COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER

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

Luxembourg, 22 December 2010

To all investment firms incorporated under Luxembourg law, to branches of non-EU investment firms and to management companies incorporated under Luxembourg law within the meaning of Chapter 13 of the law of 20 December 2002 relating to undertakings for collective investment

CIRCULAR CSSF 10/497

Re: Amendment of Circular CSSF 07/290, as amended, defining capital ratios pursuant to Article 56 of the amended Law of 5 April 1993 on the financial sector:

- **Transposition of Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies**

Ladies and Gentlemen,

Article 56 of the Law of 5 April 1993 on the financial sector, as amended, requires the CSSF to lay down structure coefficients to be observed by investment firms, pursuant, in particular, to the provisions of EU directives.

This circular transposes into Luxembourg regulations for investment firms, Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the

trading book and for re-securitisations, and the supervisory review of remuneration policies.

This transposition can be executed by means of an amendment of Circular CSSF 07/290, as amended by Circulars CSSF 10/451 and CSSF 10/483 (hereafter "Circular CSSF 07/290"), as set forth below.

Moreover, this circular introduces a few technical changes, which do not result from the aforementioned directive, to Circular CSSF 07/290, as amended.

The coordinated version of Circular CSSF 07/290 as amended by the provisions of this circular will be available on the CSSF website (www.cssf.lu) in the following weeks. References made in this coordinated version will be adapted in order to take account of the amendments brought by this circular.

As regards the scope of application of the provisions transposing the requirements relating to the remuneration policies, it should be noted that, pursuant to point 1 of Part II of Circular CSSF 07/290, the persons referred to in Article 1-1(2) of the Law of 5 April 1993 on the financial sector and investment firms which shall only be authorised to provide investment advice and/or to receive and transmit orders from investors without holding themselves funds or securities belonging to their clients are not subject to Circular CSSF 07/290. Pursuant to point 2 of Part II of Circular CSSF 07/290, Luxembourg-incorporated management companies within the meaning of Chapter 13 of the Law of 20 December 2002 as amended, which manage portfolios of investments, including those owned by pension funds, on a discretionary and client-by-client basis within the scope of a mandate given by investors, are subject to Circular CSSF 07/290, if these portfolios include one or several instruments listed in Section B of Annexe II of the Law of 5 April 1993 on the financial sector, as amended. However, Parts XVII and XVIII (including the provisions that transpose the requirements relating to the remuneration policies) of that circular do not apply to them. Nevertheless, the entities shall comply with the remuneration policy requirements laid down in Circular CSSF 10/437.

Moreover, it should be noted that for investment firms which are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annexe I of Directive 2004/39/EC (dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis), it may turn out to be disproportionate to comply with **all** the principles referred to in point (2) of Section 12 (i.e. points 4-1, 4-2 and 4-3 of Part XVII of Circular CSSF 07/290).

Section 11 of this circular, which relates to large exposures, shall enter into force on **31 December 2010**.

Points (1) and (7) of Section 1, point (2) of Section 2, points (3), (4), (6) and (7) of Section 6, Sections 12 and 13, point (8) of Section 14 and Sections 15 and 16 of this circular, which mainly relate to remuneration policies and the extension of some transitional provisions, shall enter into force **on 1 January 2011**.

Investment firms shall also apply the principles referred to in points 4-1, 4-2 and 4-3 of Part XVII of Circular CSSF 07/290:

i) to remunerations due based on contracts signed before 1 January 2011 and granted or paid beyond that date; and
ii) to the services provided in 2010, the remunerations granted but not yet paid before 1 January 2011.

The other points and sections of this circular shall enter into force on **31 December 2011**.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON Director	Andrée BILLON Director	Simone DELCOURT Director	Jean GUILL Director General

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Circular CSSF 07/290, as amended, defining capital ratios pursuant to Article 56 of the amended Law of 5 April 1993 on the financial sector shall be amended as follows:

Section 1. Amendment of the Introduction

The introduction shall be amended as follows:

(1) The second sub-paragraph of the introduction shall be amended as follows:

"This text transposes, with respect to investment firms, the following EU directives into Luxembourg regulations:

- Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investments firms and credit institutions;
- Commission Directive 2007/18/EC of 27 March 2007 amending Directive 2006/48/EC of the European Parliament and of the Council;
- Commission Directive 2009/27/EC of 7 April 2009 amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management;
- Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management; ~~and~~
- Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management; **and**
- **Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.**";

(2) The eighth sub-paragraph of the introduction shall be amended as follows:

"In particular, the purpose of this circular is to define:

- own funds of investment firms;
- procedures for reporting and limitation of large exposures of investment firms;
- capital requirements for credit risk and dilution risk associated with overall investment firm business, safe for trading book-related activities;
- **capital requirements for settlement risk associated with overall investment firm business;**
- capital requirements for operational risk associated with overall investment firm business;

- capital requirements for foreign exchange risk associated with overall investment firm business;
- capital requirements for commodity risk associated with overall investment firm business;
- capital requirements for risks associated with trading-book activities;
- a simplified/integrated ratio comparing own funds to the weighted amount of risks incurred.";

(3) The last sentence of the description of the third part shall be amended as follows:

"To this end, investment firms shall, where applicable, make valuation adjustments ~~or reserves~~.";

(4) The description of the tenth part shall be amended as follows:

"***Part X*** introduces a harmonised set of capital requirements for securitisation **and re-securitisation** activities that apply to the originators and sponsors of securitisation transactions (traditional and synthetic) as well as to investors in instruments such as Asset-Backed Securities (ABS) or Collateralized Debt Obligations (CDO). Similarly to Part VII (credit risk), the new framework on securitisation provides for a standardised and an IRB approach. In both cases, where a securitisation position is externally rated, this rating is used to determine the capital requirement. The new framework proposes alternative methods to calculate requirements for unrated positions, notably for exposures in the context of an Asset-Backed Commercial Paper (ABCP) programme, such as liquidity facilities. The treatment for the securitisation **and re-securitisation** positions provided for in the tenth part of this circular is subject to compliance with the significant risk transfer policy conditions.";

(5) The third sentence of the description of the eleventh part shall be amended as follows:

"This circular differs from the former Circular 2000/12 **in particular** in that it introduces ~~a~~ specific treatment**s** for investments in units/shares of undertakings for collective investment **as well as for securitisation positions**."

(6) The second sentence of the description of the fourteenth part shall be amended as follows and a new sentence shall be inserted after this sentence:

"Subject to the prior ~~consent~~ **authorisation** of the CSSF, investment firms may use this method instead of or in combination with the standardised approach ("**partial use**") in order to calculate capital requirements in respect of foreign exchange, position risk (interest rate, equities, undertakings for collective investment) or the risk linked to commodity price changes. **Investment firms using internal models to calculate capital requirements for market risks shall henceforth also calculate a "value-at-risk in a crisis situation" and, where applicable and concerning debt securities in the trading book, shall put in place an approach which allows them to take into account the incremental default and migration risks.**";

(7) The description of the seventeenth part shall be amended as follows:

"***Part XVII*** requires investment firms to set up an “internal capital adequacy assessment process”. This process should allow investment firms to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or could be exposed. This economic capital adequacy, which supplements the minimum capital requirement framework, shall be based on a sound internal governance and risk management system.

As regards the risk management, and in order to address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals, investment firms shall establish and maintain, for those categories of staff whose professional activities have a material impact on their risk profile, remuneration policies and practices that are consistent with effective risk management.

The internal process for internal capital assessment shall fit the nature, scale and complexity of investment firms’ activities. **When applying the principles relating to the remuneration policies and practices, investment firms shall also take into account their size and their internal organisation.**

This principle of proportionality means in particular that smaller-sized investment firms require less sophisticated **policies**, processes and **practices**.".

Section 2. Amendment of Part I: DEFINITIONS

Part I shall be amended as follows:

(1) Point 22-1 shall be added:

"**22-1. *re-securitisation*: means a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position;**";

(2) Point 41 shall be added:

"**41. *discretionary pension benefits*: means enhanced pension benefits granted on a discretionary basis by an investment firm to an employee as part of that employee’s variable remuneration package, which do not include accrued benefits granted to an employee under the terms of the pension scheme of is institution.**".

Section 3. Amendment of Part III: TRADING BOOK

Part III shall be amended as follows:

(1) The following box shall be inserted between Chapter 4 and Sub-chapter 4.1.:

Pursuant to point 17-1 of Part IV, the provisions relating to the careful assessment of this chapter shall also apply to all the instruments assessed at fair value, whether or not they belong to the trading book.

(2) Point 11 shall be amended as follows:

"11. For the purposes of this part the following definitions shall apply:

- Marking to market is the at least daily valuation of positions at readily available close out prices that are sourced independently. Examples include exchange prices, screen prices, or quotes from several independent reputable brokers.
- Marking to model is defined as any valuation which has to be benchmarked ("**benchmarking**"), extrapolated or otherwise calculated from a market input.

Without prejudice to point 14, investment firms shall mark their positions to market whenever possible.";

(3) Point a) of point 12 shall be amended as follows:

"(a) documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, **guidelines for the use of unobservable inputs reflecting the investment firm's assumptions of what market participants would use in pricing the position**, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;";

(4) Point 17 shall be amended as follows:

"17. Where marking to market is not possible, investment firms shall mark to model their positions/portfolios before applying trading book capital treatment.";

(5) Point a) of point 18 shall be amended as follows:

"(a) broad management shall be aware of the elements of the trading book **or the other elements** which are subject to mark to market (**mark-to-model**) and shall

understand the materiality of the uncertainty this created in the reporting of the risk/performance of the business;";

(6) The title of Sub-chapter 4.2 shall be amended as follows:

"**Sub-chapter 4.2. Valuation adjustments ~~or reserves~~**";

(7) A new Sub-section 4.2.1.1. shall be inserted before point 20:

"***Sub-section 4.2.1.1. Valuation adjustments***";

(8) Point 20 as well as the box that follows it shall be amended as follows:

"20. Investment firms shall establish and maintain procedures for considering valuation adjustments/~~reserves~~.

Please note that they are downward valuation adjustments ~~or reserves~~.

";

(9) A new Sub-section 4.2.1.2. shall be inserted after the box that follows point 20:

"***Sub-section 4.2.1.2. General standards***";

(10) Point 21 shall be amended as follows:

"21. The CSSF requires the following valuation adjustments ~~or reserves~~ shall be formally considered for the following elements: unearned credit spreads, close-out costs, operational risk, early termination, investing and funding costs, future administrative costs and, where relevant, model risk.";

(11) Point 23 shall be replaced by the following:

"**23. Investment firms shall establish and maintain procedures for calculating an adjustment to the current valuation of less liquid positions. Such adjustments shall, where necessary, be in addition to any changes to the value of the position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position. Under those procedures, investment firms shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. Those factors include the amount of time it would take to hedge out the position/risks within the position, the volatility and average of bid/offer spreads, the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress, market concentrations, the aging of positions, the extent to which valuation relies on marking to model, and the impact of other model risks.**";

(12) Point 24 shall be amended as follows:

"24. When using third party valuations or marking to model, investment firms shall consider whether to apply a valuation adjustment. **In addition, investment firms shall consider the need for establishing adjustments for less liquid positions and review their continued suitability, on an ongoing basis.**";

(13) Point 25 shall be replaced by the following:

"**25. With regard to complex products including, but not limited to, securitisation exposures and nth-to-default credit derivatives, investment firms shall explicitly assess the need for valuation adjustments to reflect the two following forms of model risks:**
i) that associated with using a possibly incorrect valuation methodology; and
ii) that associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.";

(14) Points 26 and 27 shall be repealed and the box which follows them shall be deleted.

Section 4. Amendment of Part IV: DEFINITION OF PRUDENTIAL OWN FUNDS

Part IV shall be amended as follows:

(1) Point 17-1 shall be added:

"**17-1. Investment firms shall apply the requirements of Chapter 4 of Part III to all their assets measured at fair value when calculating the amount of own funds. In addition to the elements referred to in point 17, investment firms shall deduct from of the total the elements referred to in point 16, the amount of any additional value adjustments necessary.**";

(2) Point 49 shall be amended as follows and a box shall be added:

"49. The exposure value of risk exposures under a securitisation subject to a 1,250% weighting pursuant to ~~Part X of this circular calculated in accordance with the relevant terms~~ **this circular and the exposure value of risk exposures under a securitisation in the trading book that would receive a 1,250 % weighting if they were in the same investment firm's non-trading book** shall be deducted from the prudential own funds pursuant to the terms laid down in point 50.";

This point shall henceforth apply to all securitisation exposures, whether or not they are in the non-trading book or in the trading book.

(3) Point 50 shall be amended as follows:

"50. The sum of the elements set forth in points 46 (notably interest in credit institutions and financial institutions), 47 (notably interest in insurance undertakings, reinsurance undertakings and insurance holding company), 48 (shortfall) and 49 (deduction of certain securitisation exposures) shall be deducted half from the sum of the elements of point 16, after deduction of the sum of the elements of point 17 (original own funds before deductions) and half from the sum of the elements under Sub-chapter 3.2. (additional own funds) by taking account of the limits laid down in point 43. Insofar as half of the sum of the elements under points 46, 47, 48, and 49 exceeds the sum of the elements under Sub-chapter 3.2., the excess shall be deducted from the sum of the elements of point 16, after deduction of the sum of the elements under point 17. The items in point 49 shall not be deducted if they have been included in the calculation of risk-weighted exposure amounts as specified **by this circular.**~~in Chapter 4 of Part X.~~".

Section 5. Amendment of Part V: RISK COVERAGE: GENERAL PRINCIPLES

Part V shall be amended as follows:

(1) Point 4, which defines the integrated ratio, shall be amended as follows:

"4. The denominator constitutes the overall capital requirement, calculated as the sum of:

- the capital requirement for credit risk and dilution risk associated with non-trading-book business, calculated in accordance with the method set out in the following parts:
  - Part VII - credit risk and dilution risk (including counterparty credit risk);
  - Part X - securitisation-related credit risk;
- the capital requirements for risks associated with the trading book:
  - ~~Part VIII – settlement risk;~~
  - Part VIII – counterparty credit risk;
  - Part XI – position risk (interest rate, equities, UCIs);
  - Part XVI – trading-book positions contributing to the excess of large exposure limits;
- **the capital requirement for settlement risk associated with overall investment firm business, calculated in accordance with the method set out in Part VIII;**
- the capital requirement for foreign exchange risk associated with overall investment firm business, calculated in accordance with the method set out in Part XII;
- the capital requirement for commodity risk associated with overall investment firm business, calculated in accordance with the method set out in Part XIII;
- the capital requirement for operational risk associated with overall investment firm business, calculated in accordance with the method set out in Part XV;
- where applicable, the capital requirements determined using the model-based approach described in Part XIV.

The calculation of the capital requirement for credit risk and dilution risk, including counterparty credit risk, as referred to above and in point 5, shall take account of the credit risk mitigation techniques referred to in Part IX of this circular.";

(2) Point a) of point 5 shall be amended as follows:

"a) on the one hand, the overall requirement corresponding to the sum of:

- the capital requirement for credit risk and dilution risk associated with non-trading-book business, calculated in accordance with the method set out in the following parts:
    - Part VII - credit risk and dilution risk (including counterparty credit risk);
    - Part X - securitisation-related credit risk;
- the capital requirements for risks associated with the trading book:
    - ~~Part VIII – settlement risk;~~
    - Part VIII – counterparty credit risk;
    - Part XI – position risk (interest rate, equities, UCIs);
    - Part XVI – trading book positions contributing to the excess of large exposure limit;
- **the capital requirement for settlement risk associated with overall investment firm business, calculated in accordance with the method set out in Part VIII;**
- the capital requirement for foreign exchange risk associated with overall investment firm business, calculated in accordance with the method set out in Part XII;
- the capital requirement for commodity risk associated with overall investment firm business, calculated in accordance with the method set out in Part XIII;
- where applicable, the capital requirements determined using the model-based approach described in Part XIV;";

(3) Point 8, which defines the simplified ratio, shall be amended as follows:

"8. By way of derogation from point 1, investment firms that fulfil the conditions set out in point 11 may calculate a simplified ratio. The simplified ratio differs from the integrated ratio defined in point 1 in that its denominator is calculated as the sum of:

- the capital requirement for credit risk and dilution risk associated with overall investment firm business, calculated in accordance with the method set out in the following parts:
    - Part VII - credit risk and dilution risk (including counterparty credit risk);
    - Part X - securitisation-related credit risk;
- **the capital requirement for settlement risk associated with overall investment firm business, calculated in accordance with the method set out in Part VIII;**
    - the capital requirement for foreign exchange risk associated with overall investment firm business, calculated in accordance with the method set out in Part XII;
    - the capital requirement for commodity risk associated with overall investment firm business, calculated in accordance with the method set out in Part XIII;
    - the capital requirement for operational risk associated with overall investment firm business, calculated in accordance with the method set out in Part XV;
    - where applicable, the capital requirements determined using the model-based approach described in Part XIV.

The calculation of the capital requirement for credit risk and dilution risk, including counterparty credit risk, as referred to above and in point 9, shall take account of the credit risk mitigation techniques referred to in Part IX of this circular.";

(4) Point a) of point 9 shall be amended as follows:

"a) on the one hand, the overall requirement corresponding to the sum of:

- the capital requirement for credit risk and dilution risk associated with overall investment firm business, calculated in accordance with the method set out in the following parts:
  - Part VII - credit risk and dilution risk (including counterparty credit risk);
  - Part X - securitisation-related credit risk;
- **the capital requirement for settlement risk associated with overall investment firm business, calculated in accordance with the method set out in Part VIII;**
- the capital requirement for foreign exchange risk associated with overall investment firm business, calculated in accordance with the method set out in Part XII;
- the capital requirement for commodity risk associated with overall investment firm business, calculated in accordance with the method set out in Part XIII;
- where applicable, the capital requirements determined using the model-based approach described in Part XIV;".

Section 6. Amendment of Part VII: MINIMUM CAPITAL REQUIREMENT FOR NON-TRADING BOOK CREDIT RISK

Part VII shall be amended as follows:

(1) Point 17 shall be amended as follows:

"17. Exposures to regional governments and local authorities which do not fall under point 16 are risk weighted as exposures to institutions, **subject to point 17-1**. The preferential treatment reserved to short-term exposures pursuant to point 29 does not apply however.";

(2) Point 17-1 shall be added:

"**17-1. Without prejudice to point 16, exposures to regional governments and local authorities of Member States denominated and funded in the domestic currency of that regional government and local authority shall be assigned a 20% weighting.**";

(3) Points d) and e) of point 57 shall be amended as follows:

"d) loans secured by residential real estate or shares in Finnish housing companies as referred to in the second indent of point 40, up to the lesser of the principal amount of the liens that are combined with any prior liens, and 80 % of the value of the pledged properties or by senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities governed by the laws of a Member State securitising residential real estate exposures. **In the event of such senior units being used as**

collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90% composed of residential mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80% of the value of the pledged properties, ~~provided~~ that the units qualify for the credit quality step 1 as set out in Annexe 1 of this circular where such units do not exceed ~~20~~**10**% of the nominal amount of the outstanding issue.
Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of loans secured by pledged properties of the senior units or debt securities shall not fall into the calculation of the 90% limit;

e) loans secured by commercial real estate or shares in Finnish housing companies as referred to in the second indent of point 44, up to the lesser of the principal amount of the liens that are combined with any prior liens, and 60% of the value of the pledged properties or by senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities governed by the laws of a Member State securitising commercial real estate exposures. **In the event of such senior units being used as collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90% composed of commercial real estate mortgages** that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60% of the value of the pledged properties, ~~provided~~ that the units qualify for the credit quality step 1 as set out in Annexe 1 of this circular and where such units do not exceed ~~20~~**10**% of the nominal amount of the outstanding issue.
~~The Loan-to Value ratio may exceed 60% up to a maximum level of 70%,~~ **Loans secured by commercial real estate may be recognised as eligible where the Loan-to-value ratio of 60 % is exceeded up to a maximum level of 70 %,** if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the **bond**~~security~~holders' claim meets the legal certainty requirements set out in Part IX of this circular. The bondholders' claim shall take priority over all other claims on the collateral.
Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of loans secured by pledged properties of the senior units or debt securities shall not fall into the calculation of the 90% limit;";

(4) Point 59 shall be amended as follows:

"59. Until 31 December 20~~10~~**13**, the ~~20~~**10**% limit for senior units issued by French *Fonds Communs de Créances* or by equivalent securitisation entities as specified in point 57(d) and (e) does not apply, provided that ~~those senior units have a credit assessment by a nominated ECAI which is the most favourable category of credit assessment made by the ECAI in respect of covered bonds. Until 31 December 2010, the figure of 60% indicated in point 57 (f) can be replaced with a figure of 70%.~~**:**
- the securitised residential or commercial real estate exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer

of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for covered bonds); and
- a member of the same consolidated group of which the issuer of the covered bonds is also a member or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated retains the whole first loss tranche supporting those senior units.";

(5) Point 96 shall be amended as follows:

"96. Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to ~~institutions and~~ corporates.";

(6) Point d) of point 169 shall be amended as follows:

"d) covered bonds as defined in points 57 to 60 of Chapter 2 may be assigned an LGD value of ~~12.5%~~ **11.25%**.
~~Until 31 December 2010, covered bonds as defined in points 57 to 60 of Chapter 2 may be assigned an LGD value of 11.25% if:~~

- ~~assets as set out in points 57(a) to (c) of Chapter 2 collateralising the bonds all qualify for credit quality grade 1 as set out in this Part;~~
- ~~where assets set out in points 57(d) and (e) of Chapter 2 are used as collateral, the respective upper limits laid down in each of those points is 10% of the nominal amount of the outstanding issue;~~
- ~~assets as set out in point 57(f) are not used as collateral; or~~
- ~~the covered bonds are the subject of a credit assessment by a nominated ECAI, and the ECAI places them in the most favourable category of credit assessment made by the ECAI in respect of covered bonds.~~";

(7) Point 176 shall be amended as follows:

"176. Until 31 December **2012**~~2010~~, the exposure weighted average LGD for all retail exposures secured by residential properties and not benefiting from guarantees from central governments shall not be lower than 10 % ("floor LGD for exposures secured by residential real estate")."

(8) Second sub-paragraph of point 207 shall be amended as follows:

"The risk-weighted exposure amounts at the equity portfolio level shall not be less than the total of the sums

i) of minimum risk-weighted exposure amounts required under the PD/LGD approach as set out in points 201 to 203; and
ii) and the corresponding expected loss amounts, calculated in accordance with point 214 and multiplied by 12.5;

both being calculated on the basis of the PD values referred to in point 168(a), i.e. 0.09% and the corresponding LGD values referred to in points 177 and 178, i.e. 65% or 90%, depending on whether the exposures are private equity exposures in sufficiently diversified portfolios or other equity exposures, respectively ("individual floor for the weighting of equity exposures according to the internal models approach").";

(9) The following text shall be added at the end of point 218:

"**Investment firms calculating risk-weighted assets according to the IRB approach in accordance with this chapter for the risks described in Part VIII of this circular shall also comply with the provisions of point 13 and, where appropriate, of the second sub-paragraph of point 6 of said Part VIII for the treatment of the expected loss amounts on the risks described in said Part VIII.**".

Section 7. Amendment of Part VIII: CALCULATING CAPITAL REQUIREMENTS FOR SETTLEMENT AND COUNTERPARTY CREDIT RISK ASSOCIATED WITH TRADING BOOK BUSINESS

Part VIII shall be amended as follows:

(1) The title of Part VIII shall be amended as follows:

"PART VIII: CALCULATING CAPITAL REQUIREMENTS FOR SETTLEMENT RISK **ASSOCIATED WITH OVERALL BUSINESS** AND COUNTERPARTY CREDIT RISK ASSOCIATED WITH TRADING BOOK BUSINESS.";

(2) The title of Chapter 1 shall be amended as follows:

“Chapter 1: Settlement/delivery risk **associated with overall business**";

(3) Point 0 shall be added before point 1:

"**0. The provisions of this chapter shall apply to overall investment firm business**";

(4) The first sub-paragraph of point 1 shall be amended as follows:

"1. Investment firms shall use the method described below for the calculation of capital requirements for settlement/delivery risk associated with transactions unsettled after their due delivery dates that relate to securities, foreign currencies or commodities~~ included in the trading book~~.";

(5) The box that follows the first sub-paragraph of point 1 shall be deleted;

(6) Point 1-1 shall be added before point 2:

"**1-1. The provisions of this chapter shall apply to overall investment firm business**";

(7) The box that follows the first sub-paragraph of point 2 shall be deleted;

(8) Point 3-1 shall be added before point 4:

"**3-1. The provisions of this chapter shall apply to overall investment firm business**";

(9) The title of Chapter 4 shall be amended as follows:

"**Chapter 4: Counterparty credit risk (CCR) associated with trading book**";

(10) The second sub-paragraph of point 6 shall be amended as follows:

"Subject to the approval of the CSSF, if the counterparty credit risk is adequately taken into account in the valuation of a position included in the trading book, investment firms that calculate the risk-weighted asset amounts according to the IRB approach may consider the expected loss amount for the counterparty risk exposure to be zero **in accordance with this part**.";

(11) The fourth sub-paragraph of point 8 shall be amended as follows:

"However, in the case of a credit default swap, an investment firm the exposure of which arising from the swap represents a long position in the underlying ("protection seller") shall be permitted to use a figure of 0 % for potential future credit exposure, unless the credit default swap is subject to close-out upon the insolvency of the entity the exposure of which arising from the swap represents a short position in the underlying ("protection buyer"), even though the underlying has not defaulted, **in which case the figure for potential future credit exposure of the investment firm shall be limited to the amount of the premia which are not yet paid by the entity to the investment firm**.";

(12) A Chapter 5 shall be added at the end of Part VIII:

"**Chapter 5: Specific provisions**

"**13. Where an investment firm calculates the risk-weighted asset amounts for the purposes of this part according to the IRB approach, as described in Part VII of Chapter 3, the treatment of expected loss amounts as provided for in point 218 of Part VII shall be as follows: the value adjustments made to take account of the credit quality of the counterparty may be included in the sum of value adjustments and provisions made for the exposures indicated in this part.**".

Section 8. Amendment of Part X: COVERAGE OF SECURITISATION CREDIT RISK

Part X shall be amended as follows:

(1) The following sub-paragraph shall be inserted before the box of point 1:

"**For the purposes of this part, the term "re-securitisation positions" shall mean all exposures to a re-securitisation.**";

(2) The first sub-paragraph of point 8 shall be amended as follows:

"8. A **sponsor** investment firm **or an originator investment firm which in respect of a securitisation has made use of points 3 and 4 when calculating the risk-weighted asset amounts, or has sold instruments from its trading book to a securitisation special purpose entity to the effect that it is no longer required to hold own funds for the risks of those instruments,** ~~or sponsor~~ shall not provide support to a securitisation beyond its contractual obligations with a view to reducing potential or actual losses to investors,.";

(3) Point c) shall be added to point 16 and shall read as follows:

"**c) The credit assessment shall not be based or partly based on unfunded support provided by the investment firm itself. In this case, the investment firm shall consider the relevant position as if it were not rated and shall apply the relevant treatment of unrated positions as set out in Sub-chapters 4.3. and 4.4. of this part.**";

(4) Point 34 shall be amended as follows:

"34. Where an investment firm has two or more overlapping positions in a securitisation, it shall include in its calculation of risk-weighted asset amounts to the extent that they overlap only the position or portion of a position producing the higher risk-weighted exposure amount. **The investment firm may also take account of this overlap between specific risk capital requirements for positions in the trading book and capital requirements in the non-trading book, provided that they are able to calculate and compare the capital requirements for the relevant positions. For the purpose of this point,** ~~In this respect,~~ "overlapping" occurs when the positions, wholly or partially, represent an exposure to the same risk such that to the extent of the overlap there is a single exposure.

Suppose, for example, a securitisation of underlying exposures of a total amount of 100. An investment firm has granted liquidity facilities for a total amount of 100 and, moreover, has retained a first-loss tranche of 10. In this case, investment firms only take into account 90 for the liquidity facilities and 10 for the first-loss tranche (which is supposed to produce a higher risk-weighted asset amount).

Where point 16(c) applies to the positions of an ABCP programme, the investment firm may, subject to prior CSSF approval, use the risk weight assigned to a liquidity facility in order to calculate the risk-weighted exposure amount for the commercial paper if the commercial paper of an ABCP programme and the liquidity facility form overlapping positions, 100 % of the ABCP issued by the programme is covered by liquidity facilities.";

(5) Point 40 shall be amended as follows:

"40. Subject to point 42, the risk-weighted asset amount of a rated securitisation or **re-securitisation** position shall be calculated by assigning to the exposure value the associated risk weight, associated as set out in table~~s~~ 1 ~~and 2~~ below, to the credit quality step to which the CSSF has decided to associate credit assessment under Chapter 3 and Annexe 1.";

(6) Table 2 after point 40 shall be repealed and its content shall be included in table 1. A line on re-securitisation positions shall moreover be added to table 1. Table 1 shall now be as follows:

Table 1

~~Positions other than ones with short-term assessments~~

Credit Quality Step	1	2	3	4 **(only for credit assessments other than short term)**	~~5 and beyond~~ **All other credit quality steps**
Weighting of **securitisation positions**	20%	50%.	100%	350%	1,250%
Weighting of re-securitisation positions	**40%**	**100%**	**225%**	**650%**	**1,250%**

(7) Point 72 shall be amended as follows:

"72. Under the ratings based method, the risk-weighted asset amount of a rated securitisation or **re-securitisation** position shall be calculated by assigning the associated risk weight to the exposure value, as set out in table~~s~~ 4 ~~and 5~~ below, to the credit quality step to which the CSSF has decided to associate credit assessment under Chapter 3 and Annexe 1, times 1.06fn.[1]";

(8) Table 5 after point 72 shall be repealed and its content shall be included in table 4. Two columns on re-securitisation positions shall moreover be added to table 4. Table 4 is now as follows:

Table 4

~~Positions other than ones with short-term assessments~~

Credit Quality Step		Weighting of **securitisation positions**			**Weighting of re-securitisation positions**	
Credit assessments other than short term	**Short term credit assessments**	A (“senior”)	B (“base risk weights”)	C (“non-granular”)	**D**	**E**
1	1	7 %	12 %	20 %	**20 %**	**30 %**
2		8 %	15 %	25 %	**25 %**	**40 %**
3		10 %	18 %	35 %	**35 %**	**50 %**

[1] The multiplication by 1.06 shall not apply to securitisation positions in respect of which a 1,250%-weight is applied. In accordance with Sub-chapter 3.6 of Part IV, these positions may alternatively be deducted from own funds.

4	2	12 %	20 %		**40 %**	**65 %**
5		20 %	35 %		**60 %**	**100 %**
6		35 %	50 %		**100 %**	**150 %**
7	3.	60 %	75 %		**150 %**	**225 %**
8		100 %			**200 %**	**350 %**
9		250 %			**300 %**	**500 %**
10		425 %			**500 %**	**650 %**
11		650 %			**750 %**	**850 %**
~~Over 11~~ **All other and unrated**		1,250 %				

(9) Point 73 shall be amended as follows:

"73. **Weightings in column C of each table shall be applied where the securitisation position is not a re-securitisation position and where the effective number of securitised exposures is less than six. For the remainder of the securitisation positions that are not re-securitisation positions, the weightings in column B shall be applied unless the position is in the most senior tranche of a securitisation, in which case the weightings in column A shall be applied. For re-securitisation positions, the weightings in column E shall be applied unless the re-securitisation position is in the most senior tranche of the re-securitisation and none of the underlying exposures were themselves a re-securitisation position, in which case column D shall be applied.**

The weightings of column D may thus be applied when:

- **it is a senior tranche, and**
- **the pool of underlying exposures does not include re-securitisation.**

When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fee, and other similar payments due.";

(10) The box after point 73 shall be amended as follows.

A securitisation position **which is not a re-securitisation position** is treated as the most senior, if it is backed or guaranteed by a senior debt based on the total underlying pool of securitised exposures.

(11) Point 75 shall be amended as follows:

"75. ~~The weightings in column C of each table shall be applied where the position is in a securitisation where the effective number of exposures securitised is less than six.~~ In calculating the effective number of exposures, securitised multiple exposures to one obligor shall be treated as one exposure. The effective number of exposures is calculated as:

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the sum of the exposure values of all exposures to the ith obligor. ~~In the case of re-securitisation (securitisation of securitisation exposures), the investment firm must take account of the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem.~~

If the portfolio share associated with the largest exposure, C_1, is available, the investment firm may compute N as $1/C_1$.";

(12) Point 76 shall be repealed;

(13) Point 82 shall be amended as follows:

"82. Subject to points 87 and 88, under the Supervisory Formula Method, the risk weight for a securitisation position shall ~~be the greater of the following percentages: 7% or the risk weight~~ determined by means of the ~~following~~ calculation **hereafter**. **However, this risk weight shall be no less than 7% for securitisation positions and 20% for re-securitisation positions.**

(...)

- N is the effective number of exposures calculated in accordance with point 75. **In case of re-securitisations, the investment firm shall look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem.**

- ELGD, the exposure-weighted average LGD, shall be calculated as follows:

$$ELGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the ith obligor, where LGD is determined in accordance with the provisions of Chapter 3 of Part VII. In the case of **re-securitisation**, an LGD of 100 % shall be applied to the securitised positions. When default and dilution risk for purchased receivables are treated in an aggregate manner within a securitisation (e.g. a single reserve or over-collateralisation is available to cover losses from either source), the ELGD shall be constructed as a weighted average of the LGD for credit risk and the 75 % LGD for dilution risk. The risk weights shall be the stand-alone capital charges for credit risk and dilution risk, respectively.

(...)".

Section 9. Amendment of Part XI: COVERAGE OF POSITION RISK ASSOCIATED WITH TRADING BOOK BUSINESS

Part XI shall be amended as follows:

(1) The following sub-paragraph shall be included before the box of point 22:

"**Notwithstanding the preceding sub-paragraph, the investment firm may choose to replace the notional amount with the notional amount less the fluctuations in the market value with respect to the credit derivate since the beginning of the transaction.**";

(2) The third sub-paragraph of point 22(v) shall be amended as follows:

"If a ~~first or second-asset to~~**nth-to-**default derivative is externally rated ~~and meets the conditions for a qualfiying debt item~~, then the protection seller ~~needs only~~ **shall** calculate one specific risk charge ~~reflecting~~ **by using** the rating of the derivative **and shall apply, where applicable, the risk weights to the securitisation positions**.";

(3) The first sub-paragraph of point 34 shall be amended as follows and a new sub-paragraph shall be inserted before table 1:

"34. Investment firms assign their net ~~short or long~~ positions **in the trading book which are not securitisation positions**, calculated in accordance with the methods set out in the previous sub-chapter, to the appropriate categories in table 1 below on the basis of their issuer/obligor, the external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in that table. They shall sum the~~ir~~ weighted (short or long) positions (~~in absolute value~~) **resulting from the application of this point** in order to calculate their capital requirement against specific risk. **They calculate their capital requirement against specific risk for positions that are securitisation positions in accordance with point 36-1.**

For the purposes of this point and points 34-1 and 36-1, an investment firm may cap the weight product and the net position at the maximum possible default-risk related loss. For a short position, that limit may be calculated as a change in value due to the underlying names becoming default risk-free.";

(4) Points 34-1, 34-2 and 34-3 shall be added after point 34 as follows:

"**34-1. By way of derogation of point 34, an investment firm may determine the larger of the following amounts as specific risk capital charge for the correlation trading portfolio:**

a) the total specific risk capital charges that would apply just to the net long positions of the correlation trading portfolio; and

b) the total specific risk capital charges that would apply just to the net short positions of the correlation trading portfolio.

34-2. The correlation trading portfolio shall consist of securitisation positions and nth-to-default credit derivatives that meet the following criteria:

a) the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche; and

b) all reference instruments are either single-name instruments, including single-name credit derivatives for which a liquid two-way market exists, or commonly-traded indices based on those reference entities. A two-way market is deemed to exist where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at such price within a relatively short time conforming to trade custom.

34-3. Positions which reference either of the following shall not be part of the correlation trading portfolio:

a) an underlying which may be assigned to:

- retail exposures as listed in Part VII, point 7(g);
- exposures secured by mortgages on residential property as listed in Part VII, point 7(h); and
- exposures secured by mortgages on commercial property as listed in Part VII, point 7(i);

non-trading book of an investment firm; or

b) a claim on a special purpose entity.

An investment firm may include in its correlation trading portfolio positions which are neither secritisation positions nor nth-to-default credit derivatives, but which hedge other positions of that portfolio, provided that a liquid two-way market as described in point 34-2(b) exists for the instrument or its underlyings.";

(5) Point 36-1 shall be added after point 36 as follows:

"36-1. For instruments in the trading book that are securitisation positions, the investment firm shall weight its net positions calculated according to the methods set out in the preceding sub-chapter as follows:

a) for securitisation positions that would be subject to the Standardised Approach for credit risk in the same investment firm's non-trading book, 8 % of the risk weight under the Standardised Approach as set out in Part X of Sub-chapter 4.3.;

b) for securitisation positions that would be subject to the Internal Ratings Based Approach in the same investment firm's non-trading book, 8 % of the

risk weight under the Internal Ratings Based Approach as set out in Part X of Sub-chapter 4.4.;

For the purposes of a) and b) of this point, the Supervisory Formula Method may be used only subject to CSSF approval by investment firms other than an originator investment firm that may apply it for the same securitisation position in its non-trading portfolio. Where relevant, estimates of PD and LGD as inputs to the Supervisory Formula Method shall be determined in accordance with Part VII, Chapter 3 or alternatively and subject to separate CSSF approval, based on estimates that are derived from an approach set out in Part XIV, point 9-1 as regards default and migration risks inherent in the trading book positions and that are in line with the quantitative standards for the Internal Ratings Based Approach.

The investment firm shall sum its weighted positions resulting from the application of this point (regardless of whether they are long or short) in order to calculate its capital requirement against specific risk.

By way of derogation from the aforementioned sub-paragraph, for a transitional period ending on 31 December 2013, the investment firm shall sum separately its weighted net long positions and its weighted net short positions. The larger of those sums shall constitute the specific risk capital requirement. However, the investment firm shall, however, report to the CSSF the total sum of its weighted net long and net short positions, broken down by types of underlying assets.";

(6) Point 93 shall be replaced by the following:

"**93. The investment firm shall sum all its net long positions and all its net short positions in accordance with Sub-chapter 2.2. of this part. It shall multiply its overall gross position by 8% in order to calculate its capital requirement against specific risk.**";

(7) Point 94 shall be repealed.

Section 10. Amendment of Part XIV: APPROACH BASED ON THE INTERNAL MODELS OF INVESTMENT FIRMS

Part XIV shall be amended as follows:

(1) Point 1 shall be amended as follows:

"1. Subject to the prior ~~consent~~ **approval** of the CSSF, investment firms may use their own internal risk-management models instead of or in combination with the methods described in Parts XI to XIII, for the purpose of calculating their capital requirements for foreign exchange risk, commodity risk, **and/or** position risk. The use of an internal model-based approach is conditional upon compliance with the criteria set forth in this Part. **The express approval of**~~Explicit recognition by~~ **the CSSF**~~competent authorities~~ of the use of these models for the calculation of capital requirements purposes shall be required in each case.";

(2) A box is added after point 1:

Using models for the purposes of determining the capital requirements of this part is subject to a detailed examination and the express approval of the CSSF, or possibly together with the competent authorities concerned within the context of the permission procedure provided for in Article 129(2) of Directive 2006/48/EC and transposed by Article 51-6(b) of the Law of 5 April 1993 on the financial sector.

It should be noted that this part disregards this joint process as they refer to the sole approval issued by the CSSF. It is understood that, as regards a single request submitted to a competent authority for the consolidated supervision and including a Luxembourg investment firm, the CSSF shall analyse this single application file together with the other competent authorities.

Please also refer by analogy to Circular CSSF 06/260 on the implementation, validation and assessment of the internal ratings-based approach (IRB approach) and the Advanced Measurement Approaches (AMA) within the framework of the new capital adequacy rules for further details as regards the authorisation process.

(3) The following sentence shall be added at the end of the seventh indent of point 2:

"**Investment firms shall also carry out reverse stress tests.**";

(4) Point 3 shall be amended as follows:

"3. The calculation of **capital requirements for market risk through an internal** value-at-risk **(VaR) model** shall comply with the following minimum specifications:

- at least daily calculation of value-at-risk;
- a 99th percentile, one-tailed confidence interval;

- a 10-day equivalent holding period **(investment firms may use value-at-risk measures calculated for short holding periods extended up to ten days according, for example, to the "square root of time"; an investment firm which uses this approach shall justify its reasonableness on a regular basis to the satisfaction of the CSSF)**;
- an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility; and
- **monthly** ~~three monthly~~ data updates.";

(5) Points 3-1, 3-2 shall be inserted after point 3 as follows:

"**3-1. In addition, each investment firm shall calculate a "stressed value-at-risk (sVaR)" based on the 10-day, 99th percentile, one-tailed confidence interval value-at-risk measure of the current portfolio, with value-at-risk model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the investment firm's portfolio. The choice of such historical data shall be subject to CSSF approval and to annual review by the investment firm.**

Investment firms shall calculate the stressed value-at-risk at least weekly.

3-2. Each investment firm shall meet, on a daily basis, a capital requirement expressed as the sum of the amounts resulting from points a) and b) as regards the capital requirements for market risks through an internal value-at-risk (VaR) model, and an investment firm that uses its internal model to calculate the capital requirement for specific position risk shall meet a capital requirement expressed as the sum of points c), d) and e) as follows:

a) the higher of:

i) its previous day's value-at-risk number calculated in accordance with point 3 of this part (VaR_{t-1}); or

ii) an average of the daily value-at-risk measures in accordance with point 3 of this part on each of the preceding 60 business days (VaR_{avg}), multiplied by the multiplication factor (m_c) as specified in point 12 and 13 of this part;

b) the higher of:

i) its latest available stressed-value-at-risk number in accordance with point 3-1 of this part (VaR_{t-1}); or

ii) an average of the stressed value-at-risk numbers, in accordance with point 3-1 of this part in the manner and frequency, during the preceding 60 business days ($sVaR_{avg}$), multiplied by the multiplication factor (m_s) as specified in point 12 and 13 of this part;

c) a capital charge calculated in accordance with Part XI for the position risks of securitisation positions and nth-to-default credit derivatives in the trading book, with the exception of those incorporated in the capital charge in accordance with

point 9-12 of this part as regards the specific provisions relating to the correlation trading portfolio;

d) the higher of the investment firm's most recent and the investment firm's 12 weeks average measure of incremental default and migration risk in accordance with point 9-1 of this part; and

e) where applicable, the higher of the investment firm's most recent and its 12-week-average measure of all price risks in accordance with point 9-12 as regards the correlation trading portfolio.";

(6) The first sub-paragraph of point 5 shall be amended as follows:

"5. The internal model shall capture a sufficient number of risk factors, depending on the level of activity of the investment firm in the respective markets ~~and in particular the following factors:~~**. Where a risk factor is incorporated into the investment firm's pricing model but not into the risk-measurement model, the investment firm shall be able to justify such an omission to the satisfaction of the CSSF. In addition, the internal model shall capture nonlinearities for options and other products as well as correlation risk and basis risk. Where proxies for risk factors are used they shall show a good track record for the actual position held. In addition, the following shall apply for individual risk types:**";

(7) Second sub-paragraph of point 8 shall be amended as follows:

"The CSSF shall examine investment firms' capability to perform backtesting on both actual (dirty backtesting) and hypothetical (clean backtesting) changes in the portfolio's value. Backtesting on hypothetical changes in the portfolio's value is based on a comparison between the portfolio's end-of-day value and, assuming unchanged positions, its value at the end of the subsequent day. Investment firms are required to take appropriate measures to improve their backtesting programme if deemed deficient. ~~The CSSF may require~~ **I**nvestment firms **shall** ~~to~~ perform backtesting on ~~either~~ hypothetical (using changes in portfolio value that would occur were end-of-day positions to remain unchanged),~~or actual trading (excluding fees, commissions, and net interest income) outcomes, or both~~.";

(8) The title of Chapter 2 shall be amended and the title of the new Sub-chapter 2.1. shall be inserted before point 9 as follows:

"Chapter 2: Provisions relating to the treatment of specific risk and **incremental default and migration risks**";

"**Sub-chapter 2.1. Provisions relating to the treatment of specific risk**";

(9) Point 9 shall be amended as follows and a box shall be added:

"9. Subject to prior ~~approval~~ **authorisation** of the CSSF, investment firms may use their **own** internal model~~s~~ to calculate capital requirements for specific risk associated with traded debt and equity positions within the trading book, provided the model:

- explains the historical price variation in the portfolio;
- captures concentration in terms of volume and changes of composition of the portfolio;
- is robust to an adverse environment;
- is validated through backtesting aimed at assessing whether specific risk is being accurately captured~~.~~**;** ~~I~~**i**f investment firms perform this backtesting on the basis of relevant sub-portfolios, **duly authorised by the CSSF**, these shall be chosen in a consistent manner;
- it captures name-related basis risk, that is**, in particular,** investment firms shall demonstrate that the internal model is sensitive to material idiosyncratic differences between similar but not identical positions; **and**
- **takes account of** ~~captures~~ the event risk**.**~~;~~

~~and~~

- ~~complies furthermore with the conditions in the remainder of this Part.~~

~~The investment firm shall also meet the following conditions:~~

- ~~where an investment firm is subject to event risk that is not reflected in its value-at-risk measure, because it is beyond the 10-day holding period and 99% confidence interval (low probability and high severity events), the investment firm shall ensure that the impact of such events is factored in to its internal capital assessment~~;

- ~~the investment firms' internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.~~

~~Further, as techniques and best practices evolve, investment firms shall avail themselves of these advances.~~

~~In addition, the investment firm shall have an approach in place to capture, in the calculation of its capital requirements, the default risk of its trading book positions that is incremental to the default risk captured by the value-at-risk measure as specified in the previous requirements of this point. To avoid double counting, an investment firm may, when calculating its incremental default risk charge, take into account the extent to which default risk has already been incorporated into the value-at-risk measure, especially for risk positions that could and would be closed within 10 days in the event of adverse market conditions or other indications of deterioration in the credit environment.~~

~~Where an investment firm captures its incremental default risk through a surcharge, it shall have in place methodologies for validating the measure.~~

~~The investment firm shall demonstrate that its approach meets soundness standards comparable to the IRB approach for credit risk set out in Part VII of this circular, under the~~

~~assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality.~~

~~An investment firm that does not capture the incremental default risk through an internally developed approach shall calculate the surcharge through an approach consistent with either the standardised approach or the IRB approach set out in Part VII of this circular.~~

~~With respect to traditional or synthetic securitisation exposures that would be subject to a deduction treatment or risk-weighted at 1,250 % shall be subject to a capital requirement that is no less than that set out under those provisions. Investment firms that are dealers in these exposures may apply a different treatment where they can demonstrate to their competent authorities, in addition to trading intent, that a liquid two-way market exists for the securitisation exposures or, in the case of synthetic securitisations that rely solely on credit derivatives, for the securitisation exposures themselves or all their constituent risk components. For the purposes of this paragraph, a two-way market is deemed to exist where there are independent good faith offers to buy and sell so that a price reasonably related to the last sales price or current good faith competitive bid and offer quotations can be determined within one day and settled at such a price within a relatively short time conforming to trade custom. For an investment firm to apply a different treatment, it shall have sufficient market data to ensure that it fully captures the concentrated default risk of these exposures in its internal approach for measuring the incremental default risk in accordance with the provisions set out above.~~

The investment firm's internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

The investment firm may choose to exclude from the calculation of its specific risk capital requirement using an internal model those positions in securitisations as well as nth-to-default credit derivatives for which it meets a capital requirement for position risks according to Part XI, with the exception of the positions that are subject to the approach set out in point 9-12 of this part as regards the correlation trading portfolio.

As techniques and best practices evolve, investment firms shall avail themselves of these advances.

An investment firm shall not be required to capture default and migration risks for traded debt instruments in its internal value-at-risk model where it is capturing those risks through the requirements set out in points 9-1 to 9-12 of this part.";

To avoid double-counting, where an internal value-at-risk model captures incremental default and migration risks, the capital requirements which result therefrom are not to be covered given that they shall be covered in accordance with

Sub-chapter 2.2.

(10) A new sub-chapter shall be inserted after point 9:

"Sub-chapter 2.2. Provisions relating to the treatment of incremental default and migration risks inherent in the trading book positions

Section 2.2.1. General provisions

9-1. Investment firms subject to the provisions of point 9 of this part for debt instruments in the trading book shall have an approach in place to capture, in the calculation of their capital requirements, the default and migration risks (incremental risk (ICR)) of their trading book positions that are incremental to the risks captured by the value-at-risk measure as specified in point 9 of this part. An investment firm shall demonstrate that its approach meets soundness standards comparable to the IRB approach for credit risk set out in Part VII of Chapter 3, under the assumption of a constant level of risk, and adjusted, where appropriate, to reflect the impact of liquidity, concentrations, hedging and optionality.

Section 2.2.2. Scope

9-2. The approach to capture the incremental default and migration risks shall cover all positions subject to a capital charge for specific interest rate risk, excluding securitisation positions and nth-to-default credit derivatives. Subject to CSSF approval, the investment firm may choose to consistently include all listed equity positions and in derivative instruments based on listed equities for which such inclusion is consistent with how the investment firm internally measures and manages risk. This approach shall reflect the impact of correlations between default and migration events. It shall not reflect the impact of diversification between default and migration events on the one hand and other market risk factors on the other hand.

Section 2.2.3. Parameters

9-3. The approach to capture the incremental default and migration risks shall measure losses due to default and internal or external ratings migration at the 99.9% confidence interval over a capital horizon of one year.

Correlation assumptions shall be supported by analysis of objective data in a conceptually sound framework. The approach to capture the incremental risks shall appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions shall also be reflected.

The approach shall be based on the assumption of a constant level of risk over the one-year capital horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon

are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, an investment firm may chose to consistently use a one-year constant position assumption.

9-4. The liquidity horizons shall be set according to the time required to sell the position or to hedge all material relevant price risks in a stressed market, having particular regard to the size of the position. Liquidity horizons shall reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon shall be measured under conservative assumptions and shall be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.

The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of three months.

The determination of the appropriate liquidity horizon for a position or set of positions shall take into account an investment firm's internal policies relating to valuation adjustments and the management of stale positions. When an investment firm determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions shall be defined in a way that meaningfully reflects differences in liquidity. The liquidity horizons shall be greater for positions that are concentrated, reflecting the longer period needed to liquidate such positions. The liquidity horizon for a securitisation warehouse shall reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.

9-5. Hedges may be incorporated into an investment firm's approach to capture the incremental default and migration risks. Positions may be netted when long and short positions refer to the same financial instrument. Hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor, as well as long and short positions in different issuers, may only be recognised by explicitly modelling gross long and short positions in the different instruments. Investment firms shall reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. An investment firm shall reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.

For trading book positions that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised provided that the investment firm:

> **i) chooses to model rebalancing of the hedge consistently over the relevant set of trading book positions;**

ii) demonstrates that the inclusion of rebalancing results in a better risk measurement; and

iii) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for this rebalancing even during periods of stress. Any residual risks resulting from dynamic hedging strategies shall be reflected in the capital charge.

9-6. The approach to capture the incremental default and migration risks shall reflect the nonlinear impact of options, structured credit derivatives and other positions with material nonlinear behaviour with respect to price changes. The investment firm shall also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.

9-7. The approach to capture the incremental default and migration risks shall be based on data that are objective and up-to-date.

Section 2.2.4. Validation

9-8. As part of the independent review of their risk measurement system and the validation of their internal models as required in this part, investment firms shall, with a view to the approach to capture incremental default and migration risks, in particular:

i) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;

ii) perform a variety of stress tests, including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the approach, particularly with regard to the treatment of concentrations. Such tests shall not be limited to the range of events experienced historically; and

iii) apply appropriate quantitative validation including relevant internal modelling benchmarks.

The approach to capture the incremental risks shall be consistent with the investment firm's internal risk management methodologies for identifying, measuring, and managing trading risks.

Section 2.2.5. Documentation

9-9. An investment firm shall document its approach to capturing incremental default and migration risks so that its correlation and other modelling assumptions are transparent to the CSSF.

Section 2.2.6. Internal approaches based on different parameters

9-10. If the investment firm uses an approach to capturing incremental default and migration risks that does not comply with all requirements of this sub-chapter but

that is consistent with investment firms' internal methodologies for identifying, measuring, and managing risks, it shall be able to demonstrate that its approach results in a capital requirement that is at least as high as if it was based on an approach in full compliance with the requirements of this sub-chapter. The CSSF shall review compliance with the previous sentence at least annually.

For instance, investment firms applying conservative assumptions such as maximum correlations, liquidation horizons which are not less than one year is likely to benefit from the provisions of point 9-10.

Section 2.2.7. Frequency of calculation

9-11. An investment firm shall perform the calculations required under its chosen approach to capture the incremental default and migration risks at least weekly.";

(11) A new Sub-chapter 2.3 shall be inserted after point 9-11:

"Sub-chapter 2.3. Specific provisions on the correlation trading portfolio

9-12. The CSSF may recognise the use of an internal approach for calculating an additional capital charge instead of a capital charge for the correlation trading portfolio in accordance with point 34-1 of Part XI, provided that all conditions in this point are fulfilled.

Such an internal approach shall adequately capture all price risks at the 99.9 % confidence interval over a capital horizon of one year under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality. The investment firm may incorporate any positions in this approach that are jointly managed with positions of the correlation trading portfolio and may then exclude those positions from the approach required under point 9-1 of this part.

The amount of the capital charge for all price risks shall not be less than 8 % of the capital charge that would be calculated in accordance with point 34-1 of Part XI for all positions incorporated in the charge for all price risks.

In particular, the following risks shall be adequately captured:

a) the cumulative risk arising from multiple defaults, including the ordering of defaults, in tranched products;

b) credit spread risk, including the gamma and cross-gamma effects;

c) volatility of implied correlations, including the cross effect between spreads and correlations;

d) basis risk, including both:

i) the basis between the spread of an index and those of its constituent single names, and

ii) the basis between the implied correlation of an index and that of bespoke portfolios;

e) recovery rate volatility, as it relates to the propensity for recovery rates to affect tranche prices; and

f) to the extent the comprehensive risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing such hedges.

For the purpose of this point, an investment firm shall have sufficient market data to ensure that it fully captures the salient risks of those exposures in its internal approach in accordance with the standards set out in this point, demonstrates through backtesting or other appropriate means that its risk measures can appropriately explain the historical price variation of those products, and is able to separate the positions for which it holds approval in order to incorporate them in the capital charge in accordance with this point from those positions for which it does not hold such approval.

With regard to portfolios subject to this point, the investment firm shall regularly apply a set of specific, predetermined stress scenarios. Such stress scenarios shall examine the effects of stress to default rates, recovery rates, credit spreads, and correlations on the profit and loss of the correlation trading desk. The investment firm shall apply such stress scenarios at least weekly and report at least quarterly to the CSSF the results, including comparisons with the investment firm's capital charge in accordance with this point. Any instances where the stress tests indicate a material shortfall of this capital charge shall be reported to the CSSF in a timely manner. Based on those stress testing results, the CSSF shall consider a supplemental capital charge against the correlation trading portfolio as set out in Article 53 of the Law of 5 April 1993 on the financial sector.

An investment firm shall calculate the capital charge to capture all price risks at least on a weekly basis.";

(12) The title of a new sub-chapter shall be inserted after point 9-12:

"**Sub-chapter 2.4. Cases of investment firms using a partial approach for internal models**";

(13) Point 10 shall be amended as follows:

"10. Investment firms ~~using internal models which are not recognised in accordance with~~ **have not been authorised to use the internal model for the purpose of calculating capital requirements for specific risk in accordance with** point 9 **of this part are**

subject to ~~shall calculate~~ the capital requirement~~s~~ for specific risk in accordance with the methods set forth in Part XI.";

(14) Point 11 shall be repealed;

(15) Point 12 shall be replaced by the following:

"**12. For the purposes of point 3-2(a) and (b) of this part, the result of investment firms' own calculation shall be scaled up by the multiplication factors (m_c) and (m_s), respectively. These factors shall be at least three.**";

(16) The first sub-paragraph of point 13 shall be amended as follows:

"13. **For the purposes of point 3-2(a) and (b) of this part,** ~~T~~**t**he multiplication factor**s** **(m_c) and (m_s)** ~~is~~ shall be increased by an add-on factor of between 0 and 1 in accordance with the following table, depending on the number of overshoots for the most recent 250 business days as evidenced by the investment firm's backtesting **of the value-at-risk measure as set out in point 3 of this part**. Investment firms shall calculate overshoots consistently on the basis of backtesting ~~either~~on actual or hypothetical changes in the portfolio's value.";

(17) The third sub-paragraph of point 13 shall be amended as follows:

"For the purpose of determining the add-on factor, the number of overshoots shall be assessed at least quarterly **and shall be equal to the number of overshoots in case of hypothetical changes of the portfolio value or, if higher, the number of overshoots in case of actual changes of this value.**";

(18) Fourth sub-paragraph of point 13 shall be amended as follows:

"The CSSF may, in individual cases and in exceptional circumstances, waive the requirement to increase the multiplication factor**s** by the add-on factor according to the above table, if the investment firm has demonstrated to the CSSF's satisfaction that such an increase is unjustified and that the model is basically sound.";

(19) Point 14 shall be amended as follows:

"14. Until 31 December ~~2010~~**2011 or any earlier date specified by the CSSF on a case-by-case basis**, investment firms that have received specific risk model recognition prior to 1 January 2007 in accordance with point 1 of Part XIV may, for that existing recognition, consider points 4 and 8 of Part XIV of Circular CSSF 2000/12.".

Section 11. Amendment of Part XVI: LIMITATION AND MODALITIES TO CALCULATE LARGE EXPOSURES

Part XIV shall be amended as follows:

(1) Point m) of point 25 shall be amended as follows:

"(m) asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day and are not denominated in a major trading currency; such as the Euro (EUR), the American dollar (USD), **the pound sterling (GBP)** or the yen (JPY);".

Section 12. Amendment of Part XVII: INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

Part XVII shall be amended as follows:

(1) The text of the first sub-paragraph of point 3 shall be amended and two boxes shall be added as follows:

"Investment firms shall have robust internal governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures, **remuneration policies and practices that are consistent with and promote a sound and effective risk management as well as control and security arrangements for information processing systems.**";

The requirements and principles referred to in points 4-1, 4-2 and 4-3 of this part shall apply to the investment firms referred to in Articles 24-2 to 24-6, 24-7(3) and 24-9 of the Law of 5 April 1993 on the financial sector. It should be noted that investment firms which do not fall under point 1 of Part II of Circular CSSF 07/290, i.e. the persons referred to in Article 1-1(2) of the Law of 5 April 1993 on the financial sector and the investment firms which shall only be authorised to provide investment advice services and/or to receive and transmit orders from investors without holding money or securities belonging to their clients shall however fulfil the remuneration policy requirements laid down in Circular CSSF 10/437. The same shall apply to management companies, which pursuant to point 2 of Part II of Circular 07/290 either do not fall under Circular CSSF 07/290 or are exempted from the application of Part XVII and XVIII of said Circular CSSF 07/290.

Annexe 7 of this circular includes the CEBS guidelines for the conduct of sound remuneration policies as referred to in point 3 above. The relevant investment firms shall comply with these guidelines by establishing and implementing overall remuneration policies.

(2) The following text shall be added to points 4-1, 4-2, 4-3 and 4-4 after point 4:

"**4-1. When establishing and applying the overall remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including the broad management, risk takers, staff engaged in control functions and any employee**

receiving total remuneration that takes them into the same remuneration bracket as the broad management and risk takers, whose professional activities have a material impact on their risk profile, investment firms shall comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation as well as the nature, the scope and the complexity of their activities:

> **The application of the proportionality principle may lead to the neutralisation of some requirements. Besides, it should be noted that neutralisation is never automatic but the institution shall, at all times, be able to explain the rationale.**
>
> **For further details, please refer to Annexe 7 of this circular.**

a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the investment firm;

b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the investment firm, and incorporates measures aiming to avoid conflicts of interest;

c) the board of directors of the investment firm adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;

d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the board of directors;

e) employees engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;

f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee referred to in point 4-2 or, if such a committee has not been established, by the board of directors;

g) where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the investment firm and when assessing individual performance, financial and non-financial criteria are taken into account;

h) the assessment of the performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the investment firm and its business risks;

i) the total variable remuneration does not limit the ability of the investment firm to

strengthen its capital base;

j) guaranteed variable remuneration is exceptional and occurs only when hiring new employees and is limited to the first year of employment;

k) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component.
Investment firms shall set the appropriate ratios between the fixed and the variable component of the total remuneration;

l) payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure;

m) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required.
The allocation of the variable remuneration components within the investment firm shall also take into account all types of current and future risks;

n) a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of an appropriate balance of the following:
   i) shares or equivalent shares in capital, subject to the legal structure of the investment firm concerned or share-linked instruments or equivalent non-cash instruments, in case of a non-listed investment firm, and
   ii) where appropriate, other instruments within the meaning of point 43(d) (i) of Part IV, that adequately reflect the credit quality of the investment firm as a going concern.

   The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the investment firm.
   This point n) shall be applied to both the portion of the variable remuneration component deferred in accordance with point o) and the portion of the variable remuneration component not deferred;

o) a substantial portion, and in any event at least 40 %, of the variable remuneration component is deferred over a period which is not less than three to five years and is correctly aligned with the nature of the investment firm, its risks and the activities of the employee in question.
Remuneration payable under deferral arrangements shall vest no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount shall be deferred. The length of the deferral period shall be established in accordance with the business cycle, the nature of the business, its risks and the activities of the employee in question;

p) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the investment firm as a

whole, and justified according to the performance of the investment firm, the business unit and the individual concerned.
Without prejudice to the general principles of national contract and labour law, the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the investment firm occurs, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;

q) the investment firm has a pension policy in place which is in line with the business strategy, objectives, values and long-term interests of the investment firm.
If the employee leaves the investment firm before retirement, discretionary pension benefits shall be held by the investment firm for a period of five years in the form of instruments referred to in point n) of this point.
In case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in point n) of this point subject to a five-year retention period;

r) employees are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

s) variable remuneration is not paid through vehicles or methods that facilitate the non-compliance of the requirements of this point as well as point 4-3 of this part;

4-2. Investment firms that are significant in terms of their size, internal organisation and the nature, the scope and the complexity of their activities shall establish a remuneration committee. The remuneration committee shall be constituted in such a way as to enable it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.
The remuneration committee is responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the investment firm concerned and which are to be taken by the board of directors. The Chair and the members of the remuneration committee shall be members of the board of directors who do not perform any executive functions in the investment firm concerned. When preparing such decisions, the remuneration committee shall take into account the long-term interests of shareholders, investors and other stakeholders in the investment firm.

4-3. Investment firms that benefit from exceptional government intervention, beyond the principles referred to in point 4-1:
i) shall strictly limit variable remuneration as a percentage of net revenue where it is inconsistent with the maintenance of a sound capital base and timely exit from government support;
ii) shall, upon request by the CSSF, restructure remuneration in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of the members of the authorised management within the meaning of Article 19 of the Law of 5 April 1993 on the financial sector;
iii) shall pay no variable remuneration to the members of the authorised

management within the meaning of Article 19 of the Law of 5 April 1993 on the financial sector, unless justified.

4-4. Investment firms shall apply the principles referred to in points 4-1 and 4-3 at group, parent company and subsidiary levels, including those established in offshore financial centres.";

(3) A new Chapter 4 shall be added:

"**Chapter 4: Reporting of information as regards remuneration policies**

26. Within the context of prudential reporting, investment firms shall notify the CSSF, on an annual basis, of the number of individuals in pay brackets of at least EUR one million including the business area involved and the main elements of salary, bonus, long-term award and pension contribution.".

Section 13. Amendment of Part XVIII: SUPERVISORY REVIEW PROCESS

Part XVII shall be amended as follows:

(1) Point 6 shall be added:

"**6. As regards the supervisory review of remuneration policies:**

ii) the CSSF requires investment firms benefitting from exceptional government intervention to restructure remuneration in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of the members of the authorised management within the meaning of Article 19 of the Law of 5 April 1993 on the financial sector;

b) the CSSF may place restrictions on the types and designs of those instruments referred to in point 4-1(n) of Part XVII or prohibit certain instruments as appropriate.".

Section 14. Amendment of Part XIX: DISCLOSURE BY INVESTMENT FIRMS

Part XIX shall be amended as follows:

(1) The title shall be replaced by the following:

"**PART XIX: TECHNICAL CRITERIA ON TRANSPARENCY AND DISCLOSURE**";

(2) Point 5 shall be amended as follows:

"5. Investment firms shall adopt a formal policy to comply with the disclosure requirements laid down in this part, and have policies for assessing the appropriateness of their disclosures, including their verification and frequency. **Investment firms shall also have policies for assessing whether their disclosures convey their risk profile comprehensively to market participants.**

Where those disclosures do not convey the risk profile comprehensively to market participants, investment firms shall publicly disclose the information necessary in addition to that required in accordance with this part. However, they shall only be required to disclose information which is material and not proprietary or confidential in accordance with the technical criteria set out in this part.";

(3) The first sentence of point 21(c) shall be amended as follows:

"c) for investment firms calculating the risk-weighted asset amounts in accordance with the IRB approaches, 8 % of the **risk-weighted asset**~~risk-weighted exposure~~ amounts for each of the exposure classes specified in points 110 to 117 of Chapter 3 of Part VII.";

(4) Point 26(a) shall be amended as follows:

"e) for each of the **following** exposure classes: "**exposures to** central governments and central banks", "**exposures to** institutions", "**exposures to** corporates" and "equity **exposures**", and for a sufficient number of obligor grades, including defaulting obligors, the following information:

i) the total exposures (for the **following** exposure classes: "**exposures to** central governments and central banks", "**exposures to** institutions" and "**exposures to** corporates", the sum of outstanding loans and exposure values for undrawn commitments; for equities, the outstanding amount);
ii) for the investment firms using own LGD estimates for the calculation of risk-weighted asset amounts, the exposure-weighted average LGD (in percentage);
iii) the average risk weight of the risk-weighted asset amounts;
iv) for the investment firms using own estimates of conversion factors for the calculation of risk-weighted exposure amounts, the amount of undrawn commitments and exposure-weighted average exposure values for each exposure class;";

(5) Point 28 shall be amended as follows:

"28. Investment firms calculating their capital requirements for market risk for the trading portfolio and **for settlement risk**, for foreign exchange risk and commodity risk on the trading portfolio and non-trading portfolio shall publish these requirements separately for each risk concerned. **In addition, the capital requirement for specific interest rate risk of securitisation positions shall be disclosed separately.** ";

(6) Point 29 shall be amended as follows:

(a) Point 29(a) shall be amended as follows:

"a) for each sub-portfolio covered:

i) the characteristics of the models used;
ii) for the capital charge in accordance with points 9-1 (for incremental default and migration risks inherent in the trading book positions) and 9-12 (for correlation trading portfolio) of Part XIV taken separately, the methodologies used and the risks measured through the use of an internal model including a description of the approach used by the investment firm to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;
ii**i**) a description of stress testing applied to the sub-portfolio;
~~ii~~ i**v**) a description of the approaches used for backtesting and validating the accuracy and consistency of the internal models and modelling processes;";

(b) Point d) shall be replaced by the following:

"**d) the highest, the lowest and the mean of the following:**
i) the daily value-at-risk measures over the reporting period and as per the period end;
ii) the stressed value-at-risk measures over the reporting period and as per the period end;
iii) capital charge in accordance with points 9-1 (for incremental default and migration inherent in the trading book positions) and 9-12 (for correlation trading portfolio) of Part XIV separately over the reporting period and as per the period end;";

(c) The current point e) shall become point f) and a new point, which reads as follows, shall be added:

"**e) the amount of capital in accordance with points 9-1 (for incremental default and migration risks inherent in the trading book positions) and 9-12 (for correlation trading portfolio) of Part XIV separately, together with the weighted average liquidity horizon for each sub-portfolio covered;**";

(7) Point 34 shall be amended as follows:

"34. Investment firms **calculating their capital requirements for** ~~that have~~ a securitisation position in accordance with Part X **or in point 36-1 of Part XI** of this circular shall publish the following information**, where relevant, separately for their trading and non-trading book**:

a) a description of the investment firm's objectives in relation to securitisation activity;

b) the nature of other risks including liquidity risk inherent in securitised assets;

c) the type of risks in terms of seniority of underlying securitisation positions and in terms of assets underlying those latter securitisation positions assumed and retained with re-securitisation activity;

~~b~~ **d**) the different roles played by the investment firm in the securitisation process;

~~c~~ **<u>e</u>**) an indication of the extent of the investment firm's involvement in each of them;

<u>f) a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures including, how the behaviour of the underlying assets impacts securitisation exposures and a description of how those processes differ for re-securitisation exposures;</u>

<u>g) a description of the investment firm's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation and re-securitisation exposures, including identification of material hedge counterparties by relevant type of risk exposure;</u>

<u>h) the approaches to calculating risk weighted exposure amounts that the investment firm follows for its securitisation activities including the types of securitisation exposures to which each approach applies;</u>

<u>i) the types of SSPE that the investment firm, as sponsor, uses to securitise third-party exposures including whether and in what form and to what extent the investment firm has exposures to those SSPEs, separately for on- and off-balance sheet exposures, as well as a list of the entities that the investment firm manages or advises and that invest in either the securitisation positions that the investment firm has securitised or in securitisation entities that the investment firm sponsors;</u>

~~d) the approaches to calculating risk weighted asset amounts that the investment firm follows for its securitisation activities;~~

~~e~~ **<u>j</u>**) a summary of the accounting methods applied by the investment firm to its securitisation activity, and notably;

i) whether the transactions are treated as sales or financings;
ii) the recognition of gains on sales;
iii) **<u>the methods, key assumptions, inputs and changes from the previous period for valuing securitisation positions</u>**; ~~the key assumptions for valuing retained interests in securitisations by the investment firm;~~
iv) the treatment of synthetic securitisations if this is not covered by other accounting policies;
<u>v) how assets awaiting securitisation are valued and whether they are recorded in the non-trading book or the trading book;</u>
<u>vi) policies for recognising liabilities on the balance sheet for arrangements that could require the investment firm to provide financial support for securitised assets;</u>

~~f~~ **<u>k</u>**) the names of the ECAIs used for securitisations and the types of exposure for which each ECAI is used;

<u>l) where applicable, a description of the Internal Assessment Approach as set out in Section 4.4.5 of Part X, including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for IAA capital purposes, the control mechanisms for the</u>

internal assessment process including discussion of independence, accountability, and internal assessment process review; the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels, by exposure type;

m) an explanation of significant changes to any of the quantitative disclosures in points (n) to (q) since the last reporting period;

n) separately for the trading and the non-trading book, the following information broken down by exposure type:

> **i) the total amount of outstanding exposures securitised by the investment firm, separately for traditional and synthetic securitisations and securitisations for which the investment firm acts only as sponsor;**
> **ii) the aggregate amount of on-balance sheet securitisation positions retained or purchased and off-balance sheet securitisation exposures;**
> **iii) the aggregate amount of assets awaiting securitisation;**
> **iv) for securitised facilities subject to the early amortisation treatment, the aggregate drawn facilities attributed to the originator's and investors' interests respectively, the aggregate capital requirements incurred by the investment firm against the originator's interest and the aggregate capital requirements incurred by the investment firm against the investor's shares of drawn balances and undrawn lines;**
> **v) the amount of securitisation positions that are deducted from own funds or risk-weighted at 1,250 %;**
> **vi) a summary of the securitisation activity of the current period, including the amount of exposures securitised and recognised gain or loss on sale;**

o) separately for the trading and the non-trading book, the following information:

> **i) the aggregate amount of securitisation positions retained or purchased and the associated capital requirements, broken down between securitisation and re-securitisation exposures and further broken down into a meaningful number of risk-weight or capital requirement bands, for each capital requirements approach used;**
> **ii) the aggregate amount of re-securitisation exposures retained or purchased broken down according to the exposure before and after hedging/insurance and the exposure to financial guarantors, broken down according to guarantor credit worthiness categories or guarantor name;**

p) for the non-trading book and regarding exposures securitised by the investment firm, the amount of impaired/past due assets securitised and the losses recognised by the investment firm during the current period, both broken down by exposure type;

q) for the trading book, the total outstanding exposures securitised by the investment firm and subject to a capital requirement for market risk, broken down into traditional/synthetic and by exposure type.

~~g) total outstanding amount of exposures securitised by the investment firm and subject to the securitisation framework (broken down into traditional and synthetic), by exposure type;~~
~~h) for exposures securitised by the investment firm and subject to the securitisation framework, a breakdown by exposure type of the amounts of impaired and past due exposures securitised, and the losses recognised by the investment firm during the period;~~
~~i) the aggregate amount of securitisation positions retained or purchased, broken down by exposure type;~~
~~j) the aggregate amount of securitisation positions retained or purchased, broken down into a meaningful number of risk weight bands. Positions that have been risk-weighted at 1,250 % or deducted from own funds shall be disclosed separately;~~
~~k) the aggregate outstanding amount of securitised revolving exposures segregated by the originator's interest and the investors' interest;~~
~~l) a summary of the securitisation activity in the period, including the amount of exposures securitised, and recognised gain or loss on sale by exposure type.~~";

(8) Chapter 5 shall be repealed and the text of point 35 shall be replaced by the following:

"**35. The following information, including regular, at least annual, updates, shall be disclosed to the public regarding the remuneration policy and practices of the investment firm for those categories of staff whose professional activities have a material impact on its risk profile:**

a) information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

b) information on the link between pay and performance;

c) the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;

d) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;

e) the main parameters and rationale for any variable component scheme and any other non-cash benefits;

f) aggregate quantitative information on remuneration, broken down by business area;

g) aggregate quantitative information on remuneration, broken down by broad management and employees whose actions have a material impact on the risk profile of the investment firm, indicating the following:

i) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;

ii) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;
iii) the amounts of outstanding deferred remuneration, split into vested and unvested portions;
iv) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;
(v) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments;
(vi) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.

For investment firms that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this point shall also be made available to the public at the level of persons who effectively direct the business within the meaning of Article 19(2) of the Law of 5 April 1993 on the financial sector.

Investment firms shall comply with the requirements set out in this point in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to Directive 95/46/EC.".

Section 15. Amendment of Part XX: TRANSITIONAL, REPEALING AND FINAL PROVISIONS

Part XX shall be amended as follows:

(1) Point 8(a) shall be renamed 8-1 and its first sub-paragraph shall be amended as follows:

"**8-1**.~~8(a)~~ For the purposes of calculating the floor referred to in point 8, the CSSF may authorise investment firms having received the authorisation to use the internal ratings-based approach in accordance with Chapter 3 of Part VII or Advanced Measurement Approaches in accordance with Chapter 4 of Part XV after 1 January 2010 to use the minimum capital requirements approaches as described in Chapter 2 of Part VII of this circular (for credit risk) and, where appropriate, Chapters 2 or 3 of Part XV of this circular (for operational risk), taking into account relevant provisions of Directive 2006/49/EC **implemented before 1 January 2011**, instead of the provisions of Circular CSSF 2000/12.";

(2) Point 8-2 shall be added:

"**8-2. Investment firms shall also apply the principles referred to in points 4-1, 4-2 and 4-3 of Part XVII of this circular:**
i) to remunerations due based on contracts signed before 1 January 2011 and granted or paid after this date; and
ii) for services provided in 2010, remuneration awarded, but not yet paid, before 1 January 2011.".

Section 16. Insertion of annexe

The following annexe shall be included in Circular CSSF 07/290:

"**Annexe 7: CEBS Guidelines of 10 December 2010 for the conduct of sound remuneration policies**

CEBS Guidelines on Remuneration Policies and Practices: http://www.c-ebs.org/News--Communications/Latest-news/CEBS-has-today-published-its-Guidelines-on-Remuner.aspx
"