



Association Luxembourgeoise
des Compliance Officers
du Secteur Financier

Newsletter

N°15

SEPTEMBER 2008

Editorial



Dear friends of the ALCO,

On your behalf I would first like to express our thanks to Karine Vilret-Huot who has directed the publication of the ALCO Newsletter since its creation with persistence and know-how.

Fifteen editions have been published since July 2003, thereby providing ALCO with a substantial basis of approximately forty articles on a major part of the various subjects which concern compliance. The Newsletter has become a significant element of our Association's reputation.

Therefore, thank you to Karine, whose numerous activities now oblige her to hand this responsibility over to others. From now on, Claudine Frutsaert will take charge of leading the Newsletter workgroup, assisted by Patrick Schott.

In this edition you will find,

- An article by Marie Bourlond which reviews the tricky question of transactions undertaken by directors of listed financial institutions, with respect to both “relevant persons” as understood by the MiFID and “approved persons” as understood by the MAD.
- An article by Charles Van Doorslaer which positions the Compliance Officer’s role in the face of corporate governance evolution. This is a significant trend where compliance is most probably the best placed to assist and intercede in a proactive manner.

This is followed by replies from the Dialogue Group to two questions posed by members. As you know, I believe that this dialogue within the ALCO is extremely useful, with respect both to basics and also the life of our Association. Please continue to inform us of your queries and thoughts!

We will perhaps meet again soon at the next American Chamber of Commerce meeting in Luxembourg where Alain Hondequin and I will speak on the role of compliance, especially enlightened by current events.

Jean-Marie Legendre
Chairman

Doctrine

Financial instruments transactions: what are the alternatives for our directors of listed European financial institutions?

a. Context

The MAD (Market Abuse Directive) and the MiFID (Market in Financial Instruments Directive) European Directives require that financial institutions set up a prevention mechanism, with special attention to be paid to the definition of specific measures for those categories of persons (approved or relevant persons depending on whether we position ourselves in accordance with one directive or the other).

The directors of listed financial institutions are amongst the first to be concerned by these provisions. If we refer to European provisions, directors do indeed fit the reference criteria for the two aforementioned categories of approved and relevant persons.

b. Consequences for our directors

On the description of relevant persons

The MiFID directive requires that investment companies define the appropriate measures for the prohibition of personal transactions by so-called “relevant” persons who take part in sensitive activities which may result in a conflict of interests, or who have access to price-sensitive information or other confidential information on clients or

transactions with clients, or on behalf of clients.

Accordingly, investment companies were required to list their relevant persons and to set up control means enabling the former to have access to information concerning all personal transactions undertaken by the latter as soon as possible. Two possibilities exist to achieve this: relevant person’s notification of their personal transactions to a control department (most often to compliance) or the identification of such transactions by the control department, for example via direct access to their securities accounts held in the investment company, duly authorised by the said relevant persons.

Investment company directors, as relevant persons, must therefore either notify all transactions to the dedicated department, or authorise the said department to monitor transactions performed on their accounts.

Registration on a list of approved persons

In compliance with the MAD directive, issuers or persons who act in the name and on behalf thereof, must draw up a list of persons who have regular access to price-sensitive information which directly or indirectly concerns the issuer.

In particular, this European rule has been transposed in Belgium in Article 25 *bis* of the law of August 2, 2002; in France in Article L621-18-4 of the Monetary and Financial Code; and in Luxembourg in Article 16 of the law of May 9, 2006.

Le Bulletin

In most cases, listed companies' directors shall be mentioned on these lists as approved persons.

The information required to draw up these lists is basically the same for all countries. However, transmission terms to the regulator may vary depending on regulations; some may be content with making information available to the regulator whereas others require systematic transmission. In all events, the list must be updated regularly.

Although approved person status does not imply the possession of price-sensitive information on the concerned issuer's financial instruments, the matter is still ambiguous.

Indeed, theoretically, a person who is mentioned on an approved persons list is authorised to undertake transactions on a financial instrument of an issuer who considers said person as an "approved person", insofar as the latter does not hold price-sensitive information.

However, in view of interpretations provided by some regulators, we are entitled to query whether it is indeed cautious, for persons indicated on the said lists, to undertake this type of operation. Accordingly, the CBFA (Belgian Banking, Financial and Insurance Committee) in its FAQ's on market abuse, mentions the existence of a (rebuttable) presumption whereby the person who is registered on a list of approved persons does in fact have access to price-sensitive information.

Registration on a list of occasional approved persons

In the framework of a specific file or operation, some persons, including approved persons and directors in particular, may have occasional access to price-sensitive information. Once again, in the capacity as issuer, the company must draw up a list of occasional approved persons, by specifying the therefore approved persons until the price-sensitive information becomes public. These persons will be informed of their being mentioned on the said list and of the resulting obligations and sanctions.

As long as they are mentioned on the list, they are banned from:

- purchasing or selling, or attempting to purchase or sell, financial instruments on their own behalf or on behalf of a third party, either directly or indirectly,
- communicating such information to any other person, unless this is undertaken within the scope of their normal work, profession or office,
- recommending to a third party that the latter purchases or sells financial instruments, or causes these to be purchased or sold by a third party, on the basis of the said information.

Definition of statutory restriction periods

Directors are systematically submitted to prohibited periods prior to the publication of results which most issuers, banking institutions at the least, have already implemented. During the said period, transactions on all financial instruments connected to the issuer are forbidden. This may concern shares, stock options, warrants or employee saving funds, mainly invested in the issuer's financial instruments.

If we cumulate the periods which precede results' publication (including access

periods to expected results) and *ad hoc* restriction periods for which a list of occasional persons has been drawn up (M&A operation, increase in capital...) directors are only left with short time periods to undertake personal transactions on the financial instruments of the issuer for whom they hold office. And these authorised time periods still have to coincide with their stock option exercise periods, their liquidity requirements, their interests...

c. Criminal and administrative sanctions

Criminal sanctions may be applied to directors of listed financial institutions in the event of non-compliance with the aforementioned rules. Amounts which directors will be ordered to pay depend on the importance of the asset advantage resulting from the offence.

MAD and MiFID directives also impose setting up administrative sanctions in the event of an infraction of the rules thereby specified. Companies subjected to these regulations, as transposed into national law, may therefore be submitted to injunctions, fines, etc...

d. Alternatives for our directors

Certain solutions exist to avoid the numerous regulatory or internal constraints.

For instance the Belgian regulator admits the principle whereby the time when the order is placed and the execution time thereof may not necessarily be simultaneous. Accordingly, the regulator admits that holders of stock options may conduct the exercise order (definition of conditions: price, quantity...) prior to

exercise periods and outside of any suspicious period¹.

A more structural and cautious solution for directors would be to delegate their assets management, including exercise of their stock options, to a financial institution as a discretionary management agreement.

In this last case, the Belgian regulator also exempts directors from notifying their transactions, but under the condition that the director does not influence the manager in any manner whatsoever as regards both the management and choice of financial instruments and that the latter does not consult the director on such issues.

e. Conclusion

In view of the preceding observations, is it not our duty as Compliance Officers to encourage our directors to use discretionary management solutions? This practice should be encouraged for two reasons, not only for the purpose of protecting the institution's interests and reputation but also and above all, that of the directors themselves.

Marie Bourlond
Chief Compliance Officer
Dexia S.A.

¹ CBFA – Market Abuse - FAQ B4

Doctrine

Evolution of corporate governance² and the Compliance Officer's role

Corporate governance: an opportunity to be taken advantage of?

Can we hope for the improved performance of companies who believe in the correct "governance" of companies? It seems that an ever increasing portion of investors and financiers are convinced of the connection between corporate governance and profitability³.

To refine their investment strategies, a constantly growing number of institutional and private investors are taking account of criteria which are not purely financial. Responsibility for our society, the environment or morality; communication, correct governance, good organisation...

Corporate governance is an additional strong point for some investors. Companies which adopt a clearly visible policy relating to correct governance are in fact judged as less risky and will therefore pay dividends or have lower interest rates.

Current news appears to connect to this need to grant increasing importance to corporate governance. Accordingly, Jean-Claude

³ McKinsey's "Global Investor Opinion Survey". This study endeavours to measure the connection between corporate governance and performance, measured by company appreciation. McKinsey questioned over 200 institutional investors and came to the conclusion that the great majority were ready to pay a premium for correct governance. The amount of the said premium varies according to the market: from 11%, 12% and 14% for well regulated markets (Canada, UK and USA) to 40% for companies where the regulator's influence is less certain (Russia, Northern Africa...). www.hermes.co.uk.

Juncker recently confirmed his desire to fix limits on certain directors' remunerations which are deemed as excessive. Some establishments are being pointed at for having offered products to their clientele which speculate on foodstuffs.

Confronted with the subprime crisis, several calls for new recommendations⁴ on corporate governance have been heard, for the purpose of restoring investors' confidence. Others see this as a niche to distinguish themselves in marketing.

What is corporate governance?

Corporate governance is all processes, regulations, laws and [institutions](#) which influence the way in which a company is directed, managed and controlled. This series of measures originates both from written law (e.g. civil law, business law, stock market law...) and from general legal principles; it includes Articles of Association, codes, charters, procedures and principles which are specific to the various companies and business sectors.

This is also a trend in public opinion which spread in the 90's. It covers both a debate and ideology.

- The debate concerns the choice of the system used for companies' management and control in compliance with the law and their corporate

⁴ Confronted with the threat of tightening up regulations, on Thursday 17.07.08 in Washington, the (380) biggest world banks presented a code of good conduct, which supposedly would end the abuse which, one year ago, led to the explosion of the subprime crisis. Application of the said measures should lead to "regaining market confidence" stated the Institute of International Finance (IIF), by presenting a 200 page report, the result of reflection which began in October 2007 (F. GARLAN, AFP - Thursday 17.07.08).

Le Bulletin

purpose. Therefore, in the first place it concerns listed companies decision-making and control organs (mainly the Board of Directors) but not exclusively.

- The purpose of the ideology is to ensure that a company is managed according to its shareholders and other stakeholders'⁵ interests.

Restrictive rules laid down by legislation must be separated from those left to companies own discretion or that of the Groups to which they belong. If the purpose of all rules is to install and consolidate a confidence connection with shareholders-investors, but also with clients and other stakeholders, their purpose is also to guide without too much constraint, and to exercise companies' decision-making powers and control in a balanced manner, without curbing their freedom to undertake business. They can become sources of law through mechanisms such as standards and behaviour practices. Civil and contractual liability is appreciated in view of such standards and practices. Above all it is also as regards these rules (also known as "*soft laws*") that the Compliance Officer has a role to play.

Where does corporate governance come from?

Corporate governance rules are probably as old as the company concept itself. From their creation, the different society codes were careful to set up rules for companies' organisation and management, by providing limits for spheres of competence, the various organs and participants' responsibilities.

However, for the last ten years or so, it must be noted that a great wave of new corporate governance requirements has swept the entire planet.

The setbacks of Worldcom, Enron, but also European companies such as Vivendi and Ahold, are usually quoted as triggering the wave. On such occasions, it was in fact much

⁵ Stakeholder: holder of interest, stake, involved party; any internal or external corporate actor concerned by correct company operating. Employees, suppliers, clients, intermediaries, neighbours...

more obvious than in the past that the shareholders' interests did not necessarily coincide with those of directors, even though in most cases the said directors had been directly or indirectly appointed by the shareholders.

The directors' temptation to take decisions which are more in line with their own interests rather than those of the company is all the greater when they do not feel that they are controlled by shareholders, or very little. In particular this case may arise when shares are mostly held by scattered investors, public or institutional shareholders who take no or little part in General Meetings.

Foreign and European markers

Before examining the situation in Luxembourg, we believe it suitable to take a look at corporate governance arrangements set up elsewhere. Indeed, as we will see below, the European Commission, and also Luxembourg, will probably use these as a basis for enacting new requirements or recommendations. Furthermore, most financial actors in Luxembourg have close connections with financial institutions located in the countries referred to below.

As mentioned above, some financial scandals which had worldwide effects often triggered a stricter approach to corporate governance. Two waves should be brought to the forefront:

1. The 90's wave.

A wave of scandals is exposed. Their source was often a too "friendly" relationship between management and the Board, or even confusion between the two organs. Amongst others, these were excessively favourable stock option plans for management, and even included backdating issues for the purpose of being even more favourable. For the first time, institutional shareholders joined forces and obtained the resignation of several Chairmen and Managing Directors of major American companies.

Le Bulletin

This is the spirit which prevailed in the United Kingdom when a first ‘*Code of best practice*’, drafted by the Cadbury Committee⁶, was produced in 1992. Its aim is to further the implementation of corporate governance standards for the purpose of raising confidence in financial reporting and auditing. The said code endeavours to define the various organs and proponents’ respective responsibilities within the company and what is expected of them. In 1995 the Greenbury Report⁷ was produced which mainly addressed the issue of directors’ remuneration.

France followed suit with the Vienot I Report⁸, drafted in 1995 by a workgroup which included the AFEP⁹ and the MEDEF¹⁰. This report studies Board of Directors’ operating in listed companies: its assignments and attributions, composition and operating, the Viénot I report was received with a certain amount of scepticism. However, four years later, a great many of the recommendations specified therein had a positive impact on Management organisation and relationships with shareholders (creation of audit, remuneration and selection committees). French companies showed a growing resolve to subscribe to corporate governance principles.

Subsequently, a new analysis of French corporate governance practices resulted in the

Viénot II Report. This recommends the separation of the offices of Chairman and Managing Director, the publication of remuneration and option plans, and the establishment of specific operating rules for Committees and Boards.

In Belgium, recommendations from the FEB¹¹, the Stock Market and the CBF¹², inspired by the Cadbury Committee to a great extent, were published in 1998. The said recommendations are based on 7 subjects: Board composition¹³, its operating¹⁴, committees set up by the Board, everyday management, results appropriation policy, relationships with principal shareholders and shareholders’ agreements.

2. The 2000’s wave.

In the United States, subsequently to the Tyco, Enron and Worldcom scandals and in order to restore investors’ confidence, the legislator rapidly implemented strong measures to further guarantee external auditors’ independence, the reliability of accounting statements, and to foresee a mechanism for the denunciation of reprehensible acts (ethical warnings) and the protection of informers. These measures are grouped in the so-called *Sarbanes-Oxley* laws¹⁵ and *Whistleblowers*

⁶ The Cadbury Committee named after its Chairman Sir Adrian Cadbury, was set up in May 1991 at the initiative of the London Stock Exchange, the Financial Reporting Council and the accounting profession. (M.-P. Gillen-Snyers, *Droit bancaire et financier au Luxembourg - Recueil de Doctrine*, 2004, p.1115, ALJB)

⁷ By the eponymous committee, this time set up by the Government.

⁸ The *Conseil National du Patronat Français* (CNPFP) and the *Association Française des Entreprises Privées* (AFEP) entrusted a committee specially set up for this purpose with the task of studying the main problems concerning the composition, attributions and operating methods of listed companies’ Boards of Directors.

⁹ AFEP: French Association of Private Companies.

¹⁰ MEDEF: Movement of French Companies.

¹¹ Federation of Belgian companies.

¹² *Commission Bancaire & Financière*, which subsequently became the *Commission Bancaire, Financière et des Assurances*: the Belgian supervisory authority (abbreviated in the text to ‘CBFA’).

¹³ It makes a difference between the following categories of directors: those who in fact represent principal shareholders, directors charged with everyday management, and directors who the company considers as independent of principal shareholders and management.

¹⁴ In particular this concerns the number of meetings, the most significant subjects which are discussed, decision-making procedures, rules and procedures relating to remunerations, percentages and advantages in kind, and share options allocated to directors.

¹⁵ Law of 31.07.02 (Pub. L. No. 107-204, 116 Stat. 745), named after the 2 main architects of the text: the Republican senator Paul Sarbanes and the Democrat deputy Michael Oxley.

Le Bulletin

*Protection*¹⁶ published in 2002. They are still topical today.

In the United Kingdom, Derek Higgs' report "*Review of the role and effectiveness of non-executive directors*"¹⁷ re-specifies the best current practices as regards Board composition and Audit Committees. The report's approach is to ask listed companies to comply with the recommendations or, if this is not the case, to explain discrepancies with best practices specified in the report ("*Comply or explain principle*").

In France, the Bouton Report¹⁸ aims to restore economic actors' confidence and particularly endeavours to measure the efficiency of the Viénot Reports. It deals with stock options, shareholders' control, corporate governance and the accounts committee.

The Winter Report, named after the workgroup commissioned by the European Commission, recommends the improvement of Community legislative framework for corporate governance through various operations, such as, for example¹⁹:

- Strengthening the roles played by independent members of Boards of Directors and Supervisory Boards, in particular in the three fields where

directors may be faced with conflicts of interests: directors' appointments and remunerations, the control of corporate accounts,

- The implementation of an adequate system as regards directors' remuneration, making corporate and main directors' remuneration policy disclosure mandatory,
- Confirmation of the joint liability of members of the Board of Directors.

Belgium reforms its corporate code in 2002 (the corporate governance law). The said reform is followed by publication of the Lippens and Buysse codes (in 2005) and a CBFA circular on "*Correct governance for financial institutions*" (in 2007).

- ♦ **The Lippens Code**²⁰. This replaces 1998 recommendations. It is applicable to all listed companies. It specifies that other companies may also use it as a basis. 9 principles are set forth therein. The following year, the Luxembourg Stock Market extensively uses it as a basis to formulate its 10 principles (see here under). The CBFA is one of the initiators of the code and contributes to external code control. Code compliance is governed by the principle "*Comply or explain*".

¹⁶ The whistleblowing system is increasingly used by companies for the purpose of curbing fraudulent behaviour or which may have a serious adverse affect on business, or may seriously commit their liability. A system that enables individuals to report behaviour from members of their organisation which in their opinion is contrary to the law, regulations or fundamental rules established within the company. Definition taken from www.cnpd.lu.

¹⁷ www.dti.gov.uk/cld/non_exec_review

¹⁸ The Bouton Report, of which the real title is "*Pour un meilleur gouvernement des entreprises cotées*" is the result of an assignment entrusted by the MEDEF and the AFEP-AGREF to Daniel Bouton, Chairman and Managing Director of the Société Générale, on 22.04.02; this is the same Daniel Bouton who was put in the hot seat in the scope of the J. Kerviel trader affair.

¹⁹ www.euractiv.com/fr/opinion/gouvernement-entreprise/article-120276

²⁰ In January 2004, a Commission chaired by Maurice Lippens, was set up for the purpose of drafting a sole code of best corporate governance practices for all listed companies. The said code came into force on January 1, 2005, and can be downloaded from the website www.corporategovernancecommittee.be. Maurice Lippens has been Chairman of the Fortis Group Board of Directors for 18 years. News on Fortis has recently evidenced the importance of the issues broached in his code. For example, with respect to communication, directors' remuneration (cf. the article by P. Gérard "*Vottron sera-t-il le fusible de Fortis?*" in "*Le Soir*" dated 11.07.08) or the separation of tasks (cf. see dossier in "*Trends*" dated 01.08.08 and the article entitled "*Vottron parti Mittler déchargé...quid de M. Lippens?*"). Also see E. de Keuleneer's interview in "*Trends*" dated 21.08.08 "*Le modèle belge de gouvernance n'est pas satisfaisant*".

- ◆ The **Buyse Code**²¹. This code is particularly interesting because it is exclusively intended for non-listed companies. It only sets forth recommendations void of any restrictive character. Some recommendations only address family shareholding companies, some only address small companies. For example, the code recommends that a charter be drafted stipulating the company's tasks and relationships between organs thereof, General Meeting ratification of the executive manager's appointment, shareholders' agreement drafting... It advises against having a Chairman of the Board who is also an executive manager.
- ◆ Although the main Belgian financial institutions already have a corporate governance charter such as the Lippens code which is accessible to the public, the CBFA requested that the main banks draft a "*Memorandum of correct governance*"²² specifically intended for the CBFA by adding a prudential dimension to correct governance. The said Memorandum must be based on 10 general principles specified by the CBFA, further to extensive consultation undertaken in 2006. The CBFA is currently examining the various "flagship" projects to identify "*best practices*" which will be generalised for all Belgian financial proponents. Other regulators may be tempted by a similar course of action.

²¹ The Corporate Governance Commission for unlisted companies (Buyse Commission) is chaired by Paul Buyse, who is Chairman of the Bekaert Board of Directors, amongst other offices. This code can be downloaded from the website www.codebuyse.be.

²² Circular PPB-2007-6-CPB-CPA of March 30, 2007; also see the feedback statement by the CBFA on the consultation "*Bonne gouvernance pour les établissements financiers*". Available on the website www.cbfa.be.

In the Grand Duchy.

A. To date, legislation has remained discreet on this subject.

This discretion probably results from 5 factors²³.

1. - Luxembourg corporate law (law of August 10, 1915, as amended),

The Board of Directors is established as the key organ with very extensive powers. It operates on a collective basis. When the Board of Directors delegates part of its powers to one (or several) executive managers, the latter must report on their management to the Board of Directors.

Other countries such as France, Germany, the Netherlands tend to favour an organisation based on a distribution of roles between a management organ (executive committee, Vorstand) and a supervisory organ for said executive committee (supervisory board, Aufsichtsrat). In 2006, this possibility was also introduced into Luxembourg legislation (see below).

But management positions (by executive managers²⁴) are nevertheless separate from control positions (by the other directors, "non executive directors"). Therefore, two fundamental principles of corporate governance, duality of powers and collectiveness, have already met.

2. - Luxembourg companies' shareholding is rarely spread over a large public. On the contrary, it is rare that a Luxembourg company does not have a parent company that decides on Board of Directors' composition, imposes

²³ Factors quoted firstly in "*Les banquiers luxembourgeois et le Corporate Governance*" by M.-P. Gillen-Snyers, *Recueil de Doctrine*, 2004, p.1115, ALJB and secondly in the "*Précis de droit des sociétés*" by A.Steichen.

²⁴ Executive managers to whom everyday management has been delegated.

Le Bulletin

strategy and controls the Luxembourg subsidiary management.

3. – Luxembourg companies in the financial sector are already submitted to more detailed regulations through numerous circulars.

4. – In Luxembourg “*soft law*” is often preferred to restrictive legislation. This indeed allows a flexible and rapid adaptation to numerous evolutions in business life and legal practices. Flexible rules for corporate governance will also enable to take account of specificities connected to each company’s shareholding structure, field of activity and size.

5. – Often, before following in the steps of neighbouring countries, Luxembourg prefers to first observe legislative forerunners in order to avoid certain excesses and pitfalls as best as possible, and select the most pragmatic channel. Luxembourg will probably wait for the publication of a European Directive before crossing the legislative threshold²⁵.

B. Principles of the Luxembourg Stock Market for listed companies

Companies listed in Luxembourg are submitted to 10 principles laid down in 2006 by the Luxembourg Stock Market²⁶. These are based on the “*Comply or explain principle*”. Their intention is to reflect international practices.

Each of the said 10 principles is in turn detailed in various recommendations and lines of conduct.

²⁵ For example, the necessity of transposing into national legislation before August 3, 2009, the directive 2007/36/EC voted in July 2007 should be noted, regarding the performance of certain listed companies’ shareholders’ rights. The purpose of the said directive is shareholders’ equal treatment by timely access to all information presented to a General Meeting, by facilitated voting right performance (by proxy), the right to add items to the agenda, to ask questions and be informed of voting results.

²⁶ These 10 principles can be accessed on the website www.bourse.lu.

1. Corporate governance system: the Company adopts a clear and transparent corporate governance system, which is adequately advertised.
2. Board of Directors’ task: the Board of Directors is charged with company management; it acts in the corporate interest and defends shareholders’ joint interests, by monitoring the company’s long-lasting development. It acts in a collective and informed manner.
3. Board of Directors and specialised committees’ composition: the Board of Directors is composed in a balanced manner so that it can take informed decisions. It monitors the creation of specialised committees required for the correct performance of its assignment.
4. Directors and Management members’ appointments: the company establishes a formal procedure for the appointment of directors and Management members.
5. Conflicts of interests: directors take their decisions according to corporate interests and refrain from taking part in any deliberation or decision which may give rise to a conflict between their personal interests and those of the company or of a company controlled by the latter.
6. Assessment of Board of Directors operating: the Board of Directors regularly assesses its operating and relationships with Management.
7. Management structure: the Board of Directors sets up an efficient Management structure. It clearly defines Management attributions and delegates thereto the powers required for their correct performance.
8. Remuneration policy: the company ensures that it is assisted by quality directors and management members via an adapted remuneration policy

which complies with the company's long-term interests.

9. Financial reporting, internal control and risk management: the Board of Directors lays down strict rules for financial reporting, internal control and risk management intended to protect corporate interests.
10. Shareholders: the company complies with its shareholders' rights and ensures their equal treatment. The company defines an active communication policy with respect to shareholders.

C. Our role as Compliance Officer - Conclusion

*The purpose of the compliance function is to protect the establishment from any prejudice which may result from currently prevailing standards, and contribute to the resulting management of risks in the broadest sense. The reputational risk which may possibly result from total lack of policy in this respect should be at the heart of the Compliance Officer's preoccupations.*²⁷

There is only one step from *risk* to *opportunity* management... that the Compliance Officer can take, better than anyone else.

Corporate governance indeed covers fields which go beyond the world of compliance. However, several essential themes for correct governance lie especially within the scope of the compliance function: rules intended to avoid and manage conflicts of interests; rules on personal transactions; transparency, whistleblowing and ethics are good examples.

Correct corporate governance is not reserved to listed companies alone. The crucial and public role played by financial institutions in the economy, in particular with respect to investors, requires that these institutions are particularly well managed, that their practices

are honest. In this context, not only is correct governance in their own management interest, but it is also essential to maintain the public and the clientele's confidence, and that of all market players.

A significant step in extending correct governance principles to all financial institutions was taken in this direction in Belgium, by the CBFA. This will certainly not be the last.

As a specialist of charters, good conduct codes and other "*soft laws*", we believe that the Compliance Officer is ideally placed to contribute his/her advice, experience and approach, hand in hand with the legal department. His/her role is to reduce activity risks and above all, to seize more opportunities, including improving the company's image with investors and clients.

The Compliance Officer can take action in his/her favoured fields, via charters, good conduct codes and other internal regulations. The Compliance Officer should also be able to express an opinion on statutory amendments or the drafting of internal regulations for the Board of Directors and other key committees.

Lastly, annual reports and other periodical publications are essential for communication: like other neighbouring states, nothing prevents Luxembourg companies from dedicating space to corporate governance.

Corporate governance is an ever evolving issue. Rather than waiting for the publication of new directives, laws or circulars or seeing the application of a parent company charter being imposed, the Compliance Officer has every interest in being proactive. In this way, he/she can bring the company to anticipate future requirements and practices. And gradually adapt internal operating rules, every time the opportunity presents itself.

Seizing the opportunities which corporate governance offers is compatible with the search for improved medium and long-term profitability. It is one of the essential elements for the company's long-lasting expansion.

²⁷ N. Carabin "*La manière dont nous investissons crée le monde dans lequel nous vivons*" ALCO Newsletter n°8, in reference to circular CSSF 04/155 §3.

D. For more information.

1. Legislation: which laws and circulars stipulate requirements with respect to corporate governance?

Below we will only quote a few examples, some of which come from the article by M.-P Gillen-Snyers “*Les banquiers luxembourgeois et le corporate governance*” to which we refer the reader.

- The law of August 10, 1915 on **trading companies** (as amended over time) is, as specified above, the law which supplies the most rules concerning companies’ organisation, management and control. Amongst others, the external auditor’s role, the various company organs’ operating, the protection of minority shareholders are broached.

- The law of December 4, 1992 defines the publicity requirements for significant acquisition and holding transfers by listed companies.

- The law of August 25, 2006 which amends the 1915 law by adding, amongst others, the possibility of entrusting public company management not only to a Board of Directors, but also to an **executive committee** supervised by a **supervisory board** or also by a sole director. These possibilities enable an improved distinction of the aforementioned duality principle.

- The law of January 11, 2008 relating to **transparency** obligations for transferable securities issuers. Amongst others, this law defines the publicity obligations for six-monthly and annual financial reports.

Some laws, and circulars, restrict their fields of action to companies in the financial sector.

- The law of June 17, 1992 imposes the publication (via the annual accounts Appendix) of directors and managers’ remuneration and advantages.

- The law of April 5, 1993 relating to the financier sector requires professional worthiness for shareholders, members of

administrative, management and supervisory organs of credit institutions. Credit institution management must be ensured by at least 2 persons (the “four eyes rule”). The said management is collective.

- Responsibility for some duties, held by a named director, is required by various circulars: internal organisation and control of market activity (93/101), AML fight (05/211), processing complaints, administrative and accounting organisation (96/126), (internal) control of accounts (98/143), the compliance function (04/155) ...

- Circular CSSF 01/027 on corporate auditors’ assignments imposes that internal committee features must be specified (audit committee, remuneration committee, appointment committee...) in analytical reports drawn up yearly by external auditors.

- Circular CSSF 08/337 on transparency completes the transparency law mentioned above.

2. Articles, doctrine, etc.

- “*Les banquiers luxembourgeois et le Corporate Governance*” by M.-P Gillen-Snyers, *Droit bancaire et financier à Luxembourg - Recueil de Doctrine*, 2004, p.1115, ALJB

- Corporate governance – “The 10 principles of corporate governance of the Luxembourg Stock Exchange”, April 2006, available on the website www.bourse.lu.

- Communication from the commission to the Council and the European Parliament on the Modernisation of Company Law and Enhancement of Corporate Governance in the European Union – “A plan to move forward” (available on the website curia.europa.eu)

- Feedback Statement from the CBFA on correct governance consultation for financial institutions and circular PPB 2007-6-CPB-CPA (available on the website www.cbfa.be)

Le Bulletin

- A. Steichen, *“Précis de droit des sociétés”*, Saint Paul Editions.

Charles van Doorslaer
“*Conseil Compliance*”
KBL European Private Bankers

Questions of general interest and dialogue with members

1) Circular 04/155 specifies that the compliance function must identify compliance risks which banks are exposed to in the framework of their activities. Some auditors request a quite detailed matrix of the said risks. Has the ALCO issued recommendations with respect to the implementation of this request?

The identification of compliance risks is in fact one of the assignments which explicitly comes within the Compliance Officer's field, as specified in circular CSSF 2004/155. The same circular defines the compliance risk as "the risk of prejudices that an institution may suffer if its activities are not performed in accordance with currently prevailing standards", currently prevailing standards to be understood as "all rules to which the institution is submitted when undertaking its activities on the various markets, in particular:

1. - Laws, regulations and circulars which govern access to the financial sector and the exercise of banking and/or professional activities in the financial sector,
2. - Laws and circulars dealing with professional obligations, i.e. rules for fighting money laundering and terrorist financing, including rules of conduct for the financial sector (for the purpose of preventing insider trading and price manipulations) and the protection of investors.

For the assessment of compliance risks and in order to define the scope of the compliance function, codes of conduct or internal ethics, professional association and financial market codes (Stock Markets or other regulated markets) are also to be taken into consideration."

To draw up a matrix of compliance risks, the various obligations specified by the aforementioned legislation and regulations must be noted, and also the key controls to be undertaken according to your activities. Once the said obligations have been listed, compliance controls (3rd level) must be set up and graded (frequency, scope of overall control...), taking account of existing 1st and 2nd level controls in your institution.

The said matrix can then be easily updated via performance of regulatory monitoring (for this purpose, subscription to the CSSF which provides access to new circulars and newsletters, in addition to newsletters published by the ABBL, are good information sources in particular, and compliance implication in launching new activities, new products... (Which leads to the ad hoc identification of compliance risks). Constant communication with other functions involved with management and risk control, such as Risk Management, Internal Control and Internal Audits will also enable to ensure that the said matrix is adequate for the compliance risks and controls and, as necessary, to implement the required adaptations.

2) Must a collective investment undertaking (OPC), in the scope of its KYC obligations, perform AML client due diligence on brokers with whom CIIs have opened accounts for asset management performance operations?

Further to studying legislation on the fight against money laundering and terrorist financing, we note that for CIIs, the following regulatory framework is applicable:

1. The law of November 12, 2004 concerning the fight against money laundering and terrorist financing, as amended by the law of July 17, 2008, imposes on credit institutions and financial sector professionals the obligation of knowing their customers.
2. Circular CSSF 05/211 of October 13, 2005 specifies that “CIIs which trade their own securities have a direct contact with investors, insofar as they undertake trading activities on their securities via the intermediary of other professionals”, also lie within the scope of application of the law dated November 12, 2004. CIIs also have the possibility of delegating the physical performance of identification obligations to credit institutions or other professionals of the financial sector who are accredited or authorised to perform their activity in Luxembourg pursuant to the law dated April 5, 1993 amended, regarding the financial sector. The said delegation is generally to the ICC transfer agent or an approved distributor.

A CII's depository bank is a credit institution submitted to application of the anti-money

laundering law, as the CII is the depository bank's customer. The depository bank's responsibility is to identify the customer (the CII) or, for the transfer agent in the event of delegation, to identify the CII customer, i.e. the investor. The document “Practices and Recommendations aimed at preventing the use of the Luxembourg fund industry for the purpose of money laundering and terrorist financing”, jointly published by ABBL, ALCO and ALFI also clarifies the fact that a depository which solely takes charge of maintaining funds assets and does not ensure duties as a transfer agent is not responsible for identifying CII investors.

The definition of “broker” is the following: the broker takes part in regulated securities markets, is a financial intermediary, charged with putting lenders and borrowers into contact. For securities, the said broker operates on the primary market by guaranteeing the correct performance of an issuing, but also on the secondary market by continuing to establish contacts between the various players.” (Source: actufinace.fr).

Therefore a broker is neither a depository bank, nor an investment fund client; accordingly the broker has no identification obligation with respect to the fight against money laundering and terrorist financing by the depository bank or the CII.

But, the broker who has the CII as a client is under obligation of identifying the latter.

Workgroup 33 “Replies to members' questions”.

Association Activities

VIE ASSOCIATIVE

GROUPES DE TRAVAIL ACTUELS

Groupe de travail 16

Commission permanente juridique et relations publiques

Responsable s Claudine FRUTSAERT
Téléphone +352 44 24 24 43 15
claudine.frutsaert@axa.lu

.....
Téléphone Patrick SCHOTT
+352 46 71 71 400
pschott@pictet.com
.....

Groupe de travail 21

Interprétation pratique des restrictions d'investissements de fonds

Responsable Tim WINFIELD
Téléphone +352 34 10 23 85
tim.winfield@jpmorganfleming.com

Groupe de travail 27

Formations IFBL

Coordinateur Jean-Noël LEQUEUE
Téléphone +352 62 11 94 941
icesa@pt.lu

Groupe de travail 29

Abus de marché

Coordinateur Cyril MATTHIEU
Téléphone +352 40 46 46 400
cyrilmatthieu@lu.hsbc.com

Groupe de travail 30

Domiciliation de sociétés

Coordinateur Sophie RASE
Téléphone +352 40 25 05 408
sophie.rase@maitlandgroup.com

Groupe de travail 33

Réponses aux questions des membres

Coordinateur Philippe SCHNEIDER
Téléphone +352 45 14 14 299
philippe.schneider@citi.com

ASSOCIATION ACTIVITIES

CURRENT WORKING GROUPS

Working group 16

Legal and public relations

Leaders Claudine FRUTSAERT
Phone +352 44 24 24 43 15
claudine.frutsaert@axa.lu

.....
Phone Patrick SCHOTT
+352 46 71 71 400
pschott@pictet.com
.....

Working group 21

Practical interpretation of fund investment restrictions

Leader Tim WINFIELD
Phone +352 34 10 23 85
tim.winfield@jpmorganfleming.com

Working group 27

Training IFBL

Coordinator Jean-Noël LEQUEUE
Phone +352 62 11 94 941
icesa@pt.lu

Working group 29

Market abuse

Leader Cyril MATTHIEU
Phone +352 40 46 46 400
cyrilmatthieu@lu.hsbc.com

Working group 30

Domiciliary agents

Leader Sophie RASE
Telephone +352 40 25 05 408
sophie.rase@maitlandgroup.com

Working group 33

Answers to questions of members

Coordinator Philippe SCHNEIDER
Phone +352 45 14 14 299
philippe.schneider@citi.com

Internet leader:

Olivier GILSON

Phone +352 48 48 80 51 08

olivier.gilson@efa.eu

Working groups coordinator:

Jean-Noël LEQUEUE

Phone +352 62 11 94 941

icesa@pt.lu

MEMBRES ET VIE ASSOCIATIVE:

Nombre de membres (au 26/09/2008):

Banques	173
Fonds	80
Fonds / Banques	32
Assurances	44
Consultants / Réviseurs	34
Admin. et domiciliation de sociétés	15
Avocats	6
PSF	26
Gestion de fortune	4
Autres	5
Effectif total:	419
Membres effectifs	349
Membres d'honneur	70
Effectif total:	419

MEMBERS AND ASSOCIATION ACTIVITIES:

Number of members (as per 26/09/2008):

Banking sector	173
Funds sector	80
Funds / Banking sector	32
Insurance sector	44
Consultants / Auditors	34
Admin. and company domiciliation	15
Law firms	6
SFP	26
Asset management	4
Other	5
Total number:	419
Active members	349
Honorary members	70
Total number:	419

Réunions et activités:

Mensuellement	Réunions du conseil d'administration
1 / 2 x par an	Réunions plénières
2 / 3 x par an	Rencontres informelles autour d'un thème

Meetings and activities:

Monthly	Board meetings
1 / 2 x per year	Plenary assemblies
2 / 3 x per year	Informal meetings on a subject

Board:

Jean-Marie LEGENDRE	President
Claudine FRUTSAERT	Vice-President - Insurance
Alain HONDEQUIN	Vice-President - Banks
Patrick WATELET	Vice-President - Funds
Valerie ALEZINE	Treasurer
Sundhevy GOÏOT	Administrator
Jean-Noël LEQUEUE	Administrator
Patrick CHILLET	Advisor
Karine VILRET-HUOT	Advisor
Vincent SALZINGER	Advisor
Tim WINFIELD	Advisor

Secretary:

Laurence THILMANY-INCOURT
secretariat@alco.lu
B.P. 13 L-2010 Luxembourg

President Secretary:

Solyane LORKOVIC
Téléphone +352 24 67 26 12
Fax +352 24 67 81 37
solyane.lorkovic@ca-luxembourg.com

Newsletter Secretary:

Laurence THILMANY-INCOURT
secretariat@alco.lu
B.P. 13 L-2010 Luxembourg

Editorial staff:

Claudine FRUTSAERT (leader), Marie BOURLOND, Carine VAN MULDER, Sophie PIROTTE, Leen BOM, Jean-Marie LEGENDRE, Philippe SCHNEIDER, Patrick SCHOTT

Visit our website: www.alco.lu