESCO consider that investors other than those mentioned in §10 and 12, including private individual investors, may also be allowed to waive some of the protections afforded by the conduct of business rules.

15. Any such waiver of the protection afforded by the standard conduct of business regime shall be considered valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the investment firm, gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved.

The fitness test applied to managers and directors of entities licensed under European Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge.

In the case of small entities, the person subject to the above assessment should be the person authorised to carry out transactions on behalf of the entity.

16. In the course of the above assessment, as a minimum, two of the following criteria should be satisfied:

- the investor has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
- the size of the investor's financial instrument portfolio, defined as including cash deposits and financial instruments<sup>8</sup> exceeds 0.5 million Euro;
- the investor works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

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<sup>7</sup> Criteria under article 27 of the Directive 78/660/EEC, on the Annual accounts of certain types of companies.

<sup>8</sup> Within the meaning of Section B of the Annex to the ISD.

## **II.2 Procedure**

17. The “large and institutional investors” defined above may waive some of the protections afforded by the conduct of business rules only after being informed in writing of the protections they will lose and stating in writing that they are aware of the consequences of losing such protections.
18. The “other investors” defined above may waive the benefit of the detailed rules of conduct only where the following procedure is followed:
  - a) they must state in writing to the investment firm they wish to be treated as a professional investor, either generally or in respect of a particular investment service or transaction, or type of transaction or product;
  - b) the investment firm must give them a clear written warning of the protections and investor compensation rights they may lose;
  - c) they must state in writing, in a separate document from the contract, that they are aware of the consequences of losing such protections.
19. Before deciding to accept any request for waiver, investment firms must be required to take all reasonable steps to ensure that the client requesting to be treated as a professional investor meets the relevant requirements stated in Section II.1 above.

However, if investors have already been categorised as professionals under parameters and procedures similar to those above, it is not intended that their relationships with investment firms should be affected by any new rules adopted pursuant to this paper.

20. Firms must implement appropriate written internal policies and procedures to categorise investors.

Professional investors are responsible for keeping the firm informed about any change that could affect their current categorisation. Should the investment firm become aware however that the investor no longer fulfils the initial conditions, which made him eligible for a professional treatment, the investment firm must take appropriate action.