

**COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER**

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

Luxembourg, 16 April 2010

To all investment firms incorporated under Luxembourg law, branches of non-EU investment firms and management companies incorporated under Luxembourg law within the meaning of Chapter 13 of the Law of 20 December 2002, as amended

CIRCULAR CSSF 10/451

Re: Amendment to Circulars CSSF 07/290 (on reporting of large exposures and on the capital floors provided for in items 3, 4, 7 and 8 of Part XX)

Ladies and Gentlemen,

This circular aims to:

- I. amend the regime of large exposure reporting. The CSSF requires from now on that investment firms indicate all their risks, including those with a 0%-risk weight, in their large exposure reporting;
- II. to extend the application of the capital floors laid down in items 3, 4, 7 and 8 of Part XX of Circular CSSF 07/290 until 31 December 2011;
- III. to inform the investment firms about the new regime applicable to large exposures of institutions as from 31 December 2010 which will allow them to take the necessary measures in order to comply with the new rules.

I. Amendment to the regime of large exposure reporting

1. Item 45 of Part XVI of Circular CSSF 07/290, which provides that certain weighted risks with a zero rate are exempted from the notification, is repealed **with effect from 1st June 2010**.

2. **Consequently, the investment firms are required to include in their large exposure reporting all their risks including the exposures to certain central administrations with a 0%-risk weight.** This information will enable the CSSF to obtain a better overview of the extent of the risks in question. These new provisions on large exposure reporting are **applicable for the first time** in respect of the drawing up of the reporting reflecting the risk concentration **as at 30 June 2010**.

3. It should be noted that although these risks shall now be reported, they still benefit from the 0%-risk weight provided for in item 22 of Part XVI of Circular CSSF 07/290 in this regard.

II. Maintenance of the capital floors laid down in items 3, 4, 7 and 8 of Part XX of Circular CSSF 07/290 for 2010 and 2011

4. Following the general approach adopted by ECOFIN on stricter capital requirements and remuneration policies in the banking sector (CRD III, <http://register.consilium.europa.eu/doc/srv?l=en&f=ST%2014732%202009%20INIT>), the capital floors are maintained for 2010 and 2011 for the investment firms using the internal ratings-based approaches ("IRB approaches") or the advanced measurement approaches ("AMA") for the calculation of the minimum capital requirements.

5. Thus, Part XX "Transitional provisions" of Circular CSSF 07/290 shall be amended as follows **with immediate effect**:

"[...]

3. Investment firms calculating risk-weighted asset amounts **for credit risk** under the internal ratings-based approach in accordance with Chapter 3 of Part VII shall, during the first, second, ~~and~~ third, **forth and fifth** twelve-month periods after 31 December 2006, provide own funds which are, at all times, more than or equal to the amounts indicated in items 5, 6 and 7.

4. Investment firms using the advanced measurement approaches as specified in Chapter 4 of Part XV for the calculation of their capital requirements for operational risk shall, during the second, ~~and~~ third, **forth and fifth** twelve-month periods after 31 December 2006, provide own funds which are at all times more than or equal to the amounts indicated in items 6 and 7.

[...]

7. For the third, **forth and fifth** twelve-month periods referred to in item 3, the amount of own funds shall be **greater or equal to** 80 % of the total minimum amount of own funds that would be required to be held during that period by the investment firm under Circular CSSF 2000/12.

[...]"

6. The following item shall be added after item 8 of Part XX of Circular CSSF 07/290:

"8a. For the purposes of determining the floors referred to in item 8, the CSSF may authorise the investment firms which received the authorisation to use the internal ratings-based approach in accordance with Chapter 3 of Part VII or the advanced measurement approaches in accordance with Chapter 4 of Part XV after 1st January 2010, to use approaches for the minimum capital requirement calculation as described in Chapter 2 of Part VII of this circular (for credit risk) and, where appropriate, in Chapters 2 or 3 of Part XV of this circular (for operational risk), while taking into account the relevant provisions of Directive 2006/49/EC, instead of Circular CSSF 2000/12.

Item 8a. is only addressed to investment firms which will obtain authorisation to use the internal ratings-based approach or the advanced measurement approaches for the calculation of the capital requirements and/or the expected losses in 2010 and 2011. For these institutions, the concrete modes of a possible implementation of the provisions of item 8a. shall form an integral part of the process provided for in Circular CSSF 06/260 for the authorisation to use the approach(es) in question.

III. New regime applicable to large exposures to institutions

7. Directive 2009/111/EC (CRD II) 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 was published on 17 November 2009 in the Official Journal of the European Union (L 302). It amends Directives 2006/48/EC and 2006/49/EC (CRD) and provides, inter alia, an overhaul of the large exposure regime. The Member States shall transpose Directive 2009/11/EC into their national law until 31 October 2010; the new provisions shall enter into force on 31 December 2010.

8. The CRD II provides that the new large exposure regime shall be applied according to the activities of the investment firms. Chapter 1 below deals with the investment firms which will be exempted from the application of large exposures as from 31 December 2010. Chapter 2 describes the new treatment of risk on institutions¹, one of the salient elements of the new regime which non-exempted investment firms shall apply as from 31 December 2010.

Chapter 1. Investment firms which will be exempted from Part XVI of Circular CSSF 07/290

9. Article 28 of Directive 2006/49/EC, as amended by Directive 2009/111/EC, provides for the exemption of certain investment firms from the large exposure regime with effect on 31 December 2010. In practice, investment firms, whose authorisation does not allow either dealing on own account or underwriting financial instruments and/or placing financial instruments on a firm commitment basis, will no longer have to comply with the large exposure limits defined in the CRDs **as from 31 December 2010**.

10. Luxembourg management companies within the meaning of Chapter 13 of the Law of 20 December 2002, as amended, which provide services of investment portfolio management, including those that are held by pension funds, on a discretionary and client-by-client basis, under a mandate given by investors, where these portfolios include one or several instruments listed in section B of Annexe II to the Law of 5 April 1993 on the financial sector, as amended, are also subject to the provisions of the preceding item.

11. As regards the large exposure reporting, the CSSF is thinking about the best way to ensure an appropriate follow-up of the possible concentration risks of the investment firms and management companies in question.

12. Pending transposition into Luxembourg law and the entry into force of the aforementioned provisions, the investment firms and management companies in

¹ The word "institution" is specified in item 16 below.

question shall continue to comply with the limits and other provisions of Part XVI of Circular CSSF 07/290 up to 30 December 2010 inclusive!

Chapter 2. New regime of large exposures to institutions for investment firms which continue to be subject to Part XVI of Circular CSSF 07/290 beyond 31 December 2010

13. The investment firms whose authorisation allows the provision of at least one of the following services:

- Dealing on own account; and/or
- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis;

will be subject to the new large exposure regime in accordance with Directive 2009/111/EC, as from 31 December 2010.

14. It should be noted that CRD II provides for a series of options and discretions that the Member States may use during the transposition of the directive into national law. **The following description is for information purposes only and is limited to the part "exposures to institutions" without dealing with the other aspects of the new large exposure regime. It reflects the regime provided for by the directive and is without prejudice to any possible changes which may arise from the decisions and choices made during the transposition of the directive in Luxembourg. This transposition will be carried out by way of a circular which will amend Circular CSSF 07/290 and whose provisions will enter into force on 31 December 2010.** The provisions of the new regime will thus be applicable to draw up the reporting which reflects the risk concentration as at 31 December 2010.

General rules concerning the exposures to institutions ²

15. The new large exposure regime is characterised by a more restrictive treatment of the risks on institutions. Whereas under the current regime, the risks benefit from 0%, 20% or 50%-preferential weights according to their maturity and their characteristics, the risk weight provided for by the new large exposure regime is 100% for all these risks. Consequently, the exposures to an institution are dealt with like any other risk incurred by the investment firm and are limited to 25% of the own funds of the investment firm.

16. For the purposes of calculating the value of risks in accordance with Part XVI of Circular CSSF 07/290, the concept of "institution" shall include, in addition to the entities referred to in item 37 of Part I of Circular CSSF 07/290, the following entities:

- any private or public undertaking, including its branches, which meets the definition of "credit institution" (item 35, Part I) and has been authorised in a third country;

² The word "institution" is specified in item 16 below.

- any recognised third-country investment firm (item 33, Part I);
- any recognised clearing house; and
- any recognised market (item 5, Part I).

Intra-group exemption

17. The exemption possibility provided by item 20 of Part XVI of Circular CSSF 07/290 shall be maintained. The CSSF may grant, totally or partially, on the basis of a prior written request with the reasons therefor, from the investment firm, an exemption for the risks, including any type of holding, taken by an investment firm vis-à-vis its parent company, its subsidiaries and the subsidiaries of the parent company, provided that these institutions are included in the supervision on a consolidated basis to which the investment firm is itself subject in accordance with Directive 2006/49/EC or equivalent standards in force in a third country.

The investment firms which now benefit from such an exemption granted by the CSSF continue to benefit from it until further notice without the need to submit a new request. However, the CSSF will assess the maintenance of the exemptions granted while taking into account the prudential requirements that have recently come into effect (including Circular CSSF 09/403) as well as the new prudential requirements which will enter into force and may, where appropriate, reverse past decisions on exemption.

Specific provisions concerning exposures to institutions ³

18. The new regime provides for two exemptions from the general rule set forth above:

(i) An absolute alternative limit of EUR 150,000,000 is provided for exposures to institutions.

Indeed, where that client is an institution or where a group of connected clients includes one or more institutions, that risk shall not exceed 25% of the investment firm's own funds or EUR 150,000,000, whichever the higher, provided that the sum of exposure values to all connected clients that are not institutions does not exceed 25% of the investment firm's own funds.

Where the amount of EUR 150,000,000 exceeds 25% of the investment firm's own funds, the exposure value shall not exceed a reasonable limit as regards the investment firm's own funds. This limit is determined by each investment firm, in accordance with the policies and procedures referred to in item 10 of Part XVII of Circular CSSF 07/290 in order to manage and control the concentration risk, and it cannot be less than 100% of the investment firm's own funds or EUR 150,000,000, whichever is less.

³ The word "institution" is specified in item 16 above.

The investment firms likely to take advantage of this provision, i.e. investment firms that have prudential own funds below EUR 600,000,000 **are required to start their analyses and considerations in order to determine the limit referred to in the preceding sub-paragraph.**

(ii) The new regime includes an exemption (0%-weight) of the risks constituted by assets items constituting claims and other exposures to institutions, provided that these exposures do not constitute own funds of these institutions, last longer than the following business day and **are not** denominated in a major trading currency such as euro (EUR), US dollar (USD) or yen (JPY). N.B. (This list is provisional and not comprehensive).

Other provisions having an impact on large exposures to institutions⁴

19. These new provisions are to be considered in the general context of the new large exposure regime in respect of which, the following items are, inter alia, likely to have an impact on the exposures to institutions.

20. The new regime is largely based on the regime applicable for the calculation of the solvency ratio as regards the risk mitigation techniques. The risk mitigation techniques may thus be more widely used to comply with the 25% limit, including for reverse repurchase and repurchase agreement transactions. However, discrepancies as regards Part IX of Circular CSSF 07/290 still exist, in particular concerning certain types of physical collateral.

21. For the purposes of calculating large exposures, the CRD II continues to allow the exemption (0%-weight) of covered bonds, as defined in item 57 of Part VII of Circular CSSF 07/290.

22. Exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in Chapter 5 of Part VII of Circular CSSF 07/290 are exempted (0%-weight) provided that an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only if it has been ascertained that it will not exceed the 25% limit of own funds.

23. Finally, the directive provides that the following exposures are not to be considered as exposures for the purposes of verifying compliance with the large exposure limit:

- in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;
- in the case of securities purchase or sale transactions, exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities, whichever is the earlier;

⁴ The word "institution" is specified in item 16 above.

- in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day; or
- in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day exposures to institutions providing those services.

Transitional regime

24. To mitigate the impact of this new regime as regards large exposures to institutions, the following transitional regime will be put in place:

For the purposes of calculating large exposures, asset items constituting claims and other exposures to institutions incurred before 31 December 2009 will continue to benefit from the provisions of item 23(b) and (c) and of item 24(a) and (b) of Part XVI of Circular CSSF 07/290 up to 31 December 2012 inclusive.

It should be noted that the provisions of item 22(j) and (k) of Part XVI of Circular CSSF 07/290 do not fall under the current transitional regime. **No other 0%-weight will be possible as from 31/12/2010 for large exposures to institutions.**

This shall also apply to such risks vis-à-vis institutions which are part of the group of the Luxembourg investment firm, if the investment firm has not requested and obtained an intra-group exemption in accordance with item 20 of Part XVI of Circular CSSF 07/290.

25. Given the significant impact that these provisions will have on the institutions of the financial centre, and in order to avoid exceeding large exposures during the entry into force of the new regime, we invite you to prepare yourselves already for these new limits on large exposures to institutions.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON
Director

Andrée BILLON
Director

Simone DELCOURT
Director

Jean GUILL
Director General