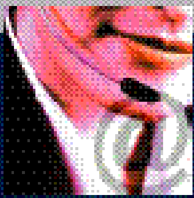
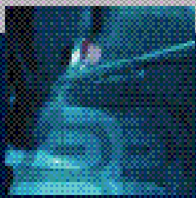
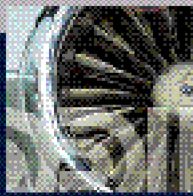
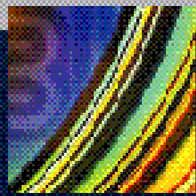
Association
des Banques
et Banquiers
Luxembourg

Luxembourg financial products and services

A guide

Association
des Banques
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Luxembourg financial products and services

A guide

In association with

PRICEWATERHOUSECOOPERS

Foreword

The multiple facets of a fully-fledged international financial centre

If still needed, this publication is the witness of the breadth and diversity of the Luxembourg financial centre.

The range of products and services available in Luxembourg may surprise even those who are in daily contact with our centre, including the initiators of this study who did not expect to encounter such impressive results when this inventory was launched.

Put in hand by the members of the committee in charge of promotional activities within the ABBL, this guide of products and services offered by the nearly 300 operators in the financial centre is the outcome of a vast collective work that was achieved in association with experts from PricewaterhouseCoopers Luxembourg. That being so, our congratulations are due to the Promotion committee conducted by Charles Hamer with the assistance of Giovanna Bassani, and Pierre Krier, who headed the PwC team.

Facing this analysis, any critic who still ventures to put the Luxembourg financial centre in the category of more or less exotic offshore centres would undoubtedly lay himself wide open to the accusation of malicious intent. After all, this publication provides unambiguous proof that Luxembourg is a financial centre in the broadest sense of the term with a range of products designed to satisfy the widely varying requirements of the international financial markets.

Consultation of the descriptive list of its products and services readily shows that our centre owes its reputation in Europe, and indeed world-wide, to the great diversity of its financial activities. What is more, it excels in innovation and in the development of new products, so demonstrating its sophisticated professional standards and creative imagination.

Operators in Luxembourg have every reason to be proud of their financial centre, its vast expertise as well as its status as a centre of excellence in some segments particularly geared towards the markets of the future. The exceptional ability of highly skilled staff and the multicultural character of a their international banking community enable our financial service providers to function so efficiently and successfully, day after day.

This publication mirrors the professionalism and expertise of the operators of our financial centre. It's only fair that it is dedicated to them.

Lucien Thiel
General Manager

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Price Driven Products

1.1 Forward Foreign Exchange Contracts

1.1.1 Definition

A forward foreign exchange contract is a firm over the counter engagement between two parties to exchange a defined quantity of currency at a fixed exchange rate at a determined future date.

1.1.1.1 Hedging

To hedge a position against exchange risks, the investor will take a forward position against his spot position.

With a forward foreign exchange contract, the investor is able to fix today a future exchange rate. If he knows today that he will receive at a future date a certain amount denominated in a currency that is not his local currency, he may engage himself in a forward foreign exchange contract. The terms of the contract would stipulate that at maturity date, the investor will deliver the amount of currency received to the contract's counterpart and receive in turn the equivalent amount in local currency using the predetermined exchange rate.

1.1.1.2 Speculation

To speculate, the investor can take a forward position corresponding to his spot position in order to get a leverage effect, or he can enter into a forward buying or selling position not related to any spot position.

1.1.1.3 Arbitrage

To take advantage of discrepancies between markets.

1.1.2 Accounting

The balance sheet will reflect the purpose of the transaction:

- Hedging purposes: the unrealised loss/gain is accrued for in the bank's transitory accounts, while the valuation of the hedged position is neutralised in the transitory accounts.
- Speculative purposes: the unrealised losses are accrued for while the unrealised gains are accounted for when realised. However unrealised losses can be compensated by unrealised gains under certain conditions.
- Arbitrage purposes: the determined future loss is accrued for while the determined future gain is accounted for at maturity.

Off-balance sheet: at the trade date, recording of amount of the currency to be delivered (no netting).

1.1.3 Regulatory Aspects

All commitments resulting from outstanding *spot transactions* (incl. foreign exchange transactions for own account or for customers' accounts if the credit institution acts as counterpart) and included in the off-balance sheet items as such are subject to capital requirements to cover foreign exchange risk. Those commitments are included in the net open position by currency and the net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is subject to an 8% capital requirement in excess of 2% of the eligible owned funds. An alternative method based on statistics may be used by credit institutions.

All commitments resulting from outstanding *forward transactions* (incl. foreign exchange transactions for own account or for customers' accounts if the credit institution acts as counterpart) and included in the off-balance sheet items as such are subject to capital requirements to cover foreign exchange risk. These commitments are included in the net open position by currency and the net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is subject to an 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by credit institutions.

Moreover, as in the case of forward foreign exchange contracts which are traded over-the-counter, an additional capital requirement to cover credit risk is required. This capital requirement, generally based on the market value of the contract ("current exposure method"), is added to the potential future credit exposure (depending on the remaining time to maturity) and subject to a 50% maximum weighting (depending on the quality of the counterpart).

Finally, the contracts included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover credit risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

1.2 Precious Metals

1.2.1 Definition

Buying, selling and providing of precious metals such as gold, silver or platinum. Transactions are concluded through physical delivery (tangible assets) or through a metal account.

Precious metals can be delivered in the form of medals, coins and bullions and in the form of certificates. In addition, forward purchase or sale is also possible.

Speculation: purchase and sale of precious metals for the bank's own account.

1.2.2 Accounting

1.2.2.1 Balance sheet

The conditions under which precious metals do not form part of the banks' net assets and should therefore not appear in its balance sheet but rather in its off-balance sheet, are met, in particular, in the case of fungible precious metal deposits made pursuant to the Grand Ducal Regulation of December 18, 1981 and non-fungible precious metal deposits. Forward purchases and sales of precious metals are also accounted for off-balance sheet. The balance sheet must include all precious metal items other than those which are excluded from the net assets and to which their owners may lay claim.

NB:

- Commitments to deliver precious metals in the case where the creditor does not own the metals concerned are included under the appropriate liabilities item (according to the type of creditor and remaining maturity).

- Precious metals held as assets (tangible assets) are included under the item "Other assets".

- Rights to the delivery of precious metals cover all instances in which the bank has a claim over the metal but does not actually own it. These claims are included under the appropriate assets item (according to the type of debtor and the remaining maturity).

1.2.2.2 P&L

Results on precious metal transactions for the bank's own account are included principally under the profit and loss account sub-item "Gains/losses on precious metals".

Results on precious metals transactions for customers are included under profit and loss account sub-item "Commission for purchase and sale of precious metals on behalf of third parties".

NB: the valuation of closed metal positions is the market price ruling on the valuation day. Open metal positions are valued according to the principle of unequal treatment.

1.2.3 Regulatory aspects

Gold is not subject to any capital requirements to cover credit risk. Other precious metals are subject to a 100% weighting on their book value.

Gold is treated as a currency and the positions are therefore subject to capital requirements to cover foreign exchange risk. Those positions (for own account or for a customer's account if the credit institution acts as counterpart) are included in the net open position by currency and the net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to an 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by credit institutions.

1.3 Options

1.3.1 Definition

An option is a contract giving its owner the right, but not the obligation, to either buy (call option) or sell (put option) a certain quantity of an underlying asset at a predetermined price (strike price) at either a fixed date (European options) or during a given period of time (American options).

The option is regarded as a "right" for the buyer (who can still benefit from a favourable evolution of the underlying) and as a "commitment" for the seller that must honour the decision of the buyer.

1.3.1.1 Underlying

Securities, indexes, interest rate (by a nominal), exchange rate (by a nominal), bonds, convertible bonds, commodities, derivatives....

1.3.1.2 Intermediaries

- Organised markets.
- OTC markets.

1.3.1.3 Basis position

There are four basis positions reflecting specific anticipations about the underlying:

- to buy a call: bullish anticipation,

- to buy a put: bearish anticipation,

- to sell a call: bearish anticipation or stability,

- to sell a put: bullish anticipation or stability.

1.3.1.4 Use

Hedging: to hedge a position against market risks, the investor will take an option position with implied anticipation opposite to his spot position.

Trading: to speculate, that means taking benefit from forecasted market evolutions but also increasing one's market risk, the investor will take an option position with implied anticipation similar to his spot position or without any spot position at all.

Arbitrage: to take advantage of discrepancies between markets. Ex.: the strategy of buying a put and the underlying at the same time should be equivalent to the strategy of buying a call. If not, there is a profit without risk to be made by selling the more expensive strategy and buying the cheapest one.

Static strategies: use a combination of options giving a specific gain profile: ex.: spread, straddle, butterfly …

Valuation: if the options are not quoted on organised markets, options can be valued with arbitrage models (ex.: Black and Scholes) or numerical procedures (ex.: Monte Carlo).

1.3.2 Accounting

In the balance sheet, the buyer/seller records a paid/received premium.

The nominal values of the options (at strike) are individually recorded in the off-balance sheet of the bank (if the bank is the writer of the options).

1.3.2.1 Trading

OTC: unrealised losses on purchased and written options are recorded in the P&L. Unrealised gains are excluded from the accounts.

Organised Market: the unrealised results - whatever gain/loss - on purchased options are recorded in the P&L, while solely unrealised losses on written options are recorded in the P&L.

1.3.2.2 Hedging

Only purchased options can be used as hedge instruments. The accounting depends on the following:

- the purpose of the hedge (hedge of balance sheet items, hedge of a forward transaction or hedge of options written by the bank);
- the market on which the option is purchased or written (OTC or organised market).

1.3.3 Regulatory aspects

All currency options are subject to a specific capital requirement to cover foreign exchange risk (other types of options are included in the net open positions by currency on the basis of the premiums paid or received). Credit institutions are required to cover the delta risk on currency options by including the net delta equivalent (provided by the market or calculated by the credit institution if the option is not quoted) in the net open position by currency. They are also required to cover the other types of risk inherent in the options (gamma, vega...). However, credit institutions whose currency option activity is limited may cover these latter risks by using a simplified method.

This method is different if the currency options are held for the purpose of hedging a spot position or not. Moreover, no capital requirement to cover such risks shall apply where positions in options written are fully covered by long positions in respect of the same option ("back-to-back options").

Interest rate linked options included in the trading book are subject to a specific capital requirement to cover interest rate risk. Credit institutions are required to cover the delta risk on interest rate linked options by including the net delta equivalent in the net open positions by currency (these net positions only include securities and derivatives which are sensitive to interest rate fluctuations). Capital requirements must be sufficient to cover the specific risk (risk of a price change in the option due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change in the option due to a change in the level of interest rates).

Capital requirements are also required to cover the other types of risk inherent to the options (gamma, vega...). However, credit institutions whose interest rate related option activity is limited may cover these latter risks by using a simplified method. This method is different if the options are held for the purpose of hedging a spot position or not. Moreover, no capital requirement to cover such risks shall apply where positions in options written are fully covered by long positions in respect of the same option ("back-to-back options").

Stock or index related options included in the trading book are subject to a specific capital requirement to cover the risk associated with variation in the price of equities.

Credit institutions are required to cover the delta risk on interest rate linked options by including the net delta equivalent in the net open positions by currency (these net positions only include securities and derivatives which are sensitive to variation in the price of equities). Capital requirements must be sufficient to cover the specific risk (risk of a price change in the option due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change in the option due to a change in the overall level of the market).

Capital requirements are also required to cover the other types of risk inherent to the options (gamma, vega...). However, credit institutions whose stock or index related option activity is limited may cover these latter risks by using a simplified method. This method is different if the options are held for the purpose of hedging a spot position or not. Moreover, no capital requirement to cover such risks shall apply where positions in options written are fully covered by long positions in respect of the same option ("back-to-back options").

Moreover, all OTC-traded options included in the banking book are subject to capital requirements to cover the credit risk. This capital requirement, generally based on the market value of the contract ("current exposure method"), is added to the potential future credit exposure (depending on the remaining time to maturity and the type of option) and subject to a 50% maximum weighting (depending on the quality of the counterpart).

1.4 Futures

1.4.1 Definition

Futures are standardised forward contracts traded on an organised market.

Forward contracts are firm commitments to buy or sell a certain quantity of specified assets (the underlying) at a specified future date (maturity date) at an agreed upon price.

The characteristics of futures contracts are standardised, meaning that:

- the underlying asset is standard;
- the quantities are multiple of standard amounts;
- the maturities are fixed;
- the legal framework is standard (system of guarantee deposits and margin account, clearing house as counterpart).

The settlement of a future occurs before maturity through the reversal of the position or at maturity with the delivery of the underlying asset.

According to the nature of the underlying asset, there are three main types of financial futures: interest rate futures, stock index futures and currency futures.

(a) Hedging

In order to hedge a position against financial risks, the investor will take a forward position opposite to his spot position.

- As a global hedge against the risk of unfavourable stock market movements, an investor will sell futures on stock market indices.
- As a global hedge against adverse interest rate fluctuations, an investor will sell interest rate futures.
- With a currency future, the investor can fix today a future exchange rate. If he receives a currency at a future date, he can sell a future contract on this currency. If he delivers a currency in the future, he can buy a future contract on this currency.

(b) Trading

To make a profit on the basis of forecasted market evolution.

- If the speculator anticipates an increase of the underlying asset's price, he will buy a future.
- On the contrary, he will sell a future if he anticipates a decrease of the underlying asset's price.

(c) Arbitrage

To take advantage of discrepancies between markets.

1.4.2 Accounting

1.4.2.1 Balance sheet

The initial margin deposit is recorded in the balance sheet of the bank (margin calls adjust the margin deposit in order to reflect the current unrealised gain or loss on a certain position).

NB:

- If guarantee deposit is a security deposit, securities in deposit should be clearly identified.
- The internal accounting system should clearly identify deposits made for the bank's own account and for clients.

1.4.2.2 P&L

- Hedging purposes: the position on the future is linked to the spot position hedged, consequently neutralisation of the valuation results through the transitory accounts.

- Speculative/arbitrage purposes: the gains/losses on open positions booked through margin calls are recorded in the P&L; realised gains/losses are recorded when the transaction is settled.

1.4.2.3 Off-balance sheet

The commitments on futures transactions are individually recorded in the off-balance sheet of the bank at nominal value (gross amounts– purchases and sales are not netted).

1.4.3 Regulatory aspects

All commitments resulting from open currency future contracts are subject to capital requirements to cover foreign exchange risk. Those commitments are included in the net open position by currency and the net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions. The other type of future transactions (stock index future, interest rate agreement, future rate agreement, commodities future...) are not subject to capital requirements to cover foreign exchange risk.

As future contracts are traded on organised markets, capital requirements to cover credit risk are only based on margin calls by applying a 20% weighting.

Interest rate futures and future rate agreements included in the trading book are subject to a specific capital requirement to cover interest rate risk. Credit institutions are required to cover the net open positions on those derivative instruments (interest rate futures and future rate agreements shall be treated as combinations of long and short positions). Capital requirements must be sufficient to cover the general risk (risk of a price change in the future contract due to a change in the level of interest rates).

Stock or stock index futures included in the trading book are subject to a specific capital requirement to cover the risk associated with variation in the price of equities. Credit institutions are required to cover the net open positions on those derivative instruments (stock and stock index futures shall be treated as combinations of long and short positions). Capital requirements must be sufficient to cover the specific risk (risk of a price change in the futures contract due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change in the future contract due to a change in the overall level of the market).

1.5 Equity Trading

1.5.1 Definition

Buying and selling of shares and other variable-yield securities for own account as well as for third-party account.

Equity trading for third party account only involves the execution in the market of third party transactions as equity trading departments of banks act as wholesaler or retailer for their private or institutional customers. This service provides customers access to the international investment community and in particular to stock exchanges.

In contrast market making, dealing and broking for own account, involves the obligation to negotiate with other professional counterparts a list of securities with minimum amounts, with predefined bid-offer spreads and between pre-agreed hours.

Transactions may be entered into for various purposes and particularly in order to:

- realise capital gains,

- realise income from trading for third parties,

- take a strategic investment in a company.

1.5.2 Accounting

1.5.2.1 Balance sheet

Shares and other variable-yield securities for own account are included under the sub-item "Shares and other variable securities". Securities which have the character of participating interests or shares in affiliated undertakings are included under the sub-items "Participating interests" respectively "Shares in affiliated undertakings".

Securities held for third parties are not included in the balance sheet.

Valuation:

- Participating interests and shares in affiliated undertakings held as fixed assets are valued at purchase price or by the lower of cost or market principle.

- Other shares and variable-yield securities and shares in affiliated undertakings not held as financial fixed assets are to be valued by the lower of cost or market principle whatever category of securities they belong to. In contrast to bonds, the mark-to-market method may therefore not be applied.

1.5.2.2 P&L

Participating interests and shares in affiliated undertakings held as financial fixed assets:

- Valuation gains and losses are included under sub-item "Value adjustments in respect of transferable securities held as financial fixed assets, participating interests and shares in affiliated undertakings" or under "Value re-adjustments in respect of transferable securities held as financial fixed assets, participating interests and shares in affiliated undertakings".

- Gains or losses on sales are to be accounted for under "Extraordinary income" or "Extraordinary losses" unless these sales form part of the normal and recurring business activities of the bank ("Other operating income/charges").

- Dividends received in cash and other income received in cash are to be included under the profit and loss account item "Income from securities".

Other shares and variable-yield securities and shares in affiliated undertakings not held as financial fixed assets:

- Valuation gains and losses are included under item "Net profit or net loss on financial operations". Realised gains or losses on sales of such securities are also to be included under this item.

- Dividends received in cash and other income received in cash are to be included under the profit and loss account item "Income from securities".

- For shares and other variable-yield securities which are held for third parties the income is to be accounted under the sub-item "Commission income" (especially "Commission income for safekeeping of assets belonging to third parties" and "Commission income for asset management").

1.5.2.3 Off-Balance Sheet

- All investment management services (eg safekeeping of assets belonging to third parties) and underwriting functions as a result of which the bank can be held responsible for negligence or for not fulfilling its duties have to be included under the item "Investment management services and underwriting functions".

- For the equity trading the item "Fiduciary operations" and "Asset management" may be relevant depending on the services rendered by the bank.

1.5.3 Regulatory aspects

Equities, as part of the trading book, are marked-to-market and included in the net open positions by currency for the purpose of calculating the capital requirement to cover the foreign exchange risk. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Equities from the trading book (except shares of undertakings for collective investments) are subject to a specific capital requirement to cover the risk associated with variation in the price of equities. Credit institutions are required to cover the net open positions. Capital requirements must be sufficient to cover the specific risk (risk of a price change in the instrument due to factors related to the issuer of the security) and the general risk (risk of a price change in the instrument due to a change in the overall level of the market).

Transactions unsettled after their due delivery dates (spot or forward sale or purchase of securities) and free deliveries (undelivered but purchased and paid securities or unpaid but sold and delivered securities) are subject to capital requirements to cover settlement/delivery risk and counterpart risk. Those requirements are calculated as a percentage applied either on the difference between the market value and the settlement value or directly on the settlement value. Those percentages are increasing with the quality of the counterpart and the ageing of the unsettled transaction.

Finally, the stocks included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover the specific risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

1.6 Equity Related Products

Warrants

1.6.1 Definition

A warrant is similar to an option but it is issued by a company or a financial institution, and initially not traded on a market. In some cases warrants are subsequently traded on an exchange. When a warrant is exercised, the original issuer settles up with the current holder of the warrant.

1.6.1.1 Underlying

Securities, indexes, interest rate (by a nominal), exchange rate (by a nominal), bonds, commodities, derivatives...

1.6.1.2 Intermediaries

Other regulated markets, OTC markets.

1.6.1.3 Use

- For companies: in a debt issue, a company might offer investors a package consisting of bonds plus call warrants on its stocks. The advantages of this operation are the premiums received and the opportunity of increasing the capital of the company.

- For financial institutions: issuing put and call warrants is a way to receive a premium by satisfying a demand in the market.

1.6.1.4 Valuation

The valuation is based on the available market price or, if not available on the market, similar valuation tools as for options are used (arbitrage pricing models, numerical procedure).

1.6.2 Accounting

This accounting treatment is similar to that applicable to options (See 1.3.2).

1.6.3 Regulatory aspects

Warrants are subject to the same capital requirements as the options.

1.7 Securities Lending

1.7.1 Definition

Securities lending is a transaction in which one of the two counterparts (the lender) delivers to the other a determined quantity of transferable securities, while the one who received the securities (the borrower) commits itself to retrocede the same quantity and quality of securities at the end of the contract.

The borrower has the right to sell the related securities to a second counterpart, and to purchase identical securities to a third counterpart, provided that he is able to respect his initial commitment to retrocede the same quantity and quality of securities at the end of the contract.

Most of the time the borrowing of securities is carried out by arbitrageurs who sell securities they do not own. It allows credit institutions to increase the profitability of their portfolios.

Sometimes it is a means for the borrower of the securities to hedge delays in delivery commitments.

1.7.2 Accounting

Based on the economical substance of the transaction, there is no effective transfer from the lender's to the borrower's portfolio.

However from an accounting point of view, as regards the lender, the securities concerned by the agreement do not continue to figure in his balance sheet. A loan corresponding to the securities to be retroceded is accounted for in his balance sheet while the interests received are recorded in the P&L account.

The borrower will record the securities at their market price in the related securities portfolio, and a debt towards the lender booked at the same market value.

1.7.2.1 Valuation

The lender values the loan corresponding to the securities lent in accordance with the valuation rules of the portfolio category to which these securities were related. The borrower values the securities in accordance with the valuation rules of the portfolio category in which they have been included. The debt towards the lender is valued on the same basis. Therefore the valuation result on the P&L is neutral.

1.7.2.2 Securities

There is no restriction regarding the kind of securities that can be the object of securities lending. However they need to be done through a standardised lending system.

1.7.2.3 Intermediaries

Standardised lending system, whatever the kind of security.

1.7.3 Regulatory aspects

1.7.3.1 Regarding funds

Securities lending is limited to 50% of net assets and for 30 days as a maximum.

1.7.3.2 Regarding banks

Unsecured securities lending transactions included in the banking book are subject to capital requirements to cover credit risk. Those transactions are to be weighted according to the higher of the two following weightings: the weighting applicable to the borrower of the securities and the weighting applicable to the securities lent. Securities borrowing transactions shall not be included in the calculation of capital requirements in respect of credit risk, provided that the securities borrowed remain in the portfolio of the borrower throughout the life of the transaction.

In the case of securities lending transactions included in the trading book and in order to meet the capital requirements to cover the settlement/delivery risk, credit institutions shall calculate the difference between the market value of the securities and the amount borrowed by the institution (interests included). In the case of securities borrowing, credit institutions shall calculate the difference between the amount lent (interests included) and the market value of the securities. Where the difference is positive, the capital requirement shall be 8% of such difference, multiplied by the risk weighting applicable to the relevant counterpart.

Debt securities or guaranteed rights relating to debt securities' entitlement which are subject to a securities lending transaction shall be included in the calculation of net positions with respect to capital requirements to cover interest rate risk, provided that they are included in the trading book. Capital requirements must be sufficient to cover the specific risk (risk of a price change due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change due to a change in the level of interest rates). By contrast, no capital requirement shall be calculated in respect of debt securities or guaranteed rights relating to debt securities' entitlement which are subject to a debt securities borrowing transaction.

Variable-yield securities or guaranteed rights relating to variable-yield securities' entitlement which are subject to a securities lending transaction shall be included in the calculation of net positions with respect to capital requirements to cover risk of variation in the price of equities, provided that they are included in the trading book. Capital requirements must be sufficient to cover the specific risk (risk of a price change due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change due to a change in the overall level of the market). By contrast, no capital requirement shall be calculated in respect of variable-yield securities or guaranteed rights relating to variable-yield securities' entitlement which are subject to a securities borrowing transaction.

1.8 Trade Finance

1.8.1 Definition

Different kinds of financing solutions offered by banks to commercial companies in order to support them in their exporting and importing activities.

There are different products banks offer with respect to trade finance:

Forfaiting: sale of medium to long-term receivables from exports at a discount and without recourse by the exporter to a bank and transfer of the related security. The bank assumes the del credere function (risk of default by the counterpart), the financing function and the exchange rate risk. The sale of receivables to the bank without recourse increases the credit rating of the exporter.

Conditions for receivables to be forfaited: defined time to maturity, prevailing trade currency and high credit rating.

Bill of exchange: an order in writing by the drawer requiring the drawee to pay a certain amount of money at a fixed date that generally involves an underlying trade in goods or services. Once the bank has accepted the bill of exchange, it assumes the del credere function.

The bank assumes the obligation to pay in case of default by the drawee when accepting the bill of exchange.

1.8.2 Accounting

1.8.2.1 Balance Sheet

Forfaiting: the bank owns the receivables and assumes the default risk. The amount is to be shown under receivables.

Bill of exchange: off-balance as long as the bank only accepts but does not purchase a bill of exchange drawn on it.

1.8.2.2 P&L

Treatment depends on the nature of the income generated from the different types of trade finance:

- interest-like fees are recorded under interest income;

- commission-like fees are to be accounted for under commission income.

1.8.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all balance sheet and off-balance sheet items in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured balance sheet/off-balance sheet items shall be weighted depending on the quality of the counterpart and that secured items shall be weighted depending on the quality of the guarantor.

1.9 Corporate Finance Services

1.9.1 Definition

Corporate finance services are rendered by banks in order to help companies setting up new or existing sources of finance, e.g. going public, and support them with financing and executing various business activities, e.g. mergers and acquisitions.

Mergers & Acquisitions
Services offered by banks in relation with M&A:

- Consulting services,

- Selection of potential targets to acquire or merge with,

- Support during the execution of the merger/acquisition process,

- Financing.

Going Public
Services offered by banks in relation with going public:

Development of a going-public concept

- Analysis of the credit rating and the potential for becoming listed.

- Evaluation of the company (earnings per share, ratio analysis, future earnings, standing) to determine the issue price.

- Development of a prospectus for the issue.

- Public Relations: in order to attract potential investors to the share issue.

- Admission to the stock exchange: done in co-operation between the issuer and a bank that is admitted to trading on the stock exchange.

- Usually, a syndicate of banks takes up the shares and places them according to the issuer's requirements.

- After the placing: consulting services regarding the information to be issued for compliance with stock exchange regulations, the preparation and execution of the Annual General Meeting, etc.

1.9.2 Accounting

Income generated from the services rendered are recorded in the P&L as commission income.

1.9.3 Regulatory aspects

No particular regulatory requirements exist if the bank only renders advisory services to a third party.

1.10 Guarantees

1.10.1 Definition

A guarantee is a contract according to which a guarantor is obliged to bear the potential damage in case of default of one of the contracting parties.

The main features of guarantees are:

- abstract warranty promises,

- legally independent from the underlying debt agreement,

- normally temporary agreements.

There are different types of guarantees depending on the underlying contractual obligations: guarantees for advance payments, for performance and delivery, for rental contracts, for credits and for corporate bond issues.

There are several uses:

- Guarantees for advance payments: especially used in cross-border trade, where the bank provides security to the importer that the amount he prepaid will be returned in case of default by the exporter.

- Guarantees for performance/delivery: especially used for long-term contracts, where the bank assumes responsibility for a performance/delivery according to the form, quantity, quality and timeliness as specified in the contract.

- Guarantees for rental contracts: to provide security as to the future payments or the deposit of a tenant.

- Guarantees for credits: the security given by the bank to the lender as to the repayment and interest payments of the credit.

- Guarantees for corporate bond issues: provided by mother companies for international bond issues of subsidiaries that are domiciled abroad, to guarantee the contractual obligations resulting from the bond issue.

1.10.2 Accounting

1.10.2.1 Balance Sheet

Guarantees are irrevocable obligations by a bank issued for a third party, which represent a credit risk. Thus, the amount of the guarantee appears as an off-balance sheet item.

If the default of the contracting party for which the guarantee was given for becomes probable, a provision has to be recorded.

1.10.2.2 P&L

Treatment depends on the nature of the income generated from the guarantee contract:

- interest-like fees, i.e. revenues that are a function of the time or the amount of the guarantee, are included in interest income;
- commission-like fees and flat fees are to be accounted for under income from commissions.

1.10.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all balance sheet and off-balance sheet items in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Furthermore, guarantees given by the bank are subject to capital requirements to cover credit risk by applying the following weightings:

- 100% to guarantees having the character of direct substitutes for credit;
- 50% to warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of direct substitutes for credit.

1.11 Credit Enhancement

1.11.1 Definition

Securities that are added to a transaction in order to protect the contracting parties from a possible default.

Main features of instruments for credit enhancement:

- improvement of the credit rating of the companies concerned,
- thus: access to credits at lower costs.

Share issues: put options are given in connection with new issues of shares in order to make them more attractive for investors.

Lending against securities: credits that are given against pledged securities that cover at least the amount of the credit. In return for the collateral, the entity taking the credit may receive a lower interest rate (Lombard rate).

Securities lending: bonds are sometimes given as a security in return for lending out shares.

1.11.2 Accounting

Share issues: for put options where the bank assumes a short position, it has to constantly evaluate the resulting liability. In case a loss crystallises, a provision has to be recorded.

Lending against securities: the credit is recorded under "Loans and advances", the pledged securities are recorded in the off-balance sheet under "Assets held by the credit institution on behalf of third parties".

Securities lending: the securities that are given as a pledge have to be earmarked and continue to remain in the bank's balance sheet or off-balance sheet.

1.11.3 Regulatory aspects

1.11.3.1 Share issues

Put options related to share issues are subject to the same capital requirements as any other options. Please refer to options for a detailed analysis of capital requirements.

1.11.3.2 Lending against securities

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all balance sheet and off-balance sheet items in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured items shall be weighted depending on the quality of the guarantor. There are no differences between lending against securities and other types of loans.

1.11.3.3 Securities lending

There are no particular capital requirements for this type of securities lending.

1.12 Documentary Credits

1.12.1 Definition

A documentary credit is an agreement whereby a bank is obliged to pay a certain amount of money to the exporter of goods or services on behalf of the importer against documents that prove the delivery of goods or the execution of services, within a predetermined period of time.

The characteristics of a documentary credit are as follows:

- irrevocable/revocable documentary credit (revocable = may be altered by the importer),

- abstract warranty agreement,

- legally independent from the underlying trade.

Thus, the bank implicitly grants a credit to the importer of the goods or services, since in case of non-payment by the importer, the bank is still obliged to pay.

It is an instrument to secure the payment by the importer to the exporter, especially concerning trade with less-developed countries, where the risk of counterpart default may be higher.

1.12.2 Accounting

Documentary credits are obligations by a bank accepted on behalf of a third party, which can turn into a credit risk. Thus, the amount of the documentary credit is recorded as an off-balance sheet position. If the party demanding the issue of a documentary credit has provided the bank with a margin account, i.e. with a security deposit, the off-balance sheet position has to be reduced by that amount.

In case the default of the counterpart the documentary credit was accepted from seems probable, a provision has to be recorded.

P&L: treatment depends on the nature of the income generated from the documentary credit:

- interest-like fees are recorded under interest income,

- commission-like fees are to be accounted for under income from commissions.

1.12.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all balance sheet and off-balance sheet items in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The weighting applicable to calculate the capital requirements to cover credit risk is 20% if the documentary credit is guaranteed by the commodities and 50% if it is not.

1.13 Syndicated Loans

1.13.1 Definition

A loan made to a borrower by a group of banks all acting together, although one bank (the agent) will act on behalf of all of them for performing certain administrative tasks.

The main characteristics of syndicated loans are:

- A lead bank or a managing group is responsible for the composition of the syndicate and the negotiations with the borrower.
- Silent syndicate: the borrower has no information on the syndicate who is granting the credit.
- The administrative function such as payments to and from the borrower are centralised with the agent bank (the arranger is not necessarily the agent).
- Useful for credits involving substantial financing requirements, such as major projects, where one bank on its own could not supply the loan facility.
- Useful for credits implying higher risks, such as venture capital, where it would be too risky for one bank on its own to assume the underlying risks.
- Each bank assumes the credit risk for the amount of its participation.

1.13.2 Accounting

1.13.2.1 Balance Sheet

- Each bank only records the loan it has accepted to grant within the syndicate.
- The share of the credit that has already been used but has not yet been reimbursed is recorded as a loan.
- The difference between the credit line and the amount disbursed is recorded as an off-balance sheet commitment.

- In case the reimbursement of the credit appears to become doubtful, a value adjustment has to be recorded.

1.13.2.2 P&L

The interest income is recorded as such. When applicable, value adjustments are recorded as a charge in the profit and loss account.

1.13.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the loans in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured loans shall be weighted depending on the quality of the guarantor. There are no differences between syndicated loans and other types of loans.

1.14 Project Finance

1.14.1 Definition

The financing of a major capital project in which the lender looks principally at the cash flows and earnings of the project as the source of funds for repayment, and at the underlying assets of the project as collateral for the loan. The general creditworthiness of the project sponsors is usually not a significant factor, either because they are a corporation without major assets or because the financing is without direct recourse to the sponsors of the project.

The typical features of project finance are:

- Sponsors involved in a project are those who undertake to support the project. They might be a consortium of interested parties such as suppliers, purchasers or contractors.

- A special purpose company is usually created for the project.

- A syndicate of banks is formed to provide the required loan facilities.

There are different types of project finance, depending on the predicted profitability and the level of risks inherent to the project. On the basis of the latter, the bank will choose for:

- *No recourse* -> the lenders look exclusively at the cash flows and assets of the project and have no other form of external support. Such financing is rare.
- *Limited recourse* -> the lenders will benefit from some form of support or comfort either from the project sponsor or third parties.
- *Full recourse to the sponsor* -> all risks will be borne by the sponsors.

1.14.2 Accounting

The accounting treatment is equivalent to other types of lending.

1.14.2.1 Balance Sheet

- Each bank only records the amount it has accepted to grant within the syndicate.
- The share of the credit that has already been used but not yet reimbursed is recorded as a loan.
- The difference between the credit line and the amount disbursed is recorded as an off-balance sheet commitment.
- In case the reimbursement of the credit appears to be doubtful, a value adjustment has to be recorded.

1.14.2.2 P&L

The interest income is recorded as such. Where applicable, value adjustments are recorded as a charge in the profit and loss account.

1.14.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the loans in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured loans shall be weighted depending on the quality of the guarantor. There are no differences between project finance and other types of loans.

1.15.1 Asset Backed Securities (ABS)

1.15.1.1 Definition

ABS is a fixed income security that predominately derives its creditworthiness from cash flows relating to a pool of assets. An Asset Backed Security is distinct from traditional secured debt in that the bankruptcy or insolvency of the seller would not generally cause an interruption of cash flows to the investors.

Assets
- Mortgage loans: MBS

- Credit cards, car loans, etc.

Intermediaries
ABS are dealt on organised markets or OTC markets.
When they are issued, they can be guaranteed by governmental or quasi governmental institutions (GNMA, FNMA, FHLMC for the MBS), insurance companies or collaterals.

Use
Structural financing technique which isolates financial assets from the credit risk to the originator/issuer and monetises the financial assets' cash flow or market value in the capital markets.

1.15.1.2 Accounting

ABS are recorded in the bank's securities portfolio and valued according to the rules pertaining to the portfolio category into which they are allocated.

1.15.1.3 Regulatory aspects

The same capital requirements exist as for other securities portfolio positions (please, refer to "Bond trading").

1.15.2 Asset Swaps

1.15.2.1 Definition

An asset swap is a synthetic structure which allows an investor to swap fixed rate payments on a bond to floating rate while maintaining the original credit exposure to the fixed rate bond and to earn a corresponding return. The pricing of asset swaps is primarily driven by the credit quality of the issue and the size of any potential loss following default.

1.15.2.2 Accounting

The accounting and valuation is based on the rules relating to the recording of the underlying bond and swap.

1.15.2.3 Regulatory aspects

Please refer to the capital requirements detailed under "Swaps".

1.16 Real Property Certificates

1.16.1 Definition

A real property certificate is a security embodying a debt-claim against the issuing company.

This means, that the certificate holder has no legal title to the property, his right is equivalent to that of a creditor and not that of a joint owner or a shareholder in the issuing company.

It is an instrument to enjoy income from immovable properties. The certificates are bearer or registered securities representing a debt.

The certificate holder receives a share of the property rent and of the capital gain in the case of a sale in proportion to the certificates held. He bears the risks of the investment (vacancy, capital loss).

These certificates are exclusively known in Luxembourg.

1.16.2 Accounting

The valuation and the accounting of these certificates are similar to bonds (please refer to "Bond Trading").

1.16.3 Regulatory aspects

Please refer to the capital requirements for bonds discribed under "Bond Trading".

1.17 Distribution of Funds

1.17.1 Definition

An investment fund can appoint intermediaries to distribute the shares/units of the fund. The name of the distributors is detailed in the prospectus. The role of the distributor can be limited to the mere reception of the subscription and redemption orders or can include an active participation in the commercialisation of the shares/units.

Characteristics
Luxembourg-based distributors other than banks must be licensed by the Minister in charge of the financial centre as "professionals of the financial sector" and fit, among other, certain requirements in terms of minimum capital, infrastructure and quality of management and shareholders of the distributor.

Distributors may also act as nominees: they act in their own name towards the fund, but for the account of final investors. Their intervention should be clearly mentioned in the prospectus and their contract with the final investors must state that the investors have always the possibility to claim their ownership of the securities purchased through a nominee.

Investment funds governed by Part I of the Law of March 30, 1988 comply with the European UCITS Directive and can therefore be distributed in other European countries. Investment funds originating from other EU countries and complying with the UCITS Directive requirements are allowed to distribute their units/shares in Luxembourg. The authorisation given by the national authorities allows them to distribute their units/shares in the entire EU without having to be licensed by other EU national authorities.

Luxembourg is as a major location for the distribution of funds in Europe. The depth and range of services offered in connection with the establishment and administration of UCIs are a clear evidence for the high degree of professionalism and innovation of the Luxembourg fund industry.

1.17.2 Accounting

The distributor receives commissions for its services which are accrued in the balance sheet and P&L.

1.17.3 Regulatory aspects

There is no capital requirement for this type of service rendered as long as the distributor accepts no money related to the subscription and redemption of shares/units.

2

Association

des Banques

et Banquiers

Luxembourg

Interest Driven Products

2.1 Traditional Products

2.1.1 Definition

2.1.1.1 Savings deposit

Savings deposit is an interest-bearing deposit account, which normally carries with it certain access restrictions or minimum balance requirements.

2.1.1.2 Brokered deposit

A brokered deposit is a deposit placed by a broker, usually in amounts small enough to be fully covered by available deposit insurance, with banks offering the most attractive available interest rates.

2.1.1.3 Credit card

A credit card is a card issued to an individual (the "cardholder"), which identifies the cardholder and permits the cardholder to purchase goods or services on credit.

Credit cards are either two-party or three-party. A two-party card may be used only to acquire goods or services from the company that issued the card. A three-party card is issued by a specialised company and may be used to obtain goods or services from any supplier authorised by the issuer of the card. The cardholder must pay the card issuer for anything purchased with the card. Arrangements between the cardholder and the issuer may be an open account (in which case the credit card is usually called a "charge card") on revolving credit or on a budget account.

2.1.1.4 Hold-mail account

A hold-mail account is an account for which the customer has requested the bank to retain all correspondence that would normally be mailed to his home address. The customer will subsequently pick up this correspondance on a visit to the bank's premises. According to the bank's internal procedure, the customer will normally sign a discharge to the bank after collecting his correspondence.

2.1.1.5 Line of credit

A line of credit is an agreement between a bank and a customer whereby the bank agrees, over a specified future period, to lend the customer funds up to an agreed maximum amount. The customer may borrow as much of the "line" as is required and pays interest on the borrowed portion only. The customer may pay a fee to the bank as consideration for making the "line" available.

2.1.2 Accounting

Deposits are accounted on the liabilities side of the balance sheet "Amounts owed to customers/credit institutions". Advances made to customers relating to credit card purchases are recorded on the assets side of the balance sheet "Loans and advances to customers". A"Line of credit" is recorded on the assets side of the balance sheet "Loans and advances to customers" for the amount used by the customer, whereas the unused part is recorded in the off-balance sheet as "Confirmed credits, not used".

2.1.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all client accounts denominated in foreign currencies in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The weighting applicable to debtor accounts is the weighting applicable to the relevant debtor and depends on the quality of the guarantees and collateral received.

2.2 Time Deposits

2.2.1 Definition

Time deposit refers to money placed by a customer or a financial institution with another financial institution for a certain period of time and bearing interest at a certain rate.

2.2.2 Accounting

In the books of the financial institution, which places a time deposit:

- It is recorded as a loan ("Loans and advances to credit institutions") on the assets side of the balance sheet. Interest income is credited to profit and loss and accrued in "Prepayments and accrued income" on the assets side.

In the books of the financial institution, which receives a time deposit:

- It is recorded as a deposit ("Amounts owed to credit institutions/to customers") on the liabilities side. Interest expenses are charged to profit and loss and accrued in "Accruals and deferred income" on the liabilities side.

2.2.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include all time deposits made by customers denominated in foreign currencies in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirements in excess of 2% of the eligible own funds. An alternative method based on statistics may also be used.

2.3 Repurchase Agreements (REPOs) – Reverse Repurchase Agreements (Reverse REPOs)

2.3.1 Definition

The REPO is a transaction in which the seller transfers the full property of securities for an initially agreed price and by which the seller and the purchaser commit themselves to reverse, at a determined date and price, this transaction (securities will be retroceded by the purchaser and the proceed will be paid back by the seller). The reverse REPO consists in a REPO transaction from the buyer point of view.

2.3.1.1 Use
Concerning the seller:

From the seller’s point of view, a repo primarily represents an alternative source of refinancing. It may also be used however to speculate on the interest rate curve.

Concerning the purchaser:

It allows to respect the required obligations in securities investments.
It is also a way to reverse an arbitrage in a reverse cash and carry operation.

2.3.2 Accounting

Based on the economical background of the transaction, there is no effective transfer of securities from the seller’s to the purchaser’s portfolio.

Securities remain in the seller’s balance sheet, but must be maintained in a specific account. The seller records a debt towards the purchaser. The purchaser records a credit towards the seller.

The debt expenses (seller) and the credit income (purchaser) are recorded as interests in the P&L account.

2.3.2.1 Valuation

The seller continues to value the securities sold in compliance with the rules applicable to the portfolio in which they are recorded.

The purchaser maintains the value of the loan based on the transaction value defined in the REPO contract.

2.3.2.2 Securities

All securities can be the object of REPO transactions.

2.3.2.3 Intermediaries

Repo market: securities dealers, bank trust departments, municipalities, corporations and money market funds.

2.3.3 Regulatory aspects

Genuine sale and repurchase agreements included in the banking book are subject to capital requirements to cover credit risk. The transferor shall weight the assets sold under such agreements by using the weighting applicable to the issuer. The transferee may, under certain conditions, apply the lower of the 2 following weightings: the weighting applicable to the transferor and the weighting applicable to the assets received, provided that certain conditions are fulfilled. Notwithstanding the general rule (weighting applicable to the counterpart), in the case of repurchase agreements on the basis of a firm agreement to sell with an option to repurchase, the weightings applicable shall be those attached to the assets and not to the counterparts of the transactions.

In the case of repurchase agreements included in the trading book and in order to meet the capital requirements to cover the settlement/delivery risk, credit institutions shall calculate the difference between the market value of the securities and the amount borrowed by the institution (interests included). In the case of reverse repurchase agreements, credit institutions shall calculate the difference between the amount lent (interests included) and the market value of the securities. Where the difference is positive, the capital requirement shall be 8% of such difference, multiplied by the risk weighting applicable to the relevant counterpart.

Debt securities or guaranteed rights relating to debt securities' entitlement which are subject to a repurchase agreement shall be included in the calculation of net positions with respect to capital requirements to cover interest rate risk, provided that they are included in the trading book. Capital requirements must be sufficient to cover the specific risk (risk of a price change due to factors related to the issuer of the collateral) and the general risk (risk of a price change due to a change in the level of interest rates). By contrast, no capital requirement shall be calculated in respect of debt securities or guaranteed rights relating to debt securities' entitlement which are subject to a reverse repurchase agreement.

Variable-yield securities or guaranteed rights relating to variable-yield securities' entitlement which are subject to a repurchase agreement shall be included in the calculation of net positions with respect to capital requirements to cover the risk of variation in the price of equities, provided that they are included in the trading book. Capital requirements must be sufficient to cover the specific risk (risk of a price change due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change due to a change in the overall level of the market). By contrast, no capital requirement shall be calculated in respect of variable-yield securities or guaranteed rights relating to variable-yield securities' entitlement which are subject to a reverse repurchase agreement.

2.4 Certificates of Deposit

2.4.1 Definition

Certificates of deposit (CDs) are negotiable bearer unsecured promissory notes with short to medium-term maturity issued by banks as receipt for deposits placed with them for a fixed period.

These securities are mainly bought by institutional and professional investors. Usually issued at a discount by using a group of dealers, certificates of deposit are traded on the international secondary market.

2.4.2 Accounting

If the CD is issued on a discount basis by the bank, it is recorded in the balance sheet at its reimbursement value. The discount is booked in the transitory account in the balance sheet and amortised prorata temporis in the P&L.

CDs are booked in the off-balance sheet when the bank is acting as dealer/broker.

CDs invested in by the bank, qualifying as a "security" are recorded in one of the bank's securities portfolio:

- trading,
- investment,
- placement.

If the CD is issued on a discount basis, the discount is considered as an interest income booked in the P&L prorata temporis and in the transitory account in the balance sheet.

The valuation of the CDs depends on the portfolio classification.

CDs not qualifying as a "security" are recorded in the loan portfolio of the bank.

2.4.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the certificates of deposit denominated in foreign currencies in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Issued certificates of deposit are not subject to any capital requirement to cover credit risk. Purchased certificates of deposits, if they are part of the banking book, are subject to capital requirements to cover credit risk by applying a weighting depending on the quality of the counterpart.

If those certificates are part of the trading book, transactions unsettled after their due delivery dates (spot or forward sale or purchase of securities) and free deliveries (undelivered but purchased and paid securities or unpaid but sold and delivered securities) are subject to capital requirements to cover settlement/delivery risk and counterpart risk. Those requirements are calculated as a percentage applied either on the difference between the market value and the settlement value or directly on the settlement value. Those percentages are increasing with the quality of the counterpart and the ageing of the unsettled transaction.

Certificates of deposit from the trading book are subject to a specific capital requirement to cover the interest rate risk. Capital requirements must be sufficient to cover the specific risk (risk of a price change in the certificate of deposit due to factors related to the issuer of the certificate) and the general risk (risk of a price change in the certificate due to a change in the level of the interest rates).

Finally, the certificates included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover the specific risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

2.5 Commercial Papers

2.5.1 Definition

Commercial papers (CPs) are negotiable bearer unsecured promissory notes with short-term maturities less than a year issued by corporate, public or semi-public entities.

These securities are mainly bought by institutional and professional investors. Usually issued at a discount by using a group of dealers, commercial papers are traded on the international secondary market.

2.5.1.1 Use

Optimisation of cash management: CPs are flexible short-term investments providing a yield depending on the rating of the issuer.

2.5.2 Accounting

CPs are booked in the off-balance sheet when the bank is acting as dealer/broker.

CPs invested in by the bank, qualifying as a "security" are recorded in one of the following securities portfolios of the bank:

• trading,
• investment,
• placement.

If the CP is issued on a discount basis, the discount is considered as an interest income booked in the P&L prorata temporis and in the transitory account in the balance sheet.

The valuation of the CP depends on the portfolio classification.

CPs not qualifying as a "security" are recorded in the loan portfolio.

2.5.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the commercial papers denominated in foreign currencies in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Issued commercial papers are not subject to any capital requirement to cover credit risk. Purchased commercial papers, if they are part of the banking book, are subject to capital requirements to cover credit risk by applying a weighting depending on the quality of the counterpart.

If those commercial papers are part of the trading book, transactions unsettled after their due delivery dates (spot or forward sale or purchase of securities) and free deliveries (undelivered but purchased and paid securities or unpaid but sold and delivered securities) are subject to capital requirements to cover settlement/delivery risk and counterpart risk. Those requirements are calculated as a percentage applied either on the difference between the market value and the settlement value or directly on the settlement value. Those percentages are increasing with the quality of the counterpart and the ageing of the unsettled transaction.

Commercial papers from the trading book are subject to a specific capital requirement to cover the risk associated with variation in the price of securities. Capital requirements must be sufficient to cover the specific risk (risk of a price change in the instrument due to factors related to the issuer of the certificate) and the general risk (risk of a price change in the certificate due to a change in the overall level of the market).

Finally, the certificates included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover the specific risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

2.6 Lombard Credits

2.6.1 Definition

Financing facilities to customers, typically short term, allowing the borrower to build up a securities portfolio which is then pledged in favour of the lending bank. The customer is usually required to give as a collateral a certain percentage of the total investment (so called "margin"), which varies from bank to bank and is set in accordance with the nature of the underlying investment (bonds or shares). Contracts usually include the requirement that the market value of the pledged portfolio should not show unrealized losses which are in excess of the margin, and in this case allow the lending bank to request additional collateral or to liquidate the portfolio.

2.6.2 Accounting

Lombard credits are recorded like any other standard credits on the assets side of the balance sheet.

Guarantees received by the bank have to be recorded:

- in its balance sheet if they are in the form of cash received by that bank;

- in its off-balance sheet if they are in the form of securities.

2.6.3 Regulatory aspects

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured loans shall be weighted depending on the quality of the guarantor. There are no differences between Lombard credits and other types of loans.

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the Lombard credits in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

2.7 Swaps

2.7.1 Definition

A swap is an agreement between two counterparts to exchange cash flows of different characteristics in the future over a determined period.

Open swap positions can be settled through a reverse swap contract with the same characteristics.

There are four main categories of swaps:

- Interest Rate Swaps (IRS),

- Currency Swaps,

- Cross Currency Interest Rate Swaps,

- Performance Swaps.

An *Interest Rate Swap* is an agreement between two counterparts to exchange interest rate payments on a specified amount (referred to as notional principal) for a specified period. In the most common instance, a swap involves the exchange of streams of variable- and fixed-rate interest payments. There is no transfer of principal.

A *Currency Swap* is an exchange of principal denominated in two different currencies at the current rate, under an agreement to repay the principal at a specified future date at a specified rate.

A *Cross Currency Interest Rate Swap* is an Interest Rate Swap where the interest flows to be exchanged are calculated on different principal amounts expressed in different currencies.

A *Performance Swap* is an agreement between two parties to exchange a cash flow linked to an index performance with an interest rate payment.

2.7.1.1 Use

For the bank's own account:

- Assets and Liabilities Management tool,
- Arbitrage,
- Re-financing,
- Hedging of currency and interest rate risk,
- Optimisation of its own portfolio management.

For the client's account: providing clients with a tailored hedge against currency and interest risk.

The bank can act as:

- intermediary (commission revenue)
- counterpart (global management of a swap portfolio).

2.7.1.2 Valuation

Three methods:

- "zero coupon" method – update of future cash flows,
- margins updating,
- replacement cost.

2.7.2 Accounting

2.7.2.1 Interest Rate Swaps:

Off-balance sheet entry: at the trade date, recording of the principal commitment amount (no transaction netting is allowed).

Interests receivable/payable are booked prorata temporis in:

- Balance sheet: transitory accounts.
- P&L: different accounts are used according to use of the swap (for hedging purpose: gain/loss on financial instrument is recorded as an interest income/expense; for trading purpose: result is recorded as a net profit/loss on financial operations).

Interest payment/receipt: accounting occurs via nostri accounts against transitory accounts.

At maturity: reversal of the off-balance sheet commitment and final payment/receipt of interest.

2.7.2.2 Currency Swaps

Off-balance sheet entry: at the trade date, recording of the principal commitment amount (no transaction netting is allowed).

At value date of the spot position, recording of the spot sale and purchase in both currencies of the swap in the balance sheet using a nostro account.

At regular intervals:

- recording and neutralisation of the revaluation of the spot position of the swap,
- recording of the unrealised gain/loss on an accrual basis (swap premium/ discount).

At maturity: reversal of the off-balance sheet commitment and recording of the forward leg using the same nostri accounts as for the spot leg of the swap.

2.7.2.3 Cross Currency Interest Rate Swap

For the accounting, considered as a currency swap linked to an IRS.

2.7.2.4 Performance Swap

Same accounting scheme as IRS (performance related income/expense received / paid instead of interest).

2.7.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the swaps denominated in foreign currencies in the net open positions by currency. Those swaps shall be regarded as a combination of a long and a short position. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Moreover, as most swap contracts are traded over-the-counter, an additional capital requirement to cover credit risk is demanded. This capital requirement, generally based on the market value of the contract ("current exposure method"), is added to the potential future credit exposure (depending on the remaining time to maturity) and subject to a 50% maximum weighting (depending on the quality of the counterpart).

Finally, the contracts included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover credit risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

2.8 Cash Vouchers

2.8.1 Definition

Cash vouchers are similar to time deposits, but the loan they represent (granted by the customer to the credit institution) is materialised by a paper.

They are non-negotiable promissory notes or bearer securities with medium- to long-term maturity issued by banks. The maturities are generally from 1 to 10 years (1 month to 5 years in France).

They are interest-bearing instruments paying yearly coupons. Most cash vouchers are issued on a tap basis and are evidenced by physical certificates. Their safekeeping with the bank issuing them is normally free of charge, as is the payment of coupons and reimbursement of capital. They are sold mainly to private investors who hold them until maturity. They are only negotiable at the issuer's counters. All large commercial banks in Luxembourg use this popular instrument to raise funds from their customers.

2.8.2 Accounting

Cash vouchers issued by a credit institution are recorded for their reimbursement value on the liabilities side of the balance sheet.

Interests due but not yet paid are recorded on a prorata temporis basis in the transitory account on the liabilities side of the balance sheet and as an interest expense in the P&L account.

2.8.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the cash vouchers denominated in foreign currencies in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

Cash vouchers issued by the credit institution are not subject to any capital requirements to cover credit risk.

2.9 Consumer Loans

2.9.1 Definition

A consumer loan is a fixed rate loan granted for the purchase of goods and services which is repayable by the borrower according to a fixed schedule of instalments, i.e. fixed amounts and maturity. Each instalment consists partly of capital and interests.

An IOU (I owe you) is a written acknowledgement of a debt of a specified sum bearing these letters, addressed to a creditor, dated and signed by a borrower. It is not evidence that money has been lent and it is not a negotiable instrument.

A Promissory Note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a certain amount of money to, or to the order of, a specified person or to the bearer. A note payable to the maker's order must be endorsed by the maker. The note is uncomplete until delivery to the payee or bearer. It is often used in the financing of foreign trade. A promissory note may involve two or more makers, and they may be liable thereon jointly and severally, according to its tenor.

2.9.1.1 Use

To realise interest margins from the gap between the loan interests and the refinancing interests.

To provide the possibility to a customer, who does not at that time have sufficient funds at his disposal, to make a particular purchase.

2.9.2 Accounting

2.9.2.1 Balance sheet

- Consumer loans are included under "Loans and advances to customers" equal in total to the amount of the loans.
- Receivables backed by non-transferable securities (for example promissory notes) are also included under the above item.
- That portion of the loan interest which is accrued but not yet due, is included under assets under the item "Prepayments and accrued income".
- Reductions in the value of individual loans are recorded as value adjustments against these loans.

2.9.2.2 P&L

- Interests income is to be included under "Interest receivable and similar income".
- Commissions received in connection with consumer loans, which are not similar in nature to interests have to be included under "Commission income".

2.9.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the loans in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured loans shall be weighted depending on the quality of the guarantor.

2.10 Building Society Products

2.10.1 Definition

A Building Society is a specialised bank for financing construction projects through target savings. Several years' savings are yielded for a target savings amount previously determined by contractual agreement. The target savings are a condition for the granting of a building society loan under favourable terms. The target savings amount is prorated using specific valuation figures in accordance with specific waiting times and the savings.

Building societies are very common in other European countries like Germany or the UK. Some of them operate in Luxembourg or distribute their products through Luxembourg banks acting as an intermediary.

2.10.1.1 Use

Providing favourable interest rates for loans granted for the purchase or the building of homes.

2.10.2 Accounting

There are no specific rules for the savings amounts and the loans relating to the building society business, which are recorded in the same way as ordinary savings accounts and loans.

2.10.3 Regulatory aspects

Building Societies operate as credit institutions and have to comply with capital adequacy requirements pertaining to loan portfolios.

2.11 Mortgage Bonds

2.11.1 Definition

A mortgage bond is a fixed interest bond that is issued by specialised mortgage bond issuing banks according to the Luxembourg mortgage bank law dated November 21, 1997. The Luxembourg law allows these specialised banks to give credits to all reliable public institutions within the OECD against mortgages or encumbrances.

The main characteristics of mortgage bonds are:

- they represent transferable securities,
- they are secured against a mortgage or an encumbrance or against credits to public institutions.

2.11.1.1 Use

Mortgage bonds are used as an investment for institutional and private investors. The mortgage bank grants credits against mortgages/encumbrances.

2.11.2 Accounting

2.11.2.1 Balance Sheet

Mortgage bonds are recorded as assets under debt securities and other fixed-income securities.

2.11.2.2 P&L

The interests are recorded under interest income.

2.11.3 Regulatory aspects

Mortgage bonds are subject to the same capital requirements as fixed-income securities whose issuer is a credit institution from Zone A, i.e. a 20% weighting applicable for the purpose of calculating capital requirements to cover credit risk.

2.12 Bond Trading

2.12.1 Definition

Buying and selling of fixed-income securities for a bank's own account as well as for third parties.

For valuation and accounting purposes with respect to bonds held for own account, credit institutions are required to divide their portfolio of fixed-income securities into three categories:

2.12.1.1 Investment Portfolio
Bonds, which are intended for use on a continuing basis in the undertaking's activities. As the period of time over which the bonds have to be held is not defined, it follows that the bank must have the intention to hold the bonds until maturity. As this categorisation depends on the intention of the bank, it is, nevertheless, possible that bonds are resold before maturity.

2.12.1.2 Trading portfolio
Bonds, which are originally purchased or sold with the intention of selling them or repurchasing them in the immediate short term and which have the following characteristics:

- they are traded on a market whose liquidity can be assumed to be certain;

- the market price of the bonds is at all times available to third parties.

Bonds with the intention of resale in the short term but which do not have the above characteristics must be included in the structural portfolio.

2.12.1.3 Structural portfolio
Bonds, which are neither financial fixed assets nor included in the trading portfolio. In principle, they are securities purchased for their investment return/yield or held to establish a particular asset structure or a secondary source of liquidity.

For each of the three mentioned categories separate accounting records have to be maintained by the banks.

2.12.2 Accounting

2.12.2.1 Balance sheet
- Fixed-income securities are included under sub-item "Treasury bills and other bills eligible for refinancing with the central bank" or "Bonds and other fixed income securities".

- The portion of the coupon income purchased, which is not yet due, does not form part of the purchase price, without prejudice to the specific treatment authorised for securities issued on a discounted basis. This portion is included under sub-item "Prepayments and accrued income" until the coupon payment date.

- Securities issued on a discounted basis (e.g. zero-bonds) are subject to a specific accounting treatment, whatever category of securities they belong to. The difference between the issue (or purchase) value and the par (or reimbursement) value represents the sole source of income. Therefore this difference is treated as income which has to be spread over the period that the security remains in the bank's portfolio on the basis of compound interest. The accrued interest calculated in this manner serves to increase the carrying value of the security, it is booked to the securities portfolio accounts and not to the transitory accounts.

- Fixed-income securities held for third parties are not included in the balance sheet but rather in the off-balance sheet of banks.

2.12.2.2 Valuation

Investment portfolio

- Banks are permitted to value their portfolio of financial fixed assets at purchase price, if the securities are issued or guaranteed by public sector borrowers from industrial countries, if they have a fixed maturity date, if the decision to perform this valuation does not adversely affect the bank's liquidity, if the volume of these securities does not exceed in amount the bank's capital and reserves as defined in current legislation and if any disposal before maturity or transfer into another category is authorised by a formal resolution of the bank's decision-making body. If these conditions have not been fulfilled simultaneously, the securities must be valued by the lower of cost or market principle. For securities linked to interest rate swaps there are other specific conditions in order to value them at purchase price.

Trading portfolio

- The basic rule is that securities should be valued by the lower of cost or market principle. In addition, exceptional value adjustments are permitted (as defined in art 58(2) of the Law of 17 June 1992 on banks' accounts) where, on the basis of a reasonable commercial assessment, these are necessary if the valuation of these securities is not to be modified in the near future because of fluctuations in market value.

Exempting conditions are defined in art. 58 (3) of the same law, under which credit institutions may value their trading portfolio by the mark-to-market method and making a specific note disclosure in the annual accounts. Exceptional value adjustments are also permitted in this case. If the mark-to-market method is retained, it must be used for all the securities in the trading portfolio.

Structural portfolio

- Securities included in the structural portfolio may only be valued by the lower of cost or market principle. In the same way as for the trading portfolio, exceptional value adjustments are permitted. Under the terms of art. 62 of the above mentioned law, banks are permitted to make value adjustments up to a certain limit, which result in a value lower than that which would result from the application of art. 58 (2).

2.12.2.3 P&L

Investment portfolio

- In the case of sale or maturity of the securities, gains and losses are recorded in the profit and loss account under item "Value re-adjustments in respect of transferable securities held as financial fixed assets, participating interests and shares in affiliated undertakings" or under item "Value adjustments in respect of transferable securities held as financial fixed assets, participating interests and shares in affiliated undertakings". Gains and losses are to be shown on a net basis.

- Interest income on these securities is to be included under item "Interests receivable and similar income".

- Value adjustments are to be included under item "Value adjustment in respect of transferable securities held as financial fixed assets, participating interest and shares in affiliated undertakings".

- Any premium or discount on securities is released on a prorata basis to the P&L through the interest income accounts and the transitory accounts in the balance sheet.

Trading portfolio

- In the case of sale or maturity of the securities, gains and losses are recorded in the profit and loss account under item "Net profit/loss on financial operations".

- Interest income is included under "Interest receivable and similar income".

- Value adjustments and amounts released to income following the writing back of such value adjustments are included under "Net profit/loss on financial operations".

Structural portfolio

- If art. 62 of the Law of 17 June 1992 is not applied, gains or losses on sales are included as a net amount under item "Net profit/loss on financial operations".

- Interest income is to be included under "Interest receivable and similar income".

- Value adjustments and the writing back of such adjustments are included under item "Net profit/loss on financial operations" (if art. 62 is not applied) and under

"Value adjustments in respect of loans and advances and provisions for contingent liabilities and commitments" (adjustments) respectively "Value re-adjustments in respect of loans and advances and provisions for contingent liabilities and commitments" (writing-back), for the valuation relating to art. 62.

- For securities which are held for third parties, the related income is accounted under the sub-item "Commission income" (especially "Commission for safekeeping of assets belonging to third parties" and "Commission for asset management").

2.12.2.4 Off-Balance Sheet

- All investment management services (e.g. safekeeping of assets) and underwriting functions as a result of which the bank can be held responsible for negligence or for not fulfilling its duties are included under the item "Investment management services and undertaking functions".

2.12.3 Regulatory aspects

The bond trading portfolio, as part of the trading book, is marked-to-market and included in the net open positions by currency for the purpose of calculating the capital requirement to cover the foreign exchange risk. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The bond trading portfolio is included in the calculation of net positions with respect to capital requirements to cover interest rate risk as it is included in the trading book. Capital requirements must be sufficient to cover the specific risk (risk of a price change due to factors related to the issuer of the underlying instrument) and the general risk (risk of a price change due to a change in the level of interest rates).

Transactions unsettled after their due delivery dates (spot or forward sale or purchase of securities) and free deliveries (undelivered but purchased and paid securities or unpaid but sold and delivered securities) are subject to capital requirements to cover settlement/delivery risk and counterpart risk. Those requirements are calculated as a percentage applied either on the difference between the market value and the settlement value or directly on the settlement value. Those percentages are increasing with the quality of the counterpart and the ageing of the unsettled transaction.

Finally, the bonds included in the trading book are subject to an additional capital requirement due to excesses over the limits of large exposures. This requirement equals 200% minimum weighting on the capital requirement to cover the specific risk mentioned above and is subject to multiplication factors as from the 11th day following the excess.

2.13 ECB OMO Instruments (European Central Bank Open Market Operations Instruments)

2.13.1 Definition

Open market operations are the main instrument used by the European Central Bank to implement its monetary policy. They aim at steering interest rates, managing the liquidity situation in the market and signalling the monetary policy stance. Thus, they show the trend of monetary policy within the Economic and Monetary Union. Most of the European Central Bank's open market operations consist of reverse transactions against eligible collateral.

There are four types of open market operations:

- *Main refinancing operations (MROs):* these operations aim at injecting liquidities into the market. They represent the main part of financial sector refinancing. They are scheduled, their frequency is weekly and they usually mature after 2 weeks.

- *Long term refinancing operations (LTROs):* they aim at providing the financial sector with supplementary refinancing, through temporary cession operations. These operations are usually conducted at floating rates. They are scheduled, their frequency is monthly and they usually mature after 3 months.

- *Fine tuning operations:* they aim at managing the system liquidity and compensating sudden fluctuations of liquidity. They can be used either to inject liquidities into the market or to withdraw liquidities from the market. These operations may be conducted through reverse transactions, outright purchases and sales of assets, collection of deposits or foreign exchange swaps.

  While the MROs and LTROs are conducted through standard tenders, fine-tuning operations can be performed either through quick tenders or through bilateral arrangements, except for outright operations which can be carried out only through bilateral transactions.

- *Structural operations:* they have a longer time horizon and a maturity which may or may not be standardised. They aim at withdrawing liquidities by the means of debt certificates' issuance and fixed sales or at injecting liquidities by the means of reverse transactions or fixed purchases. Reverse transactions and issuance of debt certificates are made through standard tenders whereas fixed operations are made through bilateral agreements.

Structural operations thus allow to fit the structural position of the European System of Central Banks to the financial system.

2.13.2 Accounting

MROs and LTROs operations are recorded as debts towards the Luxembourg Central Bank in the records of banks. Regarding fine tuning operations and structural operations, refer to other sections as the accounting rules depend on the product used.

2.13.3 Regulatory aspects

Please refer to each type of instrument. Indeed, ECB OMO instruments are a means to achieve monetary policy. The transcations are similar to other types of transactions used in the banking sector and are treated in the same way as regards capital requirements.

2.14 Portage Operations

2.14.1 Definition

These are balance sheet transactions (as opposed to fiduciary transactions) for the bank, which takes a minority stake in a corporation's equity on behalf of a third party. At the same time it enters into put and call option contracts with a third party in order to be able to liquidate its investment at a given time and at a given price. The strike price of the options is set in such a way as to remunerate the bank's capital commitment at a pre-agreed interest rate; this allows the bank to accrue over time the difference between purchase price and strike price, instead of accounting for it in one shot at expiry date as a capital gain. Full and timely exercise of the options is guaranteed to the bank by the collateralisation of liquid assets.

2.14.2 Accounting

Normally, only the commission received for the portage operation is recorded as income in the bank's P&L account. The income is accrued prorata temporis until the maturity of the agreement.

Banks acting as bearer in portage operations usually consider that they are owner of the securities. The accounting and valuation treatment of portage operations depends on whether the principal commits itself to repurchase the securities or not:

- If the principal can repurchase the securities but has no obligation to repurchase them, securities have to be recorded as an asset in the balance sheet of the bank acting as bearer. The securities have to be valued like other securities held by the bank.

- If the principal is committed to repurchase the securities, the securities still have to be recorded in the balance sheet of the bank acting as bearer. However no value adjustment has to be recorded in case of decrease in value.

2.14.3 Regulatory aspects

The same capital requirements apply as for other equity investments of the bank described elsewhere in this guide.

2.15 Real Estate Financing

2.15.1 Definition

Companies and private persons acquiring a property can get long term financing from a bank by pledging the property as security for the loan. The bank estimates the market value of the property and offers the company or the private person financing normally up to an amount of around 70-90% of the value of the property.

2.15.2 Accounting

2.15.2.1 Balance sheet
The long term financing of properties is included under the sub-item "Loans and advances to customers".

2.15.2.2 P&L
The income from the long term financing is included under the sub-item "Interest receivable and similar income".

2.15.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the loans in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans shall be weighted depending on the quality of the counterpart and that secured items shall be weighted depending on the quality of the guarantor.

2.16 Assets & Liabilities Management

2.16.1 Definition

The purpose of this activity is to take up and manage short and long- term rate positions, having regard to the anticipated trend of currency and interest rates. This position management is effected with previously fixed operational limits and in compliance with prudent rules for commitments.

NB: ALM is not a product as such but rather a bank's position management technique for which no specific accounting or regulatory rules exist which should be explained under this section.

2.17 Brokerage Operations

2.17.1 Definition

This activity consists in taking customers' orders for stock market transactions for execution via a broker; the transactions are then performed for the account and in the name of the individual customer.

2.17.2 Accounting

In connection with the brokerage services rendered by a bank to customers, the bank is entitled to a commission which is recorded as commission income.

2.17.3 Regulatory aspects

This intermediation service does not call for particular comments as regards regulatory aspects.

3

Association

des Banques

et Banquiers

Luxembourg

Hybrid Products

3.1 Security Origination

3.1.1 Definition

The purpose of this activity is to obtain lead mandates from issuers. Origination is very often accompanied by syndication under which other banks are invited to take part in a managed issue. This activity likewise covers the placing of positions taken up after syndication with professional intermediaries and institutional investors and market making for issues led by the bank by buying or selling the securities concerned.

3.1.2 Accounting

In connection with the origination services rendered by a bank, it is entitled to a fee which is recorded as commission income.

The market making activity might lead to securities positions recorded in the bank's securities portfolio.

3.1.3. Regulatory aspects

If the bank holds securities in connection with this particular activity, they will be subject to the same capital requirements as other securities held by the bank.

3.2 Asset Management

3.2.1 Definition

Asset management comprises management of customer assets according to his personal wishes and in the light of his personal situation and resources. When the customer takes the ultimate investment decision, the asset manager monitors the assets entrusted to him and, if he has an advisory role, makes recommendations for the selection of investments. Asset management can also be discretionary or mandate-based; the customer gives the asset manager the authority to select the investment products and vehicles for the assets entrusted to him and to perform all the transactions which the asset manager regards as necessary for the exercise of his mandate. To satisfy the growing demand for asset diversification, the use of structured products provides opportunities for higher performance.

Asset management may also be performed by a bank for institutional investors.

NB: the accounting and regulatory aspects are treated in the sections hereafter.

3.3 Discretionary Management

3.3.1 Definition

Discretionary management refers to investment accounts over which the fiduciary agent (i.e. the bank) has the power to make and execute investment decisions without approval from the benefical owner. This latter gives the fiduciary agent discretion to buy and sell securities or commodities including selection, timing, amount and price to be paid or received. Conditions and extent of the power are defined and detailed in a discretionary management contract.

Assets managed on a discretionary basis remains the legal property of the benefical owner. The bank is normally discharged from any performance obligation.

3.3.2 Accounting

Assets managed by a credit institution on a discretionary basis are recorded in the off-balance sheet accounts of the credit institution under the item "Investment management services and undertaking functions".

If they take the form of cash deposits, these assets also have to be recorded on the liabilities side of the balance sheet as "Amounts owed to customers".

3.3.3 Regulatory aspects

There is no specific regulation on discretionary management, except for assets, which are managed under fiduciary contracts covered by the Grand Ducal Regulation of July 19, 1983 (please, refer to section on fiduciary agreements).

Since the assets manged on a discretionary basis do not belong to the bank and are recorded off-balance sheet, there are no particular capital requirements except for such transactions that might affect the bank's balance sheet or off-balance sheet (e.g. loans, cash deposits, financial instruments).

3.4 Advisory Products

3.4.1 Definition

Advisory products encompass a wide range of services provided for private banking customers. The core service entails the delivery of specific advice on investment products, such as bonds, shares, investment funds, forex and derivative products. Varying from one bank to the other and depending on the potential of the customer, it can range from the most simple sale of a single product to the most sophisticated financial strategy (multi-currency and multi- instrument). It usually involves other services, such as safekeeping of securities, automatic reinvestment of large cash balances, the covering of debit balances and the arbitrage of securities under certain conditions. Investment advice is one of the most important private banking products in Luxembourg.

In recent years, banks have also managed to generate a substantial amount of fee income for the rendering of corporate advisory services. Such services include the following:

- *Mergers and acquisitions:* assistance with the drawing up of detailed acquisition criteria based on the client's objectives, research of companies which may fit the criteria, establishment of the feasibility of any proposed acquisition, advice on the price to be paid, assistance with the negotiations.
- *Capital raising:* assistance in constructing financing packages best suited to a company's needs; assistance with the legal, tax and regulatory issues associated with capital raising, pricing of any issue and liaison with underwriters if applicable.
- *General advice:* this may include suggestions on matters such as dividend policy, advice on stock exchange listing procedures and other miscellaneous matters. Some banks also provide advice on treasury management issues such as cash management and short term lending/borrowing strategies.

3.4.2 Accounting

Fees generated by advisory services are credited to the profit and loss account as commission income.

3.4.3 Regulatory aspects

These advisory services do not call for any particular comments as regards regulatory aspects.

3.5 Paying and Listing Agent Services

3.5.1 Definition

The Paying agent function is a service rendered to debt issuers. The bank centralises the payment of interests and principal (bonds) or dividends (equities) to bond-and stockholders.

The Listing (issuing) agent function covers the management and reporting to the issuers of the share and debt instruments concerned. The bank assumes the listing on the Luxembourg Stock Exchange by preparing the necessary documents and by making the necessary applications. For issuing debts, the bank may also manage the building of a loan syndication.

A part of the two issuing functions can be the commitment to underwrite the whole or a previously agreed portion of an issue on the financial market at a predetermined price.

3.5.2 Accounting

3.5.2.1 Balance sheet

The agent functions are basically not part of the balance sheet except if the bank has to buy the underwritten securities.

3.5.2.2 P&L

Fees obtained for the agent functions are included in the profit and loss account as commission income.

3.5.2.3 Off-Balance Sheet

The commitments to underwrite issues are included in the off-balance sheet sub-item "Securities underwriting" at the price agreed with the issuer, adjusted by amounts which are already placed and by the amount of possible sub-participations (net amount).

Agent functions in connection with a loan syndication or the basic issuance of debt instruments (not the underwriting of issues) are included in the off-balance sheet sub-item "Agency functions".

The paying agent function is also a part of the off-balance sheet and is also recorded in the above sub-item.

3.5.3 Regulatory Aspects

These services are not subject to particular regulatory requirements except for securities recorded in the balance sheet in connection with an underwriting transaction.

3.6 Investment Funds

3.6.1 Definition

Investment fund is the generic term for all collective investment schemes designed to offer diversification and professional advisory management to each of its investors. Investment funds have various legal statuses and can invest in all types of financial assets and in real estate. Most funds invest either in bonds, shares, money market instruments or a mixture of securities. Generally they do not offer a fixed performance, nor do they have a fixed maturity date. Revenues are paid either by dividend distribution or capital appreciation. They are sold to all kinds of investors: private individuals, institutions, corporates and banks. Many investment funds allow investors to buy and sell their shares/units at any moment. Some are also quoted on stock exchanges or traded on the secondary market. Luxembourg banks usually play different roles in investment funds: as manager, promoter, distributor, custodian bank, administrative, transfer, registrar or paying agent.

3.6.1.1 Luxembourg legislation

The Law of March 30, 1988 defines and regulates the investment funds which are allowed to sell their units in Luxembourg, after having been authorised by the CSSF.

The first part of the law is dedicated to UCIs (Undertakings for Collective Investments) investing in transferable securities (UCITS) and complying with the European UCITS Directive 85/611/EEC. Other UCIs are ruled by part II of the law. Finally part III of the law defines the rules applicable to foreign UCIs.

The IML (former name of the CSSF) issued a circular dated January 21, 1991 (Circular 91/75) which gives interpretation guidance about the above law. The Law dated July 19, 1991 creates a legal framework for private investment funds specifically targeted at institutional investors.

3.6.1.2 Characteristics

Luxembourg has achieved a solid reputation in the investment fund business based on many years of experience. The country offers a wide range of services in connection with UCIs.

The umbrella fund structure is a specificity of the Luxembourg law. Up to now very few other EU countries have provided for such a structure. This umbrella structure gives the possibility, under Luxembourg law to create multiple investment compartments. In umbrella funds, investors can switch from one sub-fund to another one.

A further advantage of the Luxembourg law is the possibility of expressing the base currency of the fund in a currency different from the Luxembourg franc.

Luxembourg has implemented the requirements of the European Directive on UCITS in its legislation, so that UCIs registered in Luxembourg and governed by part I of the law can be distributed in all member states of the European Union.

The issue of different classes of shares or units is possible and corresponds to:

- a specific distribution policy such as entitling to dividend distributions or not

- a specific sales and redemption charge structure.

Regarding the legal structure, UCIs may be set up as mutual funds (Fonds Commun de Placement, FCP) or investment companies (Sociétés d'Investissement à Capital Variable /Fixe, SICAV /SICAF). SICAV is an investment company with a variable capital adopting the legal form of a public limited liability company. A FCP does not constitute a legal entity itself and can only function in connection with a company in charge of managing the FCP.

According to the conditions regarding the purchase/sale of the shares/units, investment funds are open-ended (investors can buy or sell their shares at any moment) or closed-ended (redemption under certain conditions).

3.6.2 Accounting

As banks can act as manager, promoter, distributor, custodian, administrative, transfer, registrar or paying agent, please refer to these respective services described elsewhere in this guide.

3.6.3 Regulatory aspects

Credit institutions are not subject to specific capital requirements for the services rendered to investment funds. Shares/units held in investment funds by credit institutions are subject to the same capital requirements as for variable-yield securities. Capital requirements exist for certain balance sheet and off-balance sheet positions relating to a bank's transactions with investment funds (e.g. shares/units held in portfolio, fund overdrafts, financial instruments).

3.7 International Pension Funds

3.7.1 Definition

A pension fund is an instrument, the aim of which is to collect capital, to invest it to get a return and to redistribute it as a supplementary pension. A pension fund is a legal entity of its own. Its assets are composed of invested capital, which represents contributions paid by the employer or employees. Like in an investment fund, this invested capital is managed according to an investment policy defined in a "pension regulation" (equivalent to the prospectus of an investment fund).

This pension regulation defines:

- the employer's duties,

- the rights of the beneficial owners at retirement date,

- the possible beneficial owners (widows and orphans),

- the investment policy,

- the financing plan.

Its liabilities represent the fund's commitments related to pension payments.

The framework of international pension funds created in the law of June 8,1999 is intended for the international market, without being restricted by national regulations and laws. It is particularly attractive to international companies' expatriate staff.

The Luxembourg international pension funds can have two structures:

- SEPCAV ("Société d'Epargne Pension à Capital Variable", i.e. open-end savings pension company). In the SEPCAV, the beneficial owner receives a *capital* at the term of the contract (the payment can be staggered), he is shareholder of the SEPCAV.

- ASSEP ("Association d'Epargne Pension", i.e. savings pension association). In the ASSEP, the beneficial owner receives a *life annuity*, he is not a shareholder but a creditor entitled to receive a certain allowance from the association.

3.7.2 Accounting

A bank can act as service provider to a pension fund. It may be transfer agent, custodian bank, administrator, distributor, manager or advisor.

The accounting in the bank's records is the same as for investment funds: if the bank holds the fund's securities in custody, these securities are accounted for in its off-balance sheet.

Commissions received for the services rendered are recorded in the P&L account of the bank.

3.7.3 Regulatory aspects

Please refer to comments in the "Investments Funds" section which also apply for pension funds.

3.8 Private Equity

3.8.1 Definition

Private equity relates to stocks issued through a private placement. Private placement represents the direct sale of a block of stocks of a new or secondary issue to a single investor or group of investors. The sale or placement is usually made through an investment banker and the stocks public resale restricted if they are not registered.

3.8.2 Accounting

The bank, which sells the stocks issued by a company acts as service provider for this company. The fees it receives for the service rendered are recorded as commissions in its profit and loss account.

3.8.3 Regulatory aspects

No particular capital requirements exist except if a bank invests itself in such private equities. The same capital adequacy rules apply as for other portfolio positions described elsewhere in this guide.

3.9 Venture Capital

3.9.1 Definition

Venture capital relates to money invested in start-up companies to contribute to the development of new products or services.

The main features are:

- the bank providing venture capital receives a stake (ownership/control) in the company it contributes financing;
- besides the financing function, the bank can also assume a consulting function;
- the redemption of the bank's capital investment takes place at a later stage of the existence of the company;
- risk of capital loss, since there is no security apart from the estimated return of the project.

In most cases, several banks are involved in a venture capital project due to the required risk spreading.

Banks supply venture capital to companies with a high underlying risk of failure, but also with an above average potential return. There are also investment funds that primarily invest in venture capital companies in accordance with their investment policy.

3.9.2 Accounting

Depending on the characteristics of the finance provided, there are different balance sheet items in which recordings are made:

- shares and other variable-yield securities,

- participating interests,

- shares in affiliated undertakings.

The income is recorded under "Income from securities" in the P&L.

3.9.3 Regulatory Aspects

The same capital requirements apply as for other equities.

3.10 Securitisation

3.10.1 Definition

Securitisation describes the process of transformation of assets/receivables such as mortgage or credit card receivables into transferable securities. A securitised transaction is usually arranged through a special purpose vehicle, which acquires the assets/receivables and then issues bonds backed or secured by these assets/receivables. Credit enhancement is usually used to provide extra protection for the investor.

NB: this transformation process does not call for specific accounting or regulatory aspects which should be explained under this section.

3.11 Cash Management

3.11.1 Definition

This service offers the customers the possibility to improve their handling of liquidity, to optimise their treasury management and rationalise cash flows. Cash management services may include account services, payments (domestic and international), electronic link, FX-services plus investment and borrowing facilities. Many Luxembourg banks offer world-wide coverage for customers based on their own networks and common IT systems.

The service offered consists in computer-based modules, available through the customer's own terminal, linked by telephone to the world-wide time-sharing network of Automatic Data Processing Network Services. The balance-reporting module collects, consolidates and reports the data of the customer's bank account in any location or currency.

Transaction reporting can show either the total of debits and credits, or details of all transactions going through the account. Balance history reports may also be available in order to give a trend of the account activity.

3.11.2 Accounting

Cash management is a service provided by the bank, which receives commissions for the service rendered which are recorded in its profit and loss account.

If cash positions are held by a bank, the related assets and liabilities are recorded in the balance-sheet of the bank.

3.11.3 Regulatory aspects

For the purpose of calculating capital requirements to cover foreign exchange risk, credit institutions shall include the cash management positions in the net open positions by currency. The net global positions (defined as the sum of all long positions by currency on one hand and the sum of all short positions by currency on the other hand) are computed, the higher of which is submitted to a 8% capital requirement in excess of 2% of the eligible own funds. An alternative method based on statistics may be used by the credit institutions.

The general principle to calculate capital requirements to cover credit risk is that all unsecured cash advances must be weighted depending on the quality of the counterpart and that secured cash advances shall be weighted depending on the quality of the guarantor.

3.12 EIF Related Products (European Investment Fund Related Products)

3.12.1 Definition

The European Investment Fund (EIF) is a joint public-private sector organisation, based in Luxembourg. Its mission is to promote medium- to-long term investment in the two fields of Small and Medium-sized Enterprises (SMEs) and infrastructure projects. It achieves its aims by offering guarantees for third party financing and investing in venture capital funds. Its shareholders include the European Commission, the European Investment Bank and a number of financial institutions from across Europe.

The EIF offers a range of standard products, including credit insurance for loan and guarantee portfolios. It also structures tailor made operations as long as they are of a sufficient size to support the corresponding costs.

3.12.2 Accounting

In the books of a bank, the accounting treatment is similar to the treatment applied for guarantees received by a bank.

3.12.3 Regulatory aspects

This section does not call for specific comments on regulatory aspects.

3.13 Audio Visual Certificates / Film Financing

3.13.1 Definition

Investment certificates are governed by the Law of December 13, 1988 aiming at the promotion of cinematographic and audio-visual productions, co-productions to be achieved in Luxembourg. Subject to the provisions of this law, special purpose companies (venture capital) registered in Luxembourg can request the issuance of audio-visual investment certificates. The holder of the certificate benefits from a tax abatement, the "audio-visual tax abatement", not exceeding 30% of his taxable income.

NB: this section does not call for specific accounting or regulatory aspects which should be explained.

3.14 Credit Derivatives

3.14.1 Definition

Credit derivatives are financial instruments which can be used to assume (risk buyer or protection seller) or lay off (risk seller or protection buyer) credit risk. There are two basic types of credit risk:
- credit default risk: risk of financial loss due to issuer default

- credit spread risk: risk of financial loss due to changes in the level of credit spreads.

The most common types of credit derivatives:

- *Credit default swap:* a contract in which two counterparts swap the credit default risk of a reference asset without transferring the asset itself. The protection buyer makes periodic payments to the protection seller. The protection seller is committed to pay the loss in case of default of the underlying company. The payment requirement in case of a credit event is the nominal amount or another security already determined in the swap contract.

- *Total return swap:* a contract in which two counterparts swap the total economic return (both credit and market risks) of a reference asset without transferring the asset itself. The protection buyer pays to the protection seller the total return on the reference asset (including interest payments and any change in market value of the reference asset) regardless of whether or not a credit event has occurred. In return, the protection seller pays a variable interest rate on the same nominal. This operation is equivalent to a synthetic sale of the reference asset.

- *Credit-Linked Note:* it is a fixed income security with a credit derivative embedded in it (i.e. a securitised form of a credit derivative) where the investor is protection seller or risk buyer.

- *Credit Spread Option:* it is associated with bonds, which are priced and traded at a spread over a benchmark instrument of comparable maturity. For a purchaser (seller) of a credit spread call it gives the right (obligation, in case of the buyer's exercise) to buy (sell) the bond at a given spread. For a purchaser (seller) of a credit spread put it gives the right (obligation, in case of the buyer's exercise) to sell (buy) the bond at a given spread.

Separating credit risk from the underlying creates new investment opportunities.

Use

- Management of credit portfolio.

- Creation of a Synthetic Collaterized Debt Obligation: by combining securitisation and credit derivative.

- Improve return on regulatory capital: if the underlying is held on the banking book and this exposure is perfectly hedged using a credit derivative, then the risk weight of the counterpart is substituted.

3.14.2 Accounting

- *Credit Default Swap:* if the bank is "protection seller" or "risk buyer" the premium received is recorded in a commission account. In the off-balance sheet, the engagement of the guarantee is recorded in a guarantee account. In case of credit event, the nominal amount or a specified security (generally an OECD government security as specified in the swap contract) is given in guarantee and is recorded respectively in a cash account, and in place of the security in default.

  It is also possible to consider that the protection seller has issued an option (for which the commitment will be accounted for in the off-balance sheet accounts).

- *Credit spread option:* if the bank is "protection seller" or "risk buyer" the premium received is recorded in a commission account. The engagement equal to the nominal of the underlying security must be recorded in the off-balance sheet.

- *Total Return Swap:* the amounts paid by the "protection buyer" are recorded as expenses whereas the interest received is booked as an income. The interest paid by the "protection seller" is booked as an expense and any amount received from the "protection buyer" is booked as an income.

If the reference asset is traded, one can use its credit spread. If it is not, one must use a pricing method based on the yield curves which determine the total default probabilities that allow to calculate the expected cash flows.

3.14.3 Regulatory Aspects

As in many other European countries, the Luxembourg supervisory authorities are currently facing the issue of how to deal with the increasing use of credit derivatives with respect to the capital requirements. For the time being, and expecting results from the Basel Committee and the European Commission currently dealing with the amendment of the capital adequacy rules, the following prudential treatment can be assumed:

For credit derivatives included in the banking book:

- For the risk buyer, it should be considered as an issued guarantee on the credit risk assumed.
- For the risk seller, as the perfect hedging is generally not assumed with such instruments, a capital requirement to cover both the maturity and the underlying asset mismatch is needed. Regarding maturity mismatching, the weighting applicable to the guarantor can substitute the weighting applicable to the creditor provided that the duration of the guarantee is superior to the duration of the underlying asset. Regarding underlying asset mismatching, the weighting applicable to the guarantor can substitute the weighting applicable to the creditor provided that the guarantee is referenced on an asset with the same issuer as the asset to be hedged. In general, concerning credit derivatives on basket of assets, the risk seller must recognise the benefit of the hedging only on the asset of the basket with the lowest weighted risk.

For credit derivatives included in the trading book (seldom as sufficient liquidity and reliable pricing source are generally not assumed):

- For the risk buyer, they are treated like other derivatives (capital requirements to cover market risk both on the general and specific risks).
- For the risk seller, there is currently no possibility of compensation within the trading portfolio unless a perfect matching (issuer and maturity) between the underlying asset of the derivative and the asset to be hedged.

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Insurance Related Products

4.1 Unit Linked Insurance Products

4.1.1 Definition

The life assurance contract associated with investment funds / selection of investment funds is an investment management instrument under the legal framework of the life assurance. Its purpose is to enable savings to be set up and managed in the light of the investment guidelines of the depositor known as the "taker" in favour of the beneficiaries. Rather than drawing the benefits on death, however, most policyholders will cash in some or all of their units when they wish.

The premium is paid in cash or in kind (contribution of the underlying securities) and then converted into units. The cash value of the units directly reflects their underlying market value.

For this type of contract, the performance is not guaranteed and the risk is borne by the taker. Benefits are directly linked to the performance of the underlying assets.

The underlying investment can be composed by a standard investment fund either an external fund (legal entity) or an internal fund (without legal entity) or composed by specific assets chosen by the taker, this type of investment is called "dedicated fund".

4.1.2 Accounting

A bank can act as service provider for an insurance company. For a company distributing unit-linked insurance products, a bank may be transfer agent, custodian bank, fund administrator, distributor, manager or advisor for the securities. The accounting in the bank records is the same as for investment funds: if the bank is custodian of the securities, these securities are recorded in its off-balance sheet.

Commissions received for the services rendered are recorded in the P&L account of the bank.

4.1.3 Regulatory aspects

Insurance products are ruled by the laws of December 6, 1991 and December 8, 1994 on insurance companies.

4.2 Fixed Income Insurance Products

4.2.1 Definition

These instruments are life assurance contracts in virtue of which, in consideration of the payment of a single premium, the company undertakes to pay the agreed annuity to the designated beneficiary as long as the insured party is still alive.

For this type of contract, the interest rate is guaranteed and a maximum technical rate defined by Circular Letter is fixed by the insurance supervisory authority for contracts with maturity over 8 years.

4.2.2 Accounting

As mentioned in the section regarding unit-linked insurance products, a bank can act as service provider for an insurance company. If the bank is custodian of the securities, these securities are recorded in its off-balance sheet.

Commissions received for the services rendered are recorded in the P&L account of the bank.

4.2.3 Regulatory aspects

Insurance products are ruled by the laws of December 6, 1991 and December 8, 1994 on insurance companies.

4.3 Reinsurance Companies

4.3.1 Definition

A captive insurance company is a limited-purpose, wholly owned, insurance subsidiary of an organisation primarily not involved in the insurance business, which has as its primary function the insuring of some of the exposures and risks of its parent or the parent's affiliates. Since the insurance company is owned by the parent, it has its own "captive" business. These insurance companies are often set up by large commercial companies, which want to avoid paying high premiums required by other insurance companies.

A captive reinsurance company is a subsidiary of a commercial or industrial group through insurance companies ("assigning companies") not belonging to the group. The captive reinsurance company receives premiums from the assigning companies and bears the risks of the group companies.

4.3.2 Accounting

A bank may be custodian of a captive's assets; in this case, the assets of the captive are recorded in the off-balance sheet of the bank (except for cash positions recorded in the balance sheet). The bank is remunerated by commissions booked in the P&L account.

4.3.3 Regulatory aspects

Captive insurance companies are ruled by the laws of December 6, 1991 and December 8, 1994 on insurance companies. Captive reinsurance companies are ruled by the law of December 6, 1991 and the related Grand Ducal Regulation dated December 20, 1991.

4.4 Group Life Assurances

4.4.1 Definition

Group life assurance is usually provided by employers as part of an occupation pension scheme. Two main types of cover are usually provided: lump-sum death-in-service benefits and widows' and orphans' benefits. Both serve to protect the family of the employee from the effects of his premature death.

Lump-sum benefits are paid on the death of the employee and are usually related to his salary. Most schemes are set up so that death benefits are paid to heirs and dependants on trust, so that no inheritance tax is payable (to be tested against local laws applicable).

Widows' and orphans' pensions: in addition to lump-sum death-in- service benefits, a pension is often paid to surviving dependants, and many schemes also provide a widow's pension on the death of a former employee in retirement. These pensions may be increased annually to offset rises in the cost of living, although in practice cost considerations limit the extent of the increase.

The cost of a group scheme is usually paid by the employer, although the employee contributes where the benefits are part of an occupational pension scheme. The employer's total cost is calculated as the aggregate premium on a one-year temporary life policy on the life of each member employee.

Many schemes are operated on a profit-sharing basis, where the insured is offered a form of no-claim or low-claim discount. Large employers can thus obtain a refund of premiums if their claims experience has been good.

4.4.2 Accounting

A bank can act as service provider for an insurance company distributing life assurance products. Related commissions received for the services rendered are recorded in the P&L account of the bank.

4.4.3 Regulatory aspects

Insurance products are ruled by the laws of December 6, 1991 and December 8, 1994 on insurance companies.

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Service Related Products

5.1 Leasing

5.1.1 Definition

Leasing is a form of medium or long term financing by which a leasing company purchases a particular asset on a leasing basis according to the indications of the customer who has selected and negotiated the asset himself. The leasing company accepts the risk of the asset depreciation against remuneration.

This formula permits total financing of the assets' purchase price. On expiry of the contract, the customer may become the owner of the asset if he exercises his purchase option.

Under Luxembourg banking regulations, the bank remains the legal owner of the capital equipment or real estate purchased especially with a view to rental. The period of rental fixed in the agreement corresponds to the presumed duration of economic use of the leased item. The agreement usually grants the lessee the right to acquire in the course or at the end of the lease title to all of or a part of the leased items, in exchange of a fixed price specified in the agreement.

5.1.2 Accounting

5.1.2.1 Balance Sheet

- Assets are to be recorded at their net asset value, that is the cost of acquisition less accumulated depreciation.
- Depreciation relates to the part of the rental which represents the reimbursement of the principal corresponding to the cost of the asset which is the object of the leasing transaction. The part of the rental which serves as reimbursement of the principal is to be deducted directly from the balance sheet assets item and is not to be booked in the profit and loss account.

NB: this accounting principle is only applicable to real leasing transactions, as defined above. All leasing transactions which do not meet this definition are not recorded as leasing transactions. In this case, the assets belonging to the bank and simply rented to third parties are recorded as "Tangible assets".

5.1.2.2 Profit and loss account (only for real leasing transactions as defined above)

The part of the rental which represents the remuneration of the capital invested in the operation has to be accounted for as interest income on leasing transactions.

5.1.3 Regulatory Aspects

Assets related to leasing transactions are subject to the same capital adequacy requirements as other capital expenditure positions of banks.

5.2 Factoring

5.2.1 Definition

Factoring is an agreement by which a company transfers all of its debtors to a factor. The factor is remunerated by discounts which are based on the residual maturity of the debtors and the risks of liquidity possibly supported by the factor.

There are two types of factoring agreements:

- Unreal factoring: the service of the factor is limited to the collection of money (no transfer of default risk).

- Real factoring: the default risk is transferred to the factor.

Factoring offers the following functions:

- Service function (management of customer accounts such as accounting for receivables and payments, reminder procedures).

- Financing function (short term financing source).

- Transfer of default risk.

It should be noted that factoring implies having a business information department to assess solvability of customers and the default risk.

5.2.2 Accounting

5.2.2.1 Balance Sheet

- *Real factoring:* The bank owns the receivables and assumes the default risk. The debtor balance is to be recorded as a loan.

- Unreal factoring: The bank does not assume the default risk. Therefore, the amount to be received is recorded as an off-balance sheet position.

5.2.2.2 P&L

The treatment depends on the nature of the income generated by factoring:

- Interest-like fees are recorded under interest income.

- Commission-like fees are to be accounted for under income from commissions.

5.2.3 Regulatory Aspects

The same capital requirements than for other types of lending business apply.

5.3 Electronic Banking

5.3.1 Definition

Electronic banking services relate to integrated solutions linking clients to the banks' computer for on-line information and transmission of payment instructions.

Further developments lately have been:

- Dealing of securities, FX trading and other standard banking services.

Use
Electronic banking is used either in the form of "phone banking" or "Internet banking". In the first case, only simple operations are possible, such as transfer of cash. In the second case, access is possible through the Internet, and the services that are made available to the clients are manifold:

- Simple information about the bank and its products (so called "marketing" web sites).
- Simple consultation of client accounts.
- Performance of standard transactions such as cash transfers from accounts to accounts, payments, etc.
- Performance of transactions in the client’s portfolio (buy and sell securities, connection to brokers, etc.).

The trend is currently to provide more and more on-line services, and to allow for an active portfolio management for clients through the Internet.

NB: this service does not call for specific accounting or regulatory aspects which should be explained in this section.

5.4 Local and Global Custody

5.4.1 Definition

Global Custody is defined as the delivery of multi-market, multi-currency clearing, settlement, custody and reporting services which extend beyond the custodian’s and the client’s base region and currency, and encompass all types of financial instruments. This service includes income collection, corporate action processing as well as tax reclaims. The precise mix of services which an institutional investor might require from its global custodian will vary considerably from investor and may cover further services like securities lending, regulatory and compliance services, performance reporting as well as nominee services or cash management.

Local custody is basically the same as above with the exception that the financial instruments under custody relate to one specific national market, which is generally the market where the custodian himself is established / or has a branch office.

Characteristics
Luxembourg offers a wide range of diversified products under global custody from international shares and bonds to complex hybrid products. To face the sustained development of financial markets with an increasing complexity of financial instruments and new hybrid products, the country has developed a strong specific knowledge in the global custody services based on highly qualified human resources.

In Luxembourg this financial service is especially well developed due to its relevance and importance for the Luxembourg investment fund and private banking industries.

5.4.2 Accounting

Remuneration is usually a fee expressed in percentage points based on the amount of assets under custody as well as flat securities transaction rates. This fee is either recorded as commission income or interest income depending on the nature of the fee.

The securities held under custody are recorded as an off-balance sheet position. Cash deposits or advances are recorded in the bank's balance sheet.

5.4.3 Regulatory Aspects

There is no specific capital requirement for the custody business.

5.5 Fund Administration

5.5.1 Definition

The function of administrative agent covers:

- The bookkeeping of the fund in accordance with general accounting principles.
- The determination of the Net Asset Value of the fund.
- The preparation of the annual accounts and the periodical financial statements and reports in accordance with Luxembourg law and the requirements of the Luxembourg supervisory authorities.
- Further duties are a second level control over the investment restrictions and a supervision of the compliance of transactions initiated by the investment adviser with legal requirements included in the prospectus of the fund.

Further options:

- Keeping of shareholders' register and execution of transfer agency services.

- Revenue / Return Reporting and Performance Analyses.

- Sales and Distribution.

Generally, the administrative agents also provide Consulting and Fund Creation Assistance including Legal, Regulatory and Tax advice.

Characteristics
Luxembourg has achieved a solid reputation in the investment fund business based on many years of experience. Luxembourg benefits from qualified human resources and efficient IT supported accounting systems: it offers professional administration services for highly complex funds (guaranteed funds, hedged funds, intra-and extra-pooled funds, cloned funds).

5.5.2 Accounting

In connection with the delivery of its services, the administrative agent is entitled to an annual fee usually proportional to the average net asset value of the fund administrated, which is recorded as a commission.

5.5.3 Regulatory Aspects

Regulations of the Grand Duchy of Luxembourg relating to investment funds consist of the Law dated March 30, 1988 relating to undertakings for collective investment and the IML circular 91/75 of January 21, 1991. To be registered in Luxembourg, an investment fund must have its central administration and custodian bank in Luxembourg.

Further duties of the fund administrator are contractual and consequently detailed in an agreement signed with the fund.

5.6 Fund Depositary Bank Function

5.6.1 Definition

The role of the depositary bank consists in the safekeeping of the fund's assets, the supervision and the monitoring of operations made in connection with these assets.

In order to set up a Luxembourg UCI, whether under Part I or Part II, a Luxembourg depositary bank entrusted with the assets of the UCI must be selected. The law states that the depositary must be a credit institution within the meaning of the Luxembourg law, and be either incorporated in Luxembourg or have its head office established in another EU Member State.

Characteristics

The law of March 30, 1988 provides that the depositary carries out all operations concerning the day-to-day administration of the assets of the collective investment fund.

As detailed in the IML Circular 91/75 of January 21, 1991, the depositary bank must also:

(i) Ensure that the sale, issue, repurchase and cancellation of units effected on behalf of the fund or by the management company are carried out in accordance with the law and the management regulations.

(ii) Ensure that the value of units is calculated in accordance with the law and the management regulations.

(iii) Carry out the instructions of the management company, unless they conflict with the law or the management regulations.

(iv) Ensure that in transactions involving the assets of the funds, the consideration is remitted to it within the usual time limits.

(v) Ensure that the income of the fund is applied in accordance with the management regulations.

While the overall functions of a depositary bank are similar whether it acts as depositary of a FCP or that of an investment company (SICAV/SICAF), depositary banks of FCP bear a larger responsibility than those of investment companies.

The duties of the depositary bank of an investment company (SICAV/SICAF) whether created under Part I or II of the law do not include the functions (ii) and (iii) above existing for a depositary of a FCP. Hence, the supervisory and monitoring duties of an investment company's depositary are not as extensive as those provided by FCP custodians.

5.6.2 Accounting

In connection with the delivery of its services, the depositary bank is entitled to an annual fee usually proportional to the average net asset value of the fund, as well as a fee based on the number of transactions related to the fund's investments which are recorded as a commission income by the bank.

5.6.3 Regulatory Aspects

Duties of the depositary bank are detailed in an agreement signed with the fund. The IML Circular 91/75 of January 21, 1991 and the Law dated March 30, 1988 specify the role and duties of the depositary bank for investment funds.

5.7 Fund Registrar and Transfer Agent

5.7.1 Definition

The registrar and transfer agent generally handles unit/shareholder services, including maintenance of unit/shareholders' register, preparation of account statements, distribution of dividends and processing of buy and sell requests.

The most common tasks of the registrar and transfer agent are:

- To review new applications and correspondence from unit/shareholders, nominees or distributors, to complete or modify the account information and to apply anti-money laundering procedures, if appropriate.
- To handle the processing of subscriptions, redemptions, switches of shares, both bearer and registered.
- To make the transfer of funds linked to shares sold and redeemed in compliance with requirements of the articles of incorporation or the prospectus of the fund and to make the matching between payments and orders.
- To prepare the payments of dividends.
- To maintain the unit/shareholders' register and other records, to prepare the correspondence and the dispatch of prospectuses, financial reports and any other documents intended for investors.
- To mail transaction confirmations to unit/shareholders.
- To prepare and mail year-end tax information, the notification of shareholders meetings, proxies, reports and shareholders statement information.
- To calculate, as the case may be, the fees to be paid to distributors.

Some transfer agents also provide other services such as telephone response services (i.e. call centres) or trading desks. The development of e-banking opens a wide spectrum of possible services, including fund supermarkets.

Characteristics
The transfer agent must be licensed by the Minister in charge of the financial centre as "professional of the financial sector". In accordance with the principle of central administration, most of the tasks of the transfer agent must be performed in Luxembourg.

Through the system of nominees, a delegation of the tasks to a sub- transfer agent is possible.

5.7.2 Accounting

In connection with the provision of its services, the registrar and transfer agent is entitled to an annual fee usually proportional to the average net asset value of the fund, which is recorded as commission income.

5.7.3 Regulatory Aspects

There is a requirement to calculate the capital adequacy ratio if the transfer agent fulfills certain criteria (e.g. holding of customer money).

5.8 Fund Company Secretary Services and Corporate Activities of Funds

5.8.1 Definition

This function consists in handling all the secretarial and corporate activities of a fund. Tasks include arranging Board of Directors and General Meetings, management of correspondence and dispatch of prospectuses, financial reports and other documents to investors. Relations with the supervisory authorities are also maintained. In general, this function covers the domiciliary agent role.

Often, the functions of the corporate, domiciliary and administrative agent are performed by the same entity. All three agents must work in close cooperation with the registrar and transfer agent.

5.8.2 Accounting

In connection with the delivery of its services, the corporate and domiciliary agent is entitled to an annual fee fixed in the agreement signed with the fund, which is recorded as commission income.

5.8.3 Regulatory Aspects

This service does not call for specific regulatory aspects which should be explained in this section.

5.9 Depositary Function (Common and Special)

5.9.1 Definition

Depositary function

Transferable securities represented by:

- physical stock certificates (specialized depositary)
- permanent (until maturity) or temporary (until exchange for definitive stock certificates) global certificates (joint depositary)

are kept for safe custody in the bank's strongroom, for the account of the international clearing systems (Clearstream and Euroclear).

Depositary Agent for Clearstream

A number of Luxembourg-based banks act as Depositary agent for Clearstream, offering an International Central Securities Clearing and Settlement System, to hold in their vaults any security and other property in respect of which Clearstream and the Depositary agree. These securities represent assets entrusted to Clearstream by its customers and for which the place of delivery is Luxembourg. The Depositaries are bound by stringent rules and regulations in order to protect, administer and service these assets according to the highest standards. Computer-based links ensure an integrated swift processing of all the transactions.

Common Depositary for Clearstream and Euroclear

A number of Luxembourg-based banks have been appointed to act as Common Depositary for the above-mentioned clearing houses. The duties consist mainly in holding in custody the global securities issued and to keep separate accounts for each clearing system, reflecting the portion of each clearing system's participant holdings in such global certificates until their exchange into definitive certificates. The common depositaries make payments in connection with distributions by an issuer against payment on the date of the closing of the issue. This agent function is supported by state of the art communication systems.

5.9.2 Accounting

The banks receive commissions for their services, which are recorded as commission income.

The assets held under custody are recorded as an off-balance sheet position.

5.9.3 Regulatory Aspects

The capital adequacy requirements are equivalent to other banking exposures since clearing houses operate in Luxembourg as credit institutions.

5.10 Maritime Flag Products

5.10.1 Definition

The objective of the Luxembourg government in introducing the Luxembourg Flag Registration was to allow selected owners and operators in Europe and in the rest of the world to choose a secure and respected registration while maintaining favourable cost conditions (i.e. salaries, social security).

Luxembourg was considered as an ideal location, offering banking and insurance expertise as well as a good reputation, as opposed to other "flags of convenience" locations.

5.10.2 Accounting

This service does not call for specific accounting comments.

5.10.3 Regulatory Aspects

The law

The law which established the Maritime Register in Luxembourg is the Law of November 9, 1990 which was updated by the Law of June 17, 1994. This law is complemented by a number of enabling decrees and administrative regulations. The ultimate authority regarding the Maritime Register is the Minister responsible for Maritime Affairs. The day to day administration of the Maritime Register is nevertheless controlled by the "Commissariat aux affaires maritimes". A Commissioner has the overall responsibility for the supervision of the Luxembourg shipping register and the implementation of government policy.

Basic conditions for a ship to be registered under the Luxembourg flag

- A ship is considered to be of Luxembourg origin and must therefore be registered in Luxembourg if the following conditions are met:
  - More than half of the ownership is held by Luxembourg nationals resident in Luxembourg or by companies incorporated in Luxembourg with their principal centre of business located in Luxembourg.
  - The ship weighs at least 25 gross tons and is engaged in a commercial activity.

Ships can be registered during their building phase as well as subsequent to being launched.

- There is no legal requirement for the shareholders of a Luxembourg company to be Luxembourg nationals.

- No ship exceeding fifteen years of age (as at when the keel was laid) may obtain initial registration in Luxembourg.

- Ships registered with another registry which are transferred on a bareboat charter basis to Luxembourg control may, under certain conditions, be registered temporarily in Luxembourg to the extent that this is legal under the jurisdiction of the country of initial registration.

- Within thirty days of a ship acquiring Luxembourg nationality a declaration should be filed with the Registrar in order for the ship to be registered.

- The law has fixed the range under which fees can be set by decree as an annual base tax in the range of EURO 1,000 – 2,000 and annual fee in proportion to tonnage of between EURO 0.25 – 1.25 per tonne.

- The minimum capital required for such a company is LUF 1,250,000.

- Duty at a rate of 1% of subscribed capital is due.

- To complete establishment of a company, it is also necessary to obtain approval from the Ministry responsible for Maritime Affairs.

The definition of principal place of business would normally be interpreted as being that of the main administrative functions of the company (including accounting, payroll, legal records and overall coordination of ship management activities) being performed in Luxembourg, but there is no requirement for the directors to be resident in Luxembourg.

5.11 Fiduciary Agreements

5.11.1 Definition

A fiduciary agreement is a contract whereby the Fiduciary (i.e.: the bank) holds and disposes of assets on behalf of the Fiduciant (i.e.: the customer) according to instructions or guidelines laid down in the fiduciary agreement. The Fiduciary thus assumes the legal, but not economic, ownership of the assets. The assets must be held separately from any other assets of the Fiduciary and therefore do not fall within the assets to be liquidated in case of a bankruptcy.

5.11.2 Accounting

All fiduciary operations specifically covered by the Grand Ducal Regulation of July 19, 1983 on fiduciary contracts of credit institutions are recorded in the off-balance sheet as "Investment management services and underwriting functions".

If they are not specifically covered by this Regulation, they must be included in the balance sheet of the bank.

5.11.3 Regulatory aspects

The Grand Ducal Regulation of July 19, 1983 covers fiduciary agreements in which the rights of the Fiduciary are limited to obligations defined in the fiduciary agreement.

5.12 Stock Research

5.12.1 Definition

Stock research is focused on general economic developments that have an influence on growth, prices, interest rates, productivity, employment, generally all that has a direct impact on fixed rate investments, equity and derivatives.

Presentation is generally separated into:

- General economic development by region, country, sectors, industry.

- Foreign exchange levels, compared to developments in other countries and/or competing economies.

General and specific stock market analyses, per market, but mainly per individual stock, including buy, hold and sell recommendations.

Regularly, these publications also include:

- economic theory

- economic history

- economic fundamentals and developments

- legal and tax implications

- political developments and lobbying issues

- EU regulations

and others.

NB: this section does not call for specific accounting or regulatory aspects which should be explained.

5.13 Correspondent Banking

5.13.1 Definition

A "correspondent bank" acts as the agent for another bank. The correspondent bank generally provides a wide variety of banking services on behalf of the other bank in the region in which it is located.

Correspondent banking activities generally aim to promote mutual business opportunities between banks established either in the same country or financial place or established crossborder. In Luxembourg, correspondent banking usually encompass the promotion of dealing activities in treasury and capital market areas and the search of business opportunities through the important local fund industry. Its aim is also to secure smooth and fast payment processes through the TARGET (Trans-European Automated Real-Time Gross Settlement Express Transfer) system, to provide high quality operational services in the custody business and to support efficient clearing and settlement organisations (Clearstream, Euroclear).

5.13.2 Accounting

Accounts maintained between banks are "nostri" accounts.

These operating accounts are generally used to make payments and receive funds in the local currencies of the correspondent bank.

Debtor nostri accounts are recorded on the asset side under "Loans and advances to credit institutions" whereas creditor nostro accounts are recorded on the liabilities side under "Amounts owed to credit institutions".

5.13.3 Regulatory aspects

The general principle to calculate capital requirements to cover credit risk is that all unsecured loans (including nostro account balances) shall be weighted depending on the quality of the counterpart and that secured loans shall be weighted depending on the quality of the guarantor.

5.14 Netting Agreements

5.14.1 Definition

Netting Agreements are arrangements whereby a bank may off-set, in the event of a liquidation affecting a counterpart, typically another bank, deposits taken from that counterpart against deposits placed with the same counterpart. The real benefit from netting means substantially less credit risk for the banks concerned, and therefore a reduced capital requirement.

A model deposit netting agreement for use with Luxembourg institutions has been issued by the ABBL. In the case of netting agreements with counterparts located outside of Luxembourg, a legal opinion should be sought to confirm whether the law governing the counterpart and the netting provisions to be taken is valid and enforceable in the case of insolvency situations.

NB: this netting technique does not call for specific accounting or regulatory aspect which should be explained.

5.15 Trust and Administration Services

5.15.1 Definition

Trust and administration services include different services to be rendered either to holding companies incorporated under Luxembourg law or to trust entities incorporated under foreign jurisdictions.

These services include the maintenance of accounting records, the provision of a registered office, the provision of mandate of directors or auditors, the preparation of tax returns and financial statements and any other secretarial services.

5.15.2 Accounting

In connection with the delivery of trust and administration services, the bank is entitled to a periodic fee fixed in an agreement, which is recorded as commission income.

5.15.3 Regulatory aspects

The domiciliation services are regulated by the Law of May 31, 1999. The first objective of this law is to restrict the activity of the domiciliation agents to certain professionals.

By application of this law, the domiciliation agents established in Luxembourg have the following major obligations:

- A domiciliation agreement has to be signed between the domiciliation agent and the domiciled company. Moreover, an extract of the domiciliation agreement indicating the name of the beneficial owners and the duration of the agreement has to be filed with the Luxembourg trade register.

- The domiciliation agent has to identify the real identity of all representatives of the company (i.e. the beneficial owners, the directors).

Moreover, according to this law, a company having its domicile abroad and also having in Luxembourg one or several operational units, is deemed to have a second domicile in Luxembourg.

5.16 Establishment and Administration of Holding Companies

5.16.1 Definition

Luxembourg is largely used either by international groups or by individuals for the incorporation of holding companies.

The services offered by banks in relation to the establishment of holding companies consist mainly in the understanding of the clients' needs (either international groups or individuals), the analysis of the tax situation, management and control consequences relating to the incorporation of such holding companies and an administrative assistance in the incorporation process of the holding companies.

On the other hand, the services offered in relation to the administration of the holding companies include mainly the provision of a registered office, the maintenance of legal books and accounting records, company secretary services, etc.

5.16.2 Accounting

In connection with the establishment and administration of holding companies, the bank is entitled to a periodic fee fixed in an agreement, which is recorded as a commission income.

5.16.3 Regulatory aspects

Holding companies are subject to the Law of August 10, 1915 on Commercial Companies as amended. This law and its subsequent amendments regularise any matters regarding the commercial aspects applicable to any Luxembourg companies, whatever, their object and tax situation.

5.17 Off-Shore Companies

5.17.1 Definition

Offshore companies can be qualified as any investment company in an off-shore location such as for example the British Virgin Islands, the Cayman Islands...

5.17.2 Accounting

In connection with the services delivered to off-shore companies, the bank is entitled to a periodic fee fixed in an agreement, which is recorded as a commission income.

5.17.3 Regulatory aspects

Off-shore companies are subject to minimal legal requirements, which vary from one off-shore jurisdiction to the other.

5.18 Trusts and Foundations

5.18.1 Definition

5.18.1.1 The trust

A trust is an equitable obligation, normally constituted by a written document, the "Trust deed", which binds the trustee to deal with the assets over which he has control for the benefit of the beneficiaries. The beneficiaries or any one of them have the right to force the trustee to act in accordance with the terms of the trust deed and the law governing the trust.

The settlor is the person or company who contributes assets in form of a gift to the trust.

The beneficiaries are the persons or companies who benefit from the assets held within the trust. The Settlor may be included in the beneficiaries.

The trustee is the person or the company that is the legal owner of the assets within the trust and is responsible for the administration of the trust in accordance with the terms laid down within the trust deed and the law governing the trust.

Different kinds of trusts exist such as the fixed trust or the discretionary trust.

5.18.1.2 The foundation

The foundation is a legal entity endowed with funds or other assets for a specifically designated purpose, e.g. family foundation, charitable foundation. Foundations are essentially utilised to hold and administer assets and investments. Commercial activity may only be undertaken where this serves the Foundation’s non-commercial purpose or where the nature and extent of its holdings require a commercial operation.

A foundation board (similar to a Board of Directors) generally administers a foundation. The foundation is commonly regulated by its Statutes (articles of association) but may also be constituted by will or testamentary disposition. Beneficiaries are appointed through by-laws passed by the competent body. A Luxembourg foundation can not own buildings other than those required for the accomplishment of its object.

5.18.2 Accounting

In connection with the services delivered to trusts and foundations, the bank is entitled to a periodic fee fixed in an agreement, which is recorded as a commission income.

5.18.3 Regulatory aspects

The trust is mainly used in countries applying Anglo-Saxon law. Depending on the country concerned, the trust will be subject to the governing law in each country respectively.

The Luxembourg foundations are regulated by the Law of April 21, 1928 modified by the Law of March 4, 1994. The creation of a Luxembourg foundation has to be approved by a Grand Ducal order. Luxembourg only allows charitable foundations.

The purpose of this publication is not to give detailed guidance on accounting and regulatory aspects of financial products and services. For some of them, the accounting and regulatory aspects have not even been included as those are generic services which do not imply specific accounting and regulatory rules. Consequently the reader must always refer to the laws and regulations issued by the Luxembourg authorities for the correct treatment of such instruments.

Luxembourg, July 15, 2000