

Islamic Financial Services Forum 8-9 November 2005
Introduction by Yves Mersch, Governor of the Banque centrale du Luxembourg

Your Excellencies,
Ladies and Gentlemen,

Welcome to Luxembourg for the Islamic Financial Services Forum.

It is with great interest that I have followed the developments in Islamic Financial Services over recent years.

They go hand in hand with an increasing demand for financial services not only in Islamic countries, but also in internationally active financial centres with an established background.

My country is one of these international crossroads for trade and finance. As a small country we have always intended our role to be that of a go-between between different cultures. In this regard our major role is, on the European continent, to be an intermediary between France and Germany. With the emergence of a larger Europe of twenty-five we have welcomed people and products from the entire continent and were among the first countries to have no restrictions on free movement of people, goods and capital.

Today we are aware that we have to forge the link between Europe and the wider world.

This is our contribution to peace. Trade and finance, equal partnership between larger and smaller countries can only thrive on mutual respect, understanding and exchange.

These are the reasons, which prompted me to suggest to Prof. Rifaat Ahmed Abdel Karim the organisation of a conference of the Islamic Financial Services Board in Luxembourg.

Prof. Abdel Karim shares the values I have mentioned and I am obliged to him and his team for the efficient work in organizing this event.

This conference is timely if we judge by the increasing volume of private and public savings in the Islamic world and their tendency to express a preference for diversification including into the eurozone.

The eurozone has become an ever more integrated financial market across most segments be they money, bond equity or banking according to a recent financial integration indicator published by the European Central Bank.

Last weekend at an international conference in Paris the chief economist for the Bank for International Settlements stated that "European financial markets are now arguably as "broad, deep and resilient" as those in the United States".

Luxembourg has to be viewed foremost as a financial centre for the eurozone, and the Luxembourg Central Bank is one of the European national central banks offering a number of reserve management services.

But let me give you a brief overview of this financial centre, which represents 25% of GDP and 10% of the labour force of this country.

The origin of Luxembourg financial activities dates back to the 1920's when several laws were initiated aimed at attracting international capital for development purposes. The great worldwide depression and the ensuing World War II did not permit these laws to bear fruits until the 1960's.

Capital freedom, the emergence of the European Community, later the Single Market, and now the Single Currency, required financial centres to be geared towards international business. Political and social stability, multilinguism and openness to foreigners, and an open economic environment made this 1000 year old city into a thriving financial centre.

The main actors of the Luxembourg financial sector are the banking and the investment fund industries. The financial sector also encompasses the Luxembourg Stock Exchange, clearing and securities settlement business and insurance business, as well as other professionals of the financial sector.

The banking sector

- Historically, the influx of international banks to Luxembourg started in the late 60's with the development of the euro bond market and it gained further importance with the development of private banking in the 80's.¹ Luxembourg legislation has proved to be innovative and adaptive to changes in the financial landscape and therefore it attracts foreign banks.
- The Luxembourg banking sector is characterized by its high degree of internationalisation. The number of banks established in Luxembourg reached its peak in 1994 (222 units) and has decreased subsequently due in particular to the impact of mergers and acquisitions. At the end of August 2005, 157 credit institutions (of which 45 branches), out of which foreign banks represent 96%, are present in Luxembourg. This ratio stands at 19% at the EU-15 level.

With 44 establishments, German banks have the largest representation in Luxembourg followed by French (15), Italian (14), Belgian (13) and Swiss banks (13). Foreign entities represent about 94% of the total balance sheet of the banking sector whereas this ratio stands at 22% on average at the EU-15 level.

- The total balance sheet of the banking sector increased until 2001. After a slight reverse in 2002 and 2003, due to the deterioration in the international macro-economic environment and stock exchange turbulence, the ascending movement continued and this despite the reduction in the number of banks. The total balance sheet reached 758 billion euro at the end of September 2005.
- Results of the Luxembourg banking sector are in a positive position. September 2005 Profit & Loss data show a year-on-year increase in the income of 13%.
- As regards the soundness of the banking sector, Luxembourg banks are well capitalized and have a comfortable liquidity situation, well beyond minimum requirements.

¹ The influx of foreign banks started with the establishment of German banks, followed by American, Swiss, Italian and Japanese banks.

- Luxembourg banks, which are operating under the Universal Bank Statute, are highly diversified and offer a complete range of commercial and investment services to both institutional and private investors, including traditional deposits and credit business, private banking, corporate finance, insurance services (bancassurance) as well as administration and depositary activities of investment funds. In line with their commitment to innovation, banks explore new niche products such as covered bonds or securitisation, which are markets expected to grow further. This conference is an occasion to deepen this product-based knowledge.

The investment fund industry

- The investment fund industry is a core element in the Luxembourg financial sector. Luxembourg is a prime centre for the domiciliation, administration and distribution of investment funds and is, together with the United States and France, one of the world's leading investment fund centres.

One of the most evident reasons for the development of the investment fund industry in Luxembourg relates to the quick implementation in 1988 of the directive on investments providing for a European passport; i.e. the commercialisation of investment fund parts in other countries of the EU than the home country of the fund. Luxembourg was the first country to transpose this directive into domestic law.

The investment fund industry recorded impressive growth over recent years. The number of investment funds rose from 525 in 1988 to 2 027 in July 2005. The net assets held by investment funds has risen from 53 billion euro to 1 337 billion euro over this period. Fund promoters from more than 40 countries have domiciled funds in Luxembourg.

- Alternative investment funds represent roughly 67,5 billion euro, or 6% of total assets under management in Luxembourg in 2004. This fast growing activity may become an important source of income in the investment fund business.

Other actors

- The *Luxembourg Stock Exchange*, operational since 1929, is a major listing entity of international securities. The number of listed securities reached 35 425 units on 30 June 2005, an increase of 14,16% over one year. The majority of the listings are bonds (74%), followed by investment funds (17%) and warrants (8%).
- *Securities Settlement Systems*. One of the two largest international securities clearing and settlement systems worldwide is established in Luxembourg. It offers settlement and custody services to more than 2 500 customers worldwide and is handling collateral eligible for Eurosystem credit operations.
- At the end of 2004, 95 *insurance companies* with total assets of 39 billion euro were established in Luxembourg. Premium income increased by 24% in the life insurance segment over 2004 whereas premium income in the non-life insurance segment increased by 8,6% during the same period. Furthermore, 273 *reinsurance companies* with total assets of 16 billion euro are present in Luxembourg.
- *Other professionals of the financial sector* (commission agents, private portfolio managers, domiciliation agents of companies, IT systems and communication networks operators of the financial sector) who were 179 in number at the end of August 2005, are holding total assets of 56 billion euro.
- Luxembourg, also hosts the European Investment Bank, established by the Treaty of Rome, which provides long-term financing for projects and programs that comply with the objectives of the European Union, as well as the European Court of Justice, the Court of Auditors, the European Commission, the European Parliament and the European Council.
- In addition, the Luxembourg School of Finance, a branch of the Luxembourg University, is specifically dedicated to finance and business.
- Finally, we observe in Luxembourg the development of various ancillary activities, which complement the traditional finance industry. In this context, I wish to mention the development of legal advice and auditing activity, as well as compliance and risk management activities.