

**COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER**

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

Luxembourg, 23 November 2011

To all Luxembourg law credit institutions
and branches of non-EU credit institutions

CIRCULAR CSSF 11/526

Re: Use of the lump sum provision as at 31 December 2011

Ladies and Gentlemen,

The purpose of this circular is to remind the banks, as already referred in Circular CSSF 08/386, that they must use their lump sum provision at the end of the financial year 2011 in order to cover the unrealised losses resulting from the turmoil in the financial markets. In that respect, the reason for and the essentially prudential nature of this anti-cyclical provision traditionally established in Luxembourg should be pointed out.

This circular essentially concerns the accounts published under Lux GAAP since the vast majority of banks in the financial centre continue publishing their annual accounts under Lux GAAP.

The banks having already adopted IFRS for their published accounts and those considering adopting IFRS for the financial year end 2011 are requested to refer to point III. of this circular.

I. Reminder of the nature and objectives of the lump sum provision

Setting up a lump sum provision represents in Luxembourg the practical application of an anti-cyclical risk provisioning policy which contributed to the stability of Luxembourg's financial system. Historically, this provision is set up as a preventive measure in prosperous economic periods with the aim of using it in less favourable periods to face possible losses.

The lump sum provision in its current form is based on the "Instructions of the *Directeur des Contributions*" dated 16 December 1997. As per this instruction, "the purpose of this provision is to cover risks which are likely to be incurred, but not yet identified when drawing up the balance sheet".

It should be noted that the lump sum provision is not included in own funds on which the solvency ratio calculation is based, but it is deducted from the risk weighted assets representing the denominator of the solvency ratio. Consequently, the use of the lump sum provision does not affect the amount of prudential own funds and, thus, does not result in fluctuations in prudential own funds.

Experience shows that in many situations in the past, and particularly during the financial crisis of 2008, Luxembourg banks have used the lump sum provision to compensate financial losses which occurred during a financial year. The turmoil in financial markets during the financial year requires again the release of the lump sum provision to cover unrealised losses in the securities portfolio.

II. Details on the use of the lump sum provision for banks publishing their accounts according to Lux GAAP

In 2011, Luxembourg credit institutions must use the lump sum provision, set up as a preventive measure during the previous financial years, in order to cover losses in less favourable periods with the aim of absorbing the impairment of the financial assets or other losses incurred, where these are substantial.

The CSSF may grant an exemption to this principle, on a case-by-case basis, where justified explanations are provided by the credit institution.

This means that the institutions compensate the impairment or other losses incurred which are registered in the profit or loss account through a reversal of the existing lump sum provision (which includes a portion of "value adjustment" deducted from the related items of the balance sheet assets and a portion of "provision" recorded under the item 6.c "Provisions: other provisions" of the balance sheet liabilities) to the extent concerned.

Technically, banks publishing their accounts under Lux GAAP shall proceed as follows:

- The impairment/losses recorded during the financial year are registered in the related item of the profit or loss account.
- The portion of the lump sum provision which is deemed to represent "value adjustments" is reversed through a credit in item 12 "Value re-adjustments in respect of loans and advances and provisions for contingent liabilities and for commitments" of the profit or loss account or in another item of the profit or loss account, according to the type of loss to be compensated, and a debit in the related items of the balance sheet assets; the portion of the lump sum provision which is deemed to represent a "provision" is reversed through a credit in item 12 "Value re-adjustments in respect of loans and advances and provisions for contingent liabilities and commitments" or in another item of the profit or loss account, according to the type of loss to be compensated, and a debit in item 6.c "Provisions: other provisions" of the balance sheet liabilities.

With the aim of ensuring the transparency required for this purpose, additional explanations must be provided in the management report and in the notes to the accounts to be published. These explanations must refer to this circular.

III. Important comments concerning the banks having already adopted IFRS for their published accounts and those considering adopting IFRS for the financial year end 2011

1. Banks having already adopted IFRS for their published accounts

Banks which already publish their accounts under IFRS had to release the prudential provisions (i.e. the lump sum provision and the AGDL provision) previously set up under Lux GAAP to retained earnings (after tax) in the IFRS opening balance sheet. These banks may no longer compensate the losses resulting from the current financial crisis by a release of the lump sum provision set up as a preventive measure during the previous financial years according to Lux GAAP.

The banks concerned must clarify with the *Administration des Contributions directes* the tax treatment which shall apply to such bookings.

2. Banks considering adopting IFRS for their published accounts for the financial year end 2011

Until the outcome of the international discussions aiming at setting up an accounting system for the provisioning of expected losses, the CSSF considers that, in the current situation, it would be better for banks considering adopting IFRS for their published accounts in 2011, as adopted by the EU, to delay this transition until a clear and satisfactory solution is found at an international level. However, banks which are technically already prepared for the transition to IFRS may opt for the Lux GAAP regime with IAS options accepted pursuant to the law of 17 June 1992 relating to the accounts of credit institutions which allows them to draw up and present accounts based on IFRS while maintaining the prudential provisions (i.e. the lump sum provision and the AGDL provision) accepted under Lux GAAP. In this case, the accounts published are prepared according to IFRS as adopted by the EU, except for the accounting principles relating to the accounting of the lump sum provision (and of the AGDL provision), and they correspond to the FINREP prudential financial reporting implemented by the CSSF.

The banks concerned must clarify with the *Administration des Contributions directes* the tax treatment which shall apply to the Lux GAAP regime with the chosen IAS options.

For any question concerning this circular, please contact Mrs Marguy MEHLING (tel: +352 26 25 1 214, email: marguy.mehling@cssf.lu).

Yours faithfully,

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