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ANNUAL REPORT 2011

BANQUE CENTRALE DU LUXEMBOURG

EUROSYSTEM

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MISSION STATEMENT OF THE BCL

THE MISSION

The BCL is in charge of managing all the monetary and financial responsibilities granted to it as one of the National Central Banks of the ESCB.

It is also a member of the Eurosystem that gathers the European Central Bank and the National Central Banks that have adopted the euro.

On a national level, the Bank has to carry out the tasks imposed on it by the national laws and conventions.

It is developing the following fields of competence:

- Research and studies aimed at preparing, on the one hand, monetary policy decisions and, on the other hand, the development of wider knowledge concerning monetary, financial and economic issues
- Collection and analysis of statistics in the monetary, financial and balance of payments fields
- Implementation of monetary policy instruments
- Organisation and supervision of the payment and settlement systems
- Issuing and circulating banknotes and coins
- Financial asset management, both for itself and for third parties
- Participation in the prudential supervision of the financial system and the exercise of the oversight of payment and settlement systems, in order to guarantee the stability of the financial system in Luxembourg
- Advising the legislative and regulatory authorities in financial and monetary areas
- Publication of its studies and research and of the decisions in which the BCL has taken part together with explanations.

THE VISION

The BCL intends to become a centre of competence, excellence even, whose performance generates public confidence in the Central Bank.

Among Luxembourg's institutions, the BCL takes every care to be in a position to fulfil all its national, European and international obligations.

In view of the wide variety of its duties and activities, both in the public sector and in a competitive environment, the BCL must generate an income guaranteeing its institutional, functional and financial independence.

CORPORATE VALUES

As a consequence, the values associated with its action are:

- Professionalism, guaranteed by highly specialised staff, high-performance tools and high-level infra-structure

- Quality in all its services

- Stability provided by its long-term vision of all its activities

- Objectivity resulting from the establishment of precise rules that are equally applied

- Integrity, guaranteed by the transparency of its internal operation and by respect for professional ethics

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THE GOVERNOR'S MESSAGE

2011 was the year of the sovereign debt crisis in the euro area, marked by a reemergence of jittery markets over the summer, that spilled over to the real economy.

After the economic uptick of the first semester, most growth forecasts for the euro area member countries were revised downwards. The Luxembourg economy, which only grew by about 1 % in 2011, was no exception.

Since the beginning of 2012, signs have been pointing to economic stabilization and a slow and gradual restoration of market confidence. The measures taken by the authorities at the euro area and domestic levels are starting to bear fruit even though much more needs to be done. In terms of economic governance, twenty-five European countries signed a new fiscal treaty, labeled "Fiscal Compact", on 2 March 2012.

Despite these measures, tensions remain on the sovereign debt markets; the economy and its financing remain affected. Generally, subdued global demand and measures aiming at restoring fiscal balances and competitiveness explain why the growth forecast for the euro area for 2012 remains slightly negative.

Confronted with the crisis, the Eurosystem has strengthened its non-conventional measures.

At the domestic level, in light of its financial stability and liquidity supervision functions, the BCL further developed macro-prudential indicators and carried on research in this area.

The BCL also strengthened its oversight over financial market infrastructures. It participated in the inception of the new central securities depositary in Luxembourg, LuxCSD, which will allow market participants to benefit from settling their securities transactions in central bank money, thereby mitigating the risks of settling these transactions with commercial banks. LuxCSD is poised to join TARGET2-Securities, a clearing and settlement platform and landmark project of the Eurosystem that is due to start operations in 2015.

The "BCL Foundation", created in March 2011 and aiming at promoting education and research in activities that pertain to the BCL, chose research on financial stability issues as a priority topic for the period 2011-2012.

At the European level, the BCL participates in the new European System of Financial Supervisors (ESFS). The Governor of the BCL is a voting member of the European Systemic Risk Board (ESRB), which is responsible for macro-prudential surveillance of the financial system in the European Union. Since its first meeting in January 2011, the ESRB has issued three public recommendations, among which the recommendation of 22 December 2011 that provides for European Union Member States to select a domestic institution to be in charge of macro-prudential policies and for the domestic central bank to play a significant role in that policy without putting its independence into jeopardy.

Besides, in line with an agreement signed in 2011, the BCL provided operational assistance to the European Financial Stability Facility (EFSF) following its establishment in Luxembourg.

The BCL became a shareholder of the Bank for International Settlements (BIS), where it participates in different committees and working groups.

The Governor of the BCL was elected as a Co-Chair of the Regional Consultative Group for Europe, which was set up by the Financial Stability Board (FSB). The BCL hosted the inaugural meeting in Luxembourg in December 2011.

The BCL contributes to international institutions that aim at overseeing and supporting the development of Islamic finance.

The year 2012 comes with new challenges for the euro area and the Eurosystem, as well as for Luxembourg and its central bank.

At the European level, the measures adopted to improve economic governance, especially within the euro area, must be implemented without delay. Priority should be given to coordinating economic and fiscal policies of Member States effectively through the European Semester, ensuring the prevention and correction of excessive deficits and monitoring excessive macroeconomic imbalances, in line with the provisions included in the "six-pack". There is also a need to adopt harmonized constraining fiscal rules in accordance with the aforementioned Fiscal Compact.

The strengthening of the resources of the EFSF and the early entry into force of its successor, the European Stability Mechanism (ESM), on 1 July 2012 are welcome.

As regards the Eurosystem, the priority is to phase out gradually the non-conventional measures adopted during the crisis, which are by definition temporary, in order to return to a conventional monetary policy regime. The challenge is to restore confidence on the financial markets and to ensure an optimal transmission of the monetary policy and the financing of the economy.

In Luxembourg, as in other countries, we have to ensure the sustainability of public finances, while restoring competitiveness to boost potential growth that is instrumental in fostering the sustainable development of our country. Substantial structural reforms must be implemented to ensure the future of Luxembourg's economy. These reforms relate, among others, to the financing of the pension system as well as to the labour market, the educational system, the promotion of research and development as well as infrastructure development.

The BCL is determined to pursue its efforts. The Luxembourg central bank supports legislative progress achieved in Luxembourg in the field of new constitutional and legal rules, notably in the fiscal area but also in the setup of resolution mechanisms for financial institutions, which should be funded in order to protect public finances. A change in the organic law of the BCL is vital, in line with the proposals submitted two years ago, to allow the BCL to fulfill its tasks adequately.

The BCL takes particular care in informing the public about its activities. The Annual Report, which the law requires the BCL to present, after approval by its Council, follows a new format. The French version of the 2011 Annual Report was published three months earlier in comparison with the previous editions. The first part of this Report presents the Bank's most important activities. Its second part expounds the BCL's organisational developments and presents its financial accounts. As for the detailed presentation of the economic and financial situation, which was included in the previous Reports, it will henceforth be available in the Bank's other publications, in particular in its regular Bulletins and its Financial Stability Review.

Last, but not least, I would like to express my deep gratitude toward those who, over the years, in the various bodies, services and departments of the Bank, have assisted me, supported me and advised me in my constant efforts to fulfill the legal missions of the BCL and by applying the values expressed in the Bank's Mission Statement.

I share with them the pride to belong to an institution which is solidly anchored at the national, European and international levels.

Yves Mersch

01 THE BCL'S ACTIVITIES

1 THE BCL'S ACTIVITIES

1.1 MONETARY POLICY OPERATIONS

In Luxembourg, the BCL is responsible for conducting the monetary policy defined by the Eurosystem for the entire euro area.

Monetary policy operations have included conventional and non-conventional measures since 2007.

Open-market operations

The refinancing operations implemented by the BCL (open market operations) consist of funds allocated by the BCL guaranteed by eligible collateral submitted by its counterparties, the financial institutions of Luxembourg.

Open market operations include:

- Main refinancing operations (MRO) carried out through weekly tenders with a one-week maturity. These operations play a leading role in steering interest rates (thanks to the minimum bid rate or the fixed rate, since October 2008), in the management of banking liquidity and in signalling the trend of monetary policy.
- Long-term refinancing operations (LTROs), normally carried out through monthly tenders with a three-month maturity. These operations aim at providing additional long-term funding to the financial sector. They do not aim to give indications concerning the orientation of monetary policy.
- Fine-tuning operations, carried out by the Eurosystem on an *ad hoc* basis in order to counter temporary imbalances.

Standing Facilities

This instrument allows for the injection and withdrawal of liquidity on a day-to-day basis.

There are two types of standing facilities:
- The marginal lending facility: counterparties benefit from a marginal lending facility at the BCL, which they can use in the form of a current account overdraft (guaranteed by collateral) until the following working day.
- The deposit facility: counterparties benefit from the possibility to make overnight deposits with the BCL at the end of the day.

Minimum reserves

Euro area financial institutions are subject to a system of mandatory minimum reserves to be held on accounts opened at their national central bank.

These reserves aim at stabilising money market interest rates and at creating a structural liquidity deficit.

The amount of reserves to be held is determined according to the balance sheet of the financial institution.

Temporary currency auction facilities (swaps)

Besides its regular monetary policy operations, the Eurosystem extended the swap facility agreement established end-2007 with the US Federal Reserve. This agreement allows the Eurosystem to provide dollars to counterparties guaranteed by eligible collateral. Furthermore, the Eurosystem renewed the swap agreement established in December 2010 with the Bank of England. These two agreements have been renewed until at least August 2012.

In November 2011, the Eurosystem announced coordinated actions with the Bank of Canada, the Bank of England, the Bank of Japan, the Federal Reserve and the Swiss National Bank. In particular, these central banks agreed to establish temporary bilateral liquidity swap arrangements so that liquidity can be provided in each jurisdiction in any of their currencies should market conditions so warrant. These agreements remain valid until 1 February 2013.

Covered Bond Purchase Programme (CBPP)

Covered bonds are a key instrument for the credit institutions' funding. The CBPP is one of the non-conventional measures of the Eurosystem's Monetary Policy.

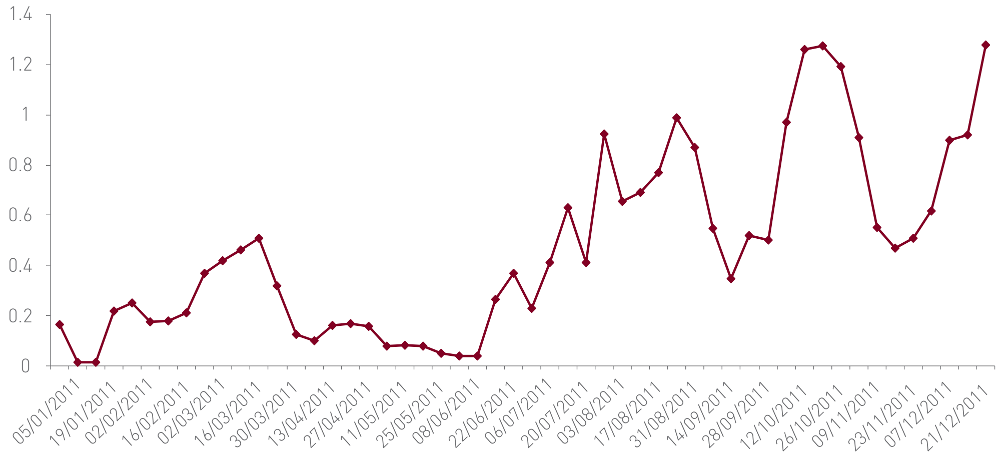
Securities Markets programme (SMP)

The SMP is a non-conventional purchase programme of both public and private bonds. The Eurosystem conducts specific operations in order to sterilise the impact of these bond purchases.

1.1.1 Open market operations

1.1.1.1 Main refinancing operations (MRO)

Chart 1:
MRO – Percentage of participation of LU compared to the euro area in 2011



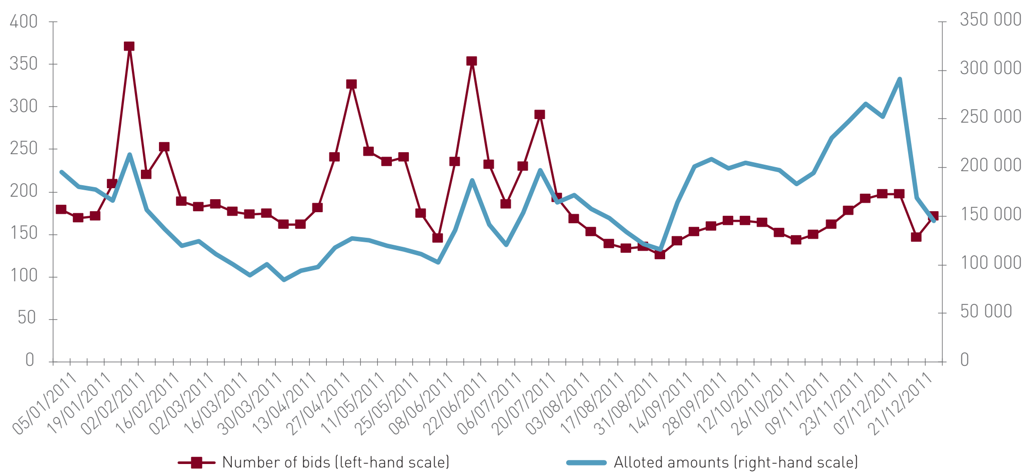
Source: BCL

Since October 2008, MROs have been conducted by the Eurosystem on a full allotment and fixed rate basis. This non-conventional measure was effective all through the year 2011. It is foreseen that this allotment method be maintained as long as necessary and at least until July 2012.

The percentage of participation of Luxembourg towards the MRO increased throughout 2011. Luxembourg currently ranks 11th in the euro area in terms of percentage of participation.

Volumes allocated through the MRO fell significantly due to the special 36-month operation launched mid-December.

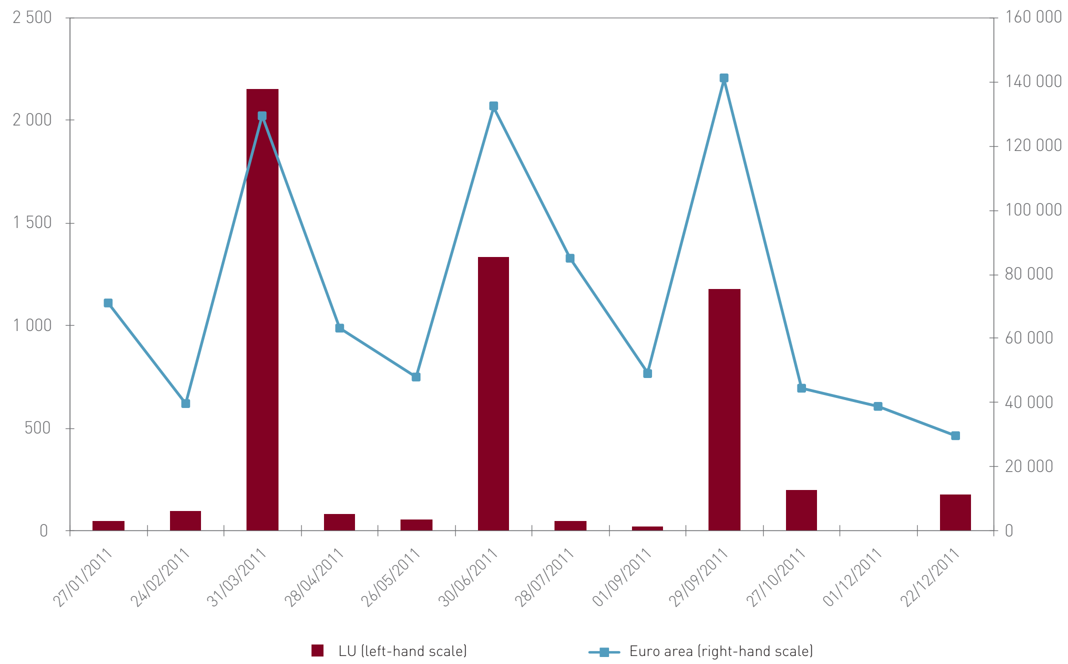
Chart 2:
MRO – Numbers of bids and allotted amounts in 2011 in euro area (in € million)



Source: BCL

1.1.1.2 Longer-term refinancing operations (LTRO)

Chart 3:
LTRO 3 months – LU and euro area – allotted amounts in 2011 (in € million)



Source: BCL

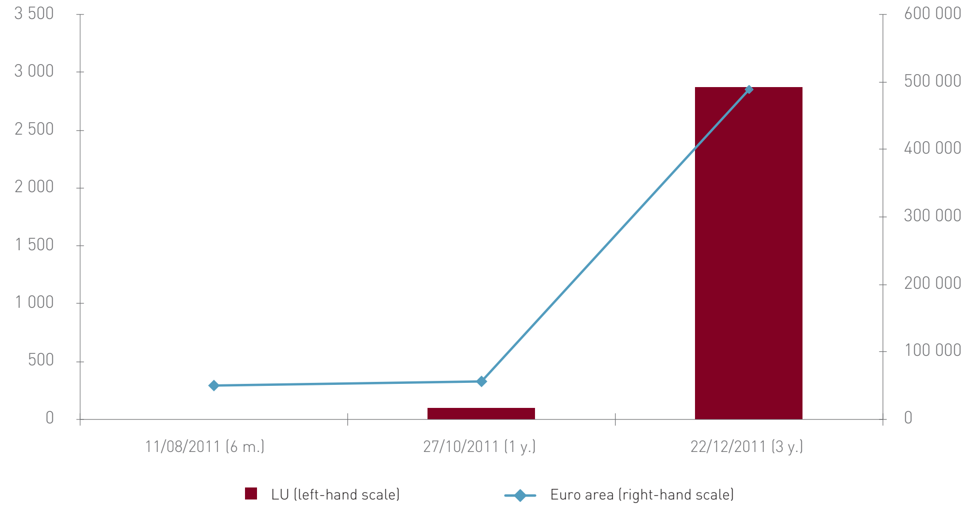
On top of the regular 3-month operations (12 over the year), one additional 6-month operation, two 12-month and one additional 36-month operation were conducted in 2011 in order to address monetary policy needs. These operations were fully allotted, at an adjustable rate that is computed at the maturity of the operation. This rate is fixed as being the average of the minimum bid rates of the MROs over the life of the operation.

Additional one-maintenance period operations were conducted throughout 2011. The Eurosystem announced that these operations would be maintained until at least mid-2012.

The 36-month operation conducted for the first time in 2011, had a remarkable success. An amount of € 489 billion was allocated to 523 counterparties in the euro area.

Luxemburgish counterparties did not participate in the supplementary 6-month operation, one counterparty took part in the one-maintenance period operation and another counterparty took part in the 12-month operation. Five Luxemburgish participants submitted bids for the 36-month operation.

Chart 4:
Additional operations – LU and euro area – allotted amounts in 2011 (in € million)



Source: BCL

1.1.1.3 Fine-tuning operations

Liquidity-absorbing operations

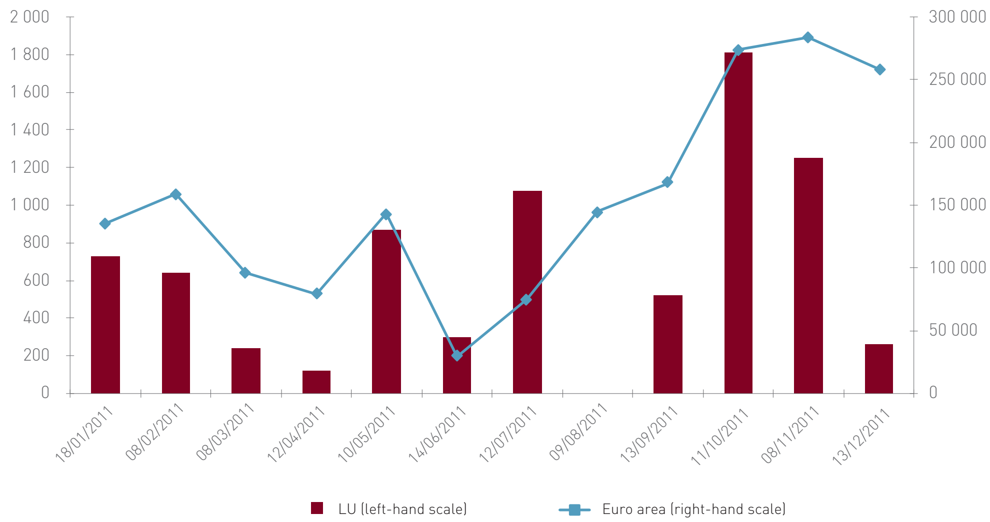
Since 2008, this type of operations has been open to all counterparties.

In 2011, fine-tuning operations were used exclusively on the last day of the maintenance period, in order to absorb excess liquidity.

Twelve operations of this type were conducted in 2011.

In December 2011, the Eurosystem announced that these operations would be discontinued in 2012.

Chart 5:
Fine tuning operations on the last day of the maintenance period – amounts absorbed – LU and euro area (in € million)



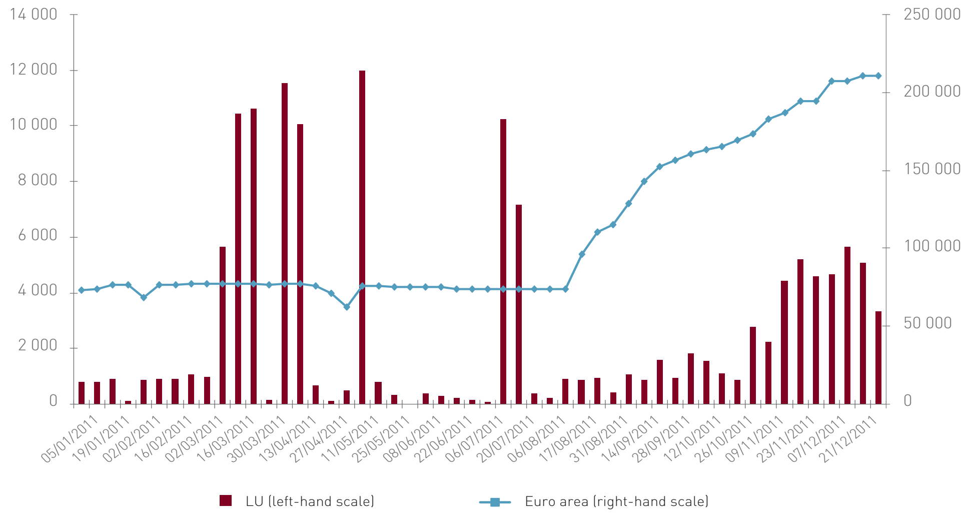
Source: BCL

From May 2010, one-week operations took place, aiming at absorbing the liquidity injected by the SMP. This is a non-conventional purchase programme targeting public and private sector bonds (see 1.1.6).

Counterparties in the euro area are allowed to submit up to four bids for this type of variable rate operation.

Overall, 52 operations of this type were conducted in 2011, absorbing on average € 2.7 billion in Luxembourg and € 110 billion in the euro area.

Chart 6:
One-week deposits in 2011 – LU and euro area (in € million)



Source: BCL

Liquidity providing operations

There was only one fine-tuning liquidity providing operation in 2011 which aimed to fill the one-day gap between the maturity of the MRO and the start value date of the 3-year supplementary operation. There was no participation in Luxembourg while an amount of € 141.9 billion was allotted in the euro area.

1.1.2 Standing facilities

Luxemburgish counterparties may resort to daily standing facilities with the BCL, i.e. deposit or marginal lending facilities, at a rate fixed beforehand.

These rates are determined each month by the Governing Council.

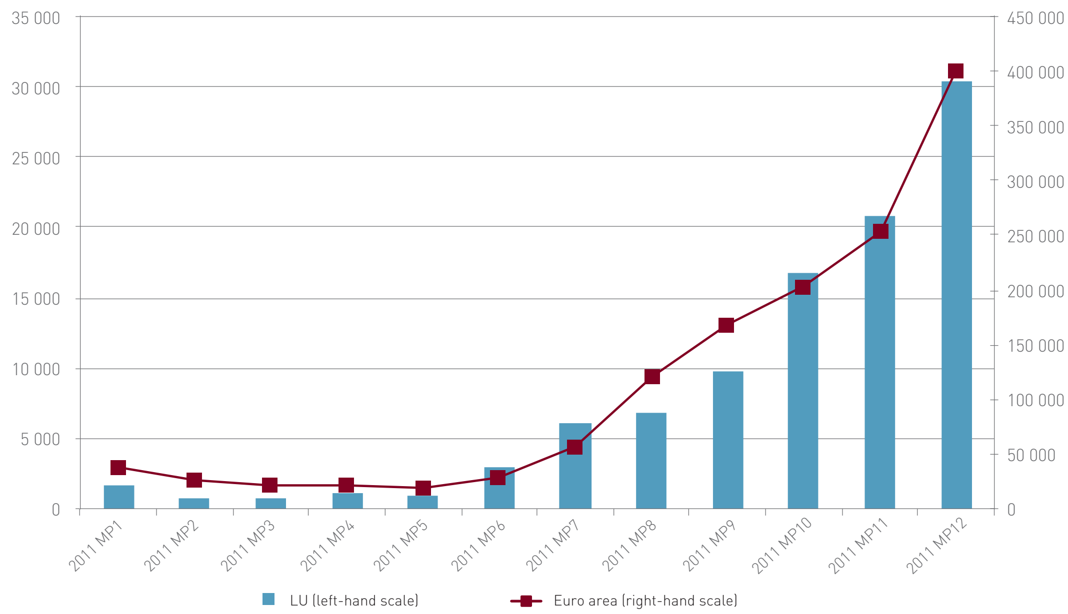
Marginal lending facility

The marginal lending facility was scarcely used in 2011 by the Luxemburgish counterparties, only on an *ad hoc* basis.

Deposit facility

After a stability phase during the first five months of the year, the amounts deposited in Luxembourg regularly increased until the end of the year.

Chart 7:
Development of the deposit facility in 2011 – LU and euro area (average daily amount in € millions)



Source: BCL

1.1.3 Minimum reserves

Euro area counterparties are required to maintain reserves at the national central bank of their country of residence. These reserves have to be kept on average over a fixed period of time. Counterparties can make free use of their liquidity throughout the maintenance period.

In 2011, in Luxembourg, the annual average amount of excess reserves was kept close to the one registered in 2010.

On 8 December, the Eurosystem announced that the minimum reserves rate would be reduced from 2 % to 1 % from 18 January 2012 onwards (start of the first reserve maintenance period in 2012).

1.1.4 Temporary currency auction facilities (swaps)

In 2011, the Eurosystem, in cooperation with the Federal Reserve System, carried on supplying dollar liquidity to the banks of the euro area. These operations were conducted as reverse transactions guaranteed by securities and had a maturity of 7 or 84 days (three 84-day operations took place in 2011).

In 2011, euro area and Luxemburgish counterparties initially displayed only a limited interest in these operations. On 30 November, the Eurosystem announced that the rate applied to these operations would be reduced by 0.5 percentage point. Consequently the number of participants and the amounts required increased significantly from December on. All bids received were set at pre-announced fixed rates.

1.1.5 Covered bonds purchase programme

The covered bond market is a key instrument for the funding of credit institutions. This market segment was particularly affected by the financial crisis.

In November 2011, the Eurosystem decided to initiate a second CBPP in the primary and secondary covered bond markets for an amount of € 40 billion. The programme expires in November 2012.

The Eurosystem intends to keep the purchased covered bonds until maturity.

1.1.6 Securities markets programme

In May 2010, the Eurosystem decided to conduct an exceptional securities markets programme (SMP).

The objective of this programme is to address the malfunctioning of securities markets and to restore an appropriate monetary policy transmission mechanism.

In order to sterilise the impact of interventions, the Eurosystem conducts specific operations to re-absorb the liquidity injected by the Programme.

As of 30 December 2011 the cumulative amount of purchases for the Securities Markets Programme reached € 211.9 billion.

1.2 FOREIGN EXCHANGE RESERVE MANAGEMENT BY THE BCL

In accordance with the Statutes of the Eurosystem and in line with its share in the ECB's capital key, the BCL transferred € 74.6 million in foreign exchange assets to the ECB. The ECB's foreign exchange reserves have been managed in a decentralised way by the NCBs since January 1999. As a result of the EU's enlargement and the relative growth of GDP and population in Luxembourg, the BCL's share in the ECB's capital key has been 0.1747 % since 1 January 2011. As of 31 December 2011, the total market value of the ECB's reserves (including accrued interest) managed by the BCL corresponded to € 326 million. One goal of the foreign exchange reserve management of the ECB is to ensure that the ECB has sufficient available liquidity to intervene in the foreign exchange markets if need be. Security and liquidity are, therefore, basic requirements in managing reserves.

The tactical benchmark is established for each currency in line with the strategic benchmark.

This tactical benchmark reflects the ECB's risk/return medium-term preference in regards to market conditions.

A change in the tactical benchmark may affect different risk categories (for example, modified duration or liquidity risk). The Value at Risk of the tactical benchmark may differ from that of the strategic benchmark in the context of fluctuation margins announced, in advance, by the ECB.

Regarding the management of this portfolio, the prime task of the BCL is to invest foreign exchange reserves on behalf of the ECB within the prescribed fluctuation bands and fixed risk limits, the objective being to maximise return. The amount of actively managed assets in gold is determined by the ECB, taking into account strategic considerations and market conditions. The BCL manages a USD portfolio on behalf of the ECB.

1.3 MANAGEMENT OF THE BCL'S ASSETS

1.3.1 Institutional structure

Asset management is based on a five-level intervention structure, in addition to risk control:

Level 1: The Council

The Council approves the guidelines of the asset management framework. Thus, the Council has allowed the BCL to provide asset management services to third parties and to hold their own funds asset portfolios in order to diversify the Bank's income. The guidelines also include a risk mitigation framework applied to asset management.

Level 2: The Executive Board

The Executive Board defines the risk management framework. Thus, it determines the maximum risk allowance (MRA) in the management of the Bank's own assets. It also specifies the risk management measures, like the Value-at-Risk (VaR) method and the application of stress-testing scenarios. The Executive Board also sets warning thresholds, which can lead to the calling of emergency meetings for assessment and arbitrage purposes. The Executive Board sets the limits of the framework annually.

Level 3: The Asset and Liability Management Committee ALCO

ALCO determines the strategic benchmark according to the framework fixed annually by the Executive Board by examining the impact of each risk profile (market, credit and liquidity risk) which would result from the proposed investment policies, in regards to both the overall balance sheet and the profit and loss account of the BCL. During the year, ALCO regularly assesses the results of the investment policy.

Level 4: The tactical committees

The tactical committees monitor the evolution of the portfolios on a short-term basis and work out proposals for tactical benchmarks that comply with the limits laid down by the strategic benchmark.

The tactical committees consist of the following:
- The *Comité de gestion*, for the BCL's own funds,
- The *Comité réserves de change* for the pooled reserves of the ECB,
- The *Comité tactical benchmark* for the pension fund of the BCL

Level 5: The portfolio managers

The transactions are executed by the portfolio managers, in strict compliance with the limits set, covering both the overall and specific investment limits.

1.3.2 Risk control

The Risk Management unit monitors the positions of all the portfolios in order to assess risks and to verify compliance with the pre-defined limits. This monitoring is carried out daily and independently from the Front Office. This monitoring structure has been given specific tasks at different levels of the organisation.

In addition, the Middle and Back Offices also take part in the monitoring process.

1.3.3 Conceptual framework

The investment policy objectives

The main objectives are to generate a high income on a regular basis and to ensure a total return over the long term by taking into account considerations concerning matters such as capital safety, stability of securities and liquidity. In order to achieve these goals and in accordance with the principle of risk diversification, the BCL implements a coordinated, progressive and pro-active investment policy based on modern portfolio theory.

The investment approach takes the following into account:
- the analysis of economies and international financial markets;
- the asset allocation decisions by assessing the returns on different international markets;
- the drawing-up of a clearly defined strategy;
- the capital value preservation of the assets under management by a policy of risk diversification and the application of specific qualitative requirements with regard to investments;
- the application of strict risk control measures.

Investment decisions are based on:
- market risks (interest rates, exchange rates, equity prices, commodity prices);
- credit risks (minimum credit ratings criteria by international rating agencies);
- liquidity risks (concentration limits by sector, by issuer, by issue and by geoChartical diversification).

Performance measurement

The quality of the investment decisions is measured by comparing the performance with the external benchmarks of leading investment banks. This allows a given performance to be assigned to a decision level (strategic, tactical) as well as to daily management.

1.3.4 Structure of portfolios

The bulk of the BCL's own funds are invested in fixed income securities denominated in euro.

This strategic orientation enables diversification in other asset categories.

The BCL manages seven kinds of portfolios.

Investment Portfolio

This portfolio consists of assets (equity and bonds), which can be deemed to represent its own funds (with a long-term investment profile). The main goal of the portfolio is to maximise return by taking the above-mentioned risk constraints into account (see section 1.3.2). As of 31 December 2011 the total market value (including accrued interest) amounted to € 2 072 million.

In 2011, the share of this portfolio invested in fixed income securities with a maturity above three years was lowered from 43 % to 29 %, whereas the percentage of bonds with a one to three-year maturity decreased from 44 % to 33 %. Moreover, by the end of 2011, variable rate and fixed rate bonds with a maturity of under one year represented 38 % of the investment portfolio.

The securities included in this portfolio are widely diversified, not only geographically but also in terms of sectors and issuers.

Liquidity Portfolio

This portfolio comprises the other assets that are largely attributable to a Eurosystem arrangement and mirrors TARGET accounts and other liabilities.

This portfolio, whose liability profile covers certain liquidity needs, also aims at maximising income. The instruments used are mainly fixed-income short-term bonds, variable rate bonds and certificates of deposits (ECP), provided that they comply with strict and predefined rating criteria. As of 31 December 2011, the total market value (including accrued interest) amounted to € 3 416 million.

Table 1: Breakdown of reserves as of 31 December 2011

Maturity	Portfolio 1	Portfolio 2
0-1 year	38 %	90 %
1-3 years	33 %	10 %
> 3 years	29 %	0 %

Domestic Reserves Portfolio

This portfolio aims to maintain an intervention portfolio in addition to the pooled foreign exchange reserves transferred to the ECB. Thus, the main requirements for this portfolio are security and liquidity. As of 31 December 2011, the total market value (including accrued interest) of this portfolio in foreign currencies amounted to € 124.3 million.

The financial participation of the BCL in the capital of the BIS[1] and the IILM[2] reduced the amount of USD in the domestic reserves portfolio.

Pension Fund Portfolio

The management of this Fund is described further in section 2.2.2 of this report.

Foreign Reserves Portfolio of the European Central Bank

The management of this portfolio is described further in section 1.2 of this report.

Covered Bond Purchase Programme

After participating in the first CBPP, the BCL also takes part in the second programme. This € 40 billion programme expires in November 2012.

Third Party Portfolios

The BCL provides non-standardised discretionary management services to institutional clients (central banks and international organisations). Furthermore, the Bank acts as one of the Eurosystems` service providers (ESP). Six central banks within the Eurosystem offer institutional clients (central banks, public authorities and international organisations) a comprehensive range of services for managing Euro-denominated reserve assets under a framework of harmonised services defined by the ECB, updated in 2009.

1.4 BANKNOTES AND COINS

1.4.1 Production of banknotes and coins

Within the Eurosystem, the euro banknote production is allocated according to a decentralised pooling scenario adopted in 2002, in which each NCB of the euro area is responsible for providing part of the total requirements. The euro banknote is produced in accordance with the requirements expressed by the participating NCBs and aggregated by the ECB. In this context, in 2011, the BCL organised the production of 7.7 million of € 20 banknotes and 8 million of € 5 banknotes for the Eurosystem's needs (compared to 17.8 million of € 20 banknotes in 2010). The BCL allocated the production of these banknotes via a tender. In addition, for its own needs, the BCL received 36.3 million banknotes from other NCBs (compared to 38.2 million in 2010).

Under an agreement with the State of Luxembourg, the BCL is also in charge of producing Luxembourg's euro coins and putting them into circulation. Following a tender, the BCL has commissioned the production of 38.6 million coins of the 2011 series to cover the needs of economic agents and numismatists.

1 Bank for International Settlements

2 International Islamic Liquidity Management Corporation (f. 1.11.2.1)

1.4.2 Circulation of banknotes and coins

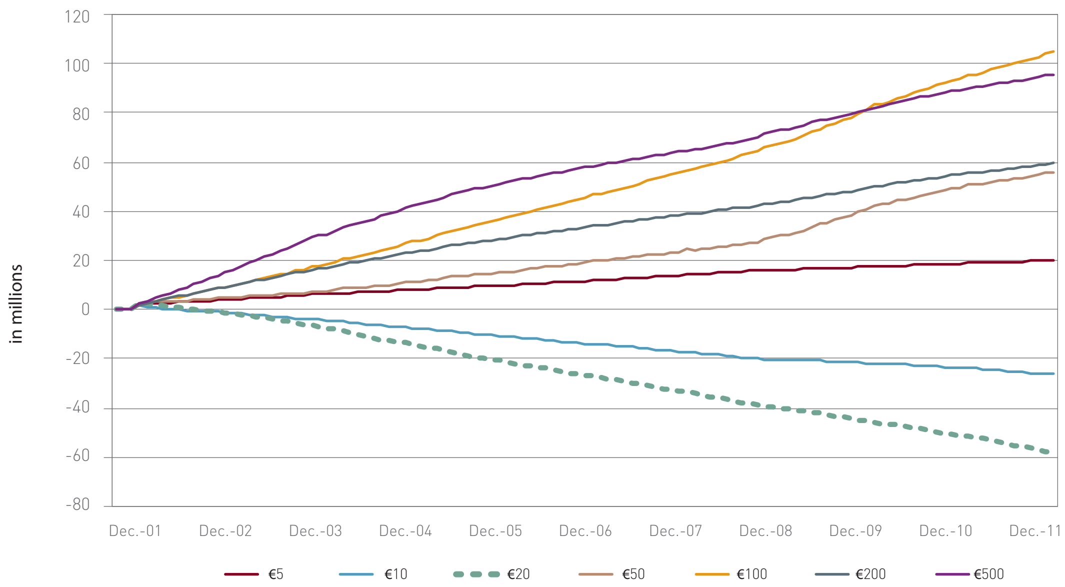
1.4.2.1 Euro banknotes and coins

The total net volume of banknotes issued by the BCL during the year 2011 amounts to 18.7 million banknotes, compared to 26.5 million in 2010, a decrease of 29.4 %. The BCL contributed for 2.4 % of the overall volume of banknotes put into circulation by the Eurosystem, compared to 5 % in 2010.

The distribution of banknotes by denomination reveals that the number of € 10 and € 20 banknotes lodged at the BCL exceeds the volume of banknotes issued. Financial institutions have indeed lodged more of these banknotes at the BCL than they withdrew, demonstrating the contribution to these denominations of tourists and especially cross-border workers from countries where they are more widely used. As to the denominations typically used for hoarding, i.e. banknotes of € 100, € 200 and € 500, the year 2011 was marked by a sustained demand, both in Luxembourg and in the euro area, in line with the tendency observed in 2010.

The chart below illustrates the different trends in the evolution of the circulation of the different denominations.

Chart 8:
Denominational breakdown of the number of euro banknotes put into circulation by the BCL

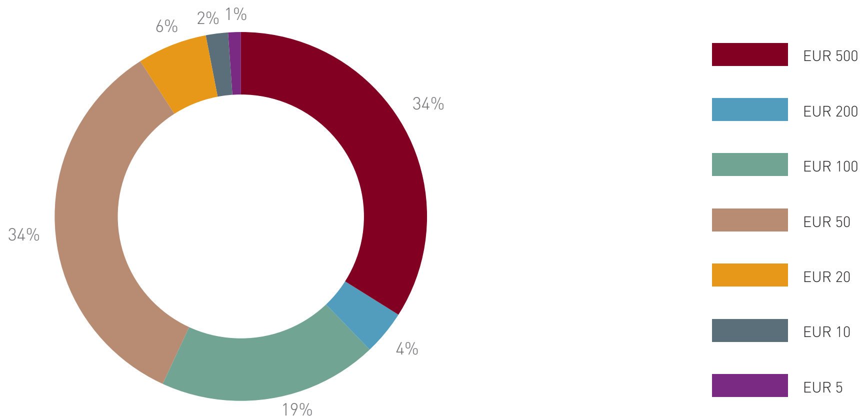


Source: BCL

In value terms, the net issuance of banknotes in Luxembourg grew at a less sustained pace in 2011 (+€ 5.1 billion, equal to an increase of 7.7 % in moving annual average) and reached € 72 billion by end December 2011. This increase is less strong than in 2010 (+10.5 %) and 2009 (+15.1 %).

Moreover, in terms of net issuance, Luxembourg ranked fourth in the Eurosystem in 2011, behind Germany (€ 391.8 billion), Italy (€ 153.6 billion) and France (€ 88.8 billion). In fact, the annual growth of net issuance in Luxembourg was higher than the one observed for the euro area as a whole (+5.8 % after +4.1 % in 2010), where it reached € 888.6 billion at the end of 2011 (compared to € 839.7 billion at end-December 2010), with the following breakdown by denomination:

Chart 9:
Distribution of the value of euro banknotes put into circulation by the Eurosystem by denomination



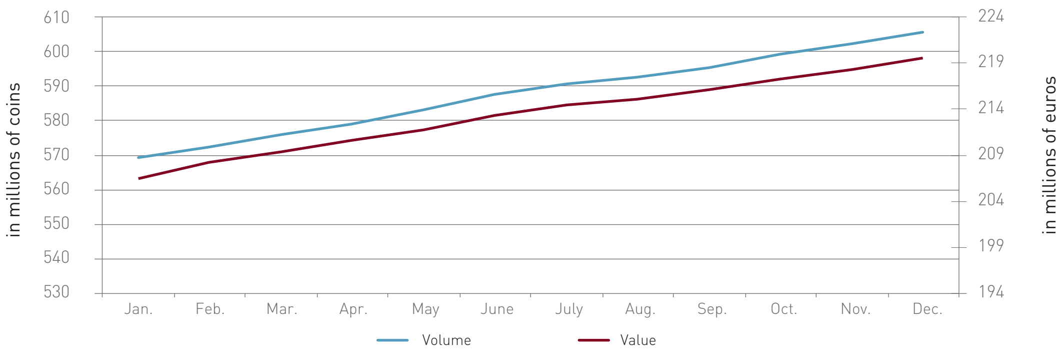
Source: ECB

Luxembourg euro coins continue to be the object of strong demand from the public. The total value of coins put into circulation increased by 6.7 % in 2011, marginally lower than in the previous year (+ 6.8 %), and rose from € 205.8 million to € 219.5 million.

The volume of coins put into circulation in the course of the year 2011 increased by 38.8 million units, equalling a growth of 6.8 %, and reaching a total of 605.7 million Luxembourg coins in circulation at the end of the year.

The chart below shows the development both in terms of volume and value of Luxembourg euro coins in circulation in 2011. The demand for Luxembourg coins grew steadily over the year.

Chart 10:
Volume and value of Luxembourg euro coins put into circulation in 2011

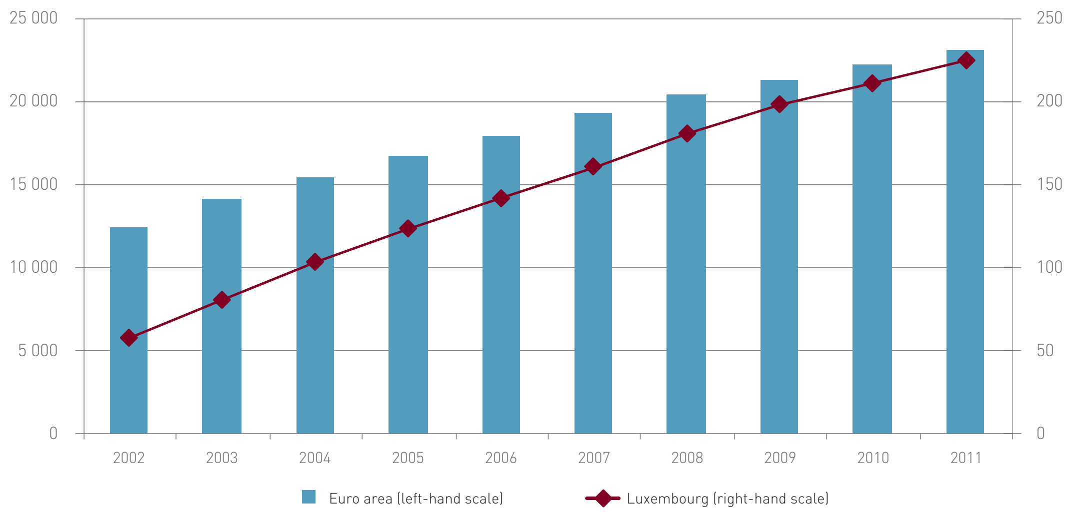


Source: BCL

Within the euro area, Luxembourg contributes nearly one percent (0.9 %) to the total value of all the issuing authorities and to 0.6 % of the total volume. The average value of Luxembourg coins in circulation remains unchanged compared to 2010: 36 cents compared to 24 cents on average in the euro area.

The following chart presents a visual comparison of the volume of coins put into circulation in Luxembourg with the corresponding volume of the euro area.

Chart 11:
Comparison of the euro coin circulation volume in Luxembourg and in the euro area

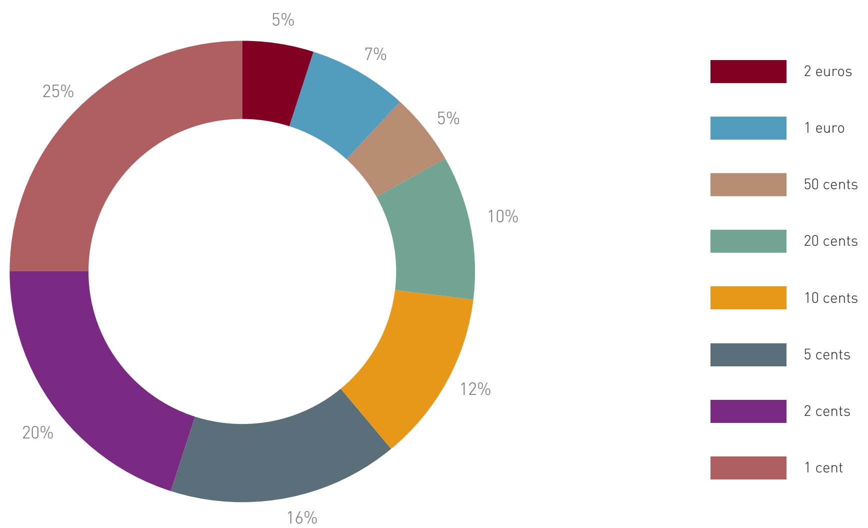


Source: ECB and BCL

The total value of euro coins put into circulation by the issuing authorities rose from € 22.3 billion in 2010 to € 24.2 billion in 2011, with their total number reaching 100.4 billion.

The following chart shows the breakdown by denomination of the volume of coins at the euro area level.

Chart 12:
Breakdown of the volume of coins of the euro area in circulation by denomination



Source: ECB

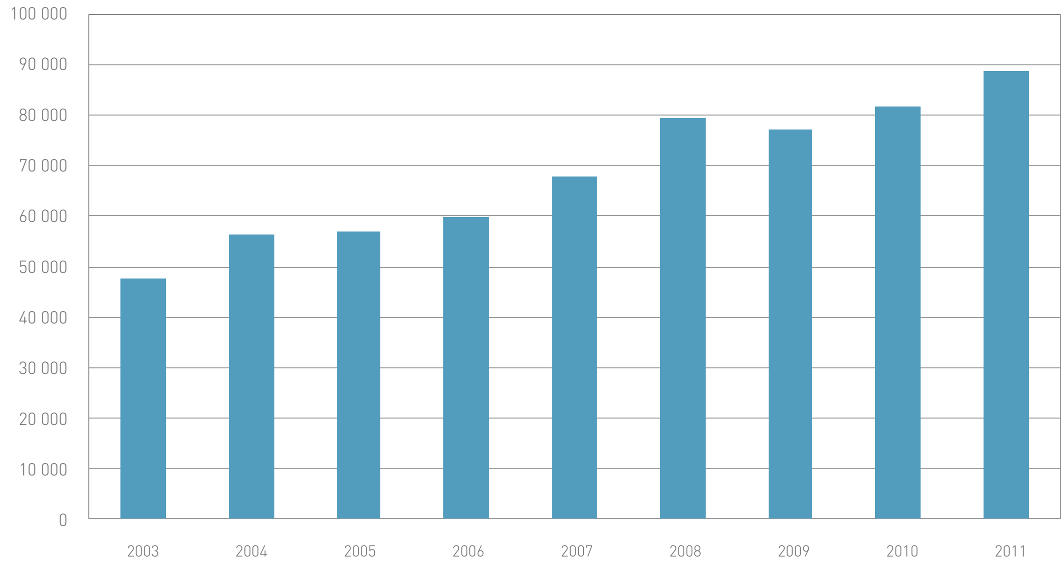
1.4.2.2 Luxembourg franc banknotes

During the year under review, the total value of Luxembourg franc banknotes issued by the *Institut Monétaire Luxembourgeois* and not yet presented for exchange, fell from LUF 208.3 million to LUF 206.9 million. This represents a decline of 0.7 % and is similar to the decline observed in 2010. In 2011, holdings of the 5 000 LUF banknote declined by 1.4 %, whilst those of 1 000 LUF banknotes decreased by 0.7 % and those of 100 LUF banknotes decreased by 0.1 %.

1.4.3 Handling of banknotes and coins

In the course of 2011 the volume of euro banknotes returned by financial institutions to the BCL increased by 8.7 % from 81.6 to 88.7 million banknotes. The chart below describes the evolution of these lodgments at the BCL since 2003.

Chart 13:
Lodgments of euro banknotes by financial institutions at the BCL (in millions of banknotes)



Source: BCL

The number of banknotes processed by sorting machines increased by 5.8 % from 77.5 million in 2010 to 82.1 million in 2011. The sorting machines check each banknote for authenticity and cleanliness. 7.9 million banknotes of all denominations had to be destroyed because they were unfit for circulation, which equals to a destruction rate of 9.6 %. This rate showed a wide variation between the denominations processed: it ranged from 6.6 % for the € 500 banknote to 25.6 % for the € 5 banknote.

1.4.4 National and international cooperation

In the fight against the counterfeiting of euro banknotes and coins, the BCL closely cooperated with the ECB and the national authorities in charge. For the analysis of counterfeit and unfit euro banknotes and coins, the BCL also collaborated with the Banque de France and the Deutsche Bundesbank since 2002 in accordance with a cooperation arrangement.

As in the past, with the support of the *Institut de formation bancaire Luxembourg* (IFBL) the BCL continues to train bank cashiers to authenticate euro banknotes and coins.

The BCL's Currency and Numismatics Department is participating in the preparation of a new euro banknote series. The design of this new series is based on the theme of "Ages and styles in Europe ". New security features will be incorporated, with the goal of providing maximum protection against counterfeiting thus allowing the public to easily distinguish a genuine banknote from a counterfeit. The introduction of this new series is foreseen for the coming years and will however be gradual. The timing and sequence of issuance of the second series and the exchange conditions of the first series will be announced in due time.

The BCL pools, with eight other central banks, its share of banknotes to be produced for the Eurosystem. This common European call for tender, whose purpose is to share resources and experience needed in monitoring the production of banknotes, foreshadows the future "Single European Tender Procedure".

The BCL also collaborates with seven other Eurosystem central banks in the management and maintenance of the CashSSP software. This software allows the Cash Department not only to manage its banknote and coin stocks and to monitor its sorting activity of fiduciary money but also to receive in a secured manner the reception of deposit and withdrawal announcements of commercial banks.

1.4.5 Numismatic issues

The BCL issues numismatic products on the theme of history and culture of the Grand Duchy. Through its numismatic premises, more than 4 400 sales transactions were completed in 2011. More than 7 000 parcels were sent out, corresponding to sales made through traditional mail or via the Internet shop of the BCL (https://eshop.bcl.lu).

In 2011, the BCL issued the following numismatic products:

- a € 2 commemorative coin, minted in 700 000 units, was put into circulation in February 2011. This coin, depicting the effigies of Their Royal Highnesses the Grand Duke Henri, Grand Duchess Charlotte and Grand Duke Jean, was also issued in BU quality as a coin card limited to 7 500 units;

- the 2011 BU set, issued in 7 500 units, comprises Luxembourg's euro coins of the 2011 series (including the € 2 commemorative coin);

- the 2011 BENELUX set, issued in an edition of 10 000 units, contains eight coins of the 2011 series of each of the three member countries;

- the 2011 PROOF set, limited to 1 500 units, is composed of nine coins;

- a silver-niobium coin, issued in July 2011 in an edition of 3 000 pieces, was dedicated to the Castle of Mersch and is the third element of the series devoted to the castles of Luxembourg;

- a gold coin, minted in 3 000 pieces, was dedicated to the «Rénert» (Reynard the Fox);

- a silver and Nordic gold coin, issued in December 2011 in an edition of 3 000 units, was dedicated to the «European Otter» and constituted the third element of the series devoted to the fauna and flora of Luxembourg.

1.5 STATISTICS

The BCL elaborates, collects, compiles and publishes a large set of statistical series. By doing so, it fulfils its commitments to the Eurosystem and the ESMA, as well as its commitments on a national level. These statistics are also used by other national institutions such as STATEC and CSSF in the framework of their own missions.

In 2011, significant efforts were made in order to improve the statistical collection of the BCL. The major challenge of the year 2011 consisted in the collection and compilation of new data related to financial stability.

1.5.1 New statistical regulations

In 2011, the BCL adopted and implemented two regulations defining new collections of source data for the compilation of external statistics for Luxembourg.

The BCL regulation BCL 2011/n°7 of 4 April 2011 is aimed at credit institutions and at the financial services of the *Entreprise des Postes et Télécommunications*. This regulation provides for the transmission of cross-border payments made on behalf of resident customers, as well as the transmission of the amount and economic nature of some cross-border own account operations, on a monthly basis.

The BCL regulation BCL 2011/n°8 of 29 April 2011 is aimed at companies taking out loans or issuing securities or derivatives on behalf of related entities. This regulation provides for the transmission, on a quarterly basis, of a balance sheet established according to accountancy standards in use. Moreover, this quarterly balance sheet is completed by data acquired monthly.

1.5.2 Publication of statistics

The BCL publishes a large array of statistics related to the financial sector on its website. In the course of 2011, several changes were implemented in order to improve the availability of statistical information for its users.

Thus, the BCL completed its publications by adding statistical tables which provide information on assets and liabilities for monetary and non-monetary UCITs detailed by main investment policies.

In the framework of the euro area debt crisis, the BCL proposed three new statistical tables providing an overview of the holding of securities issued by EU27 countries, as well as Switzerland, the United States and Japan. This information is broken down by the institutional sector of the issuer, namely banks, government and other sectors.

In 2011, the BCL also started to publish statistics on the annual stocks of assets and liabilities of insurance companies and pension funds; the data has been available since 2006 onwards.

Finally, the compilation of financial accounts for Luxembourg by the STATEC and the BCL allowed for the publication of several tables on quarterly financial accounts. These tables show the stocks and transactions occurring in the institutional sector from the first quarter of 2006 onwards.

1.6 PAYMENTS AND SECURITIES SETTLEMENT SYSTEMS

1.6.1 TARGET2-LU

Since 19 November 2007, the real-time gross settlement system TARGET2 has run on the new Single Shared Platform (SSP) operated in common by 24 central banks of the ESCB. In 2011, the National Bank of Romania joined the system.

With the Luxembourgish component TARGET2-LU, 30 direct participants (5 more than in 2007 and 2 more than in 2010), 44 indirect participants and three ancillary systems are registered.

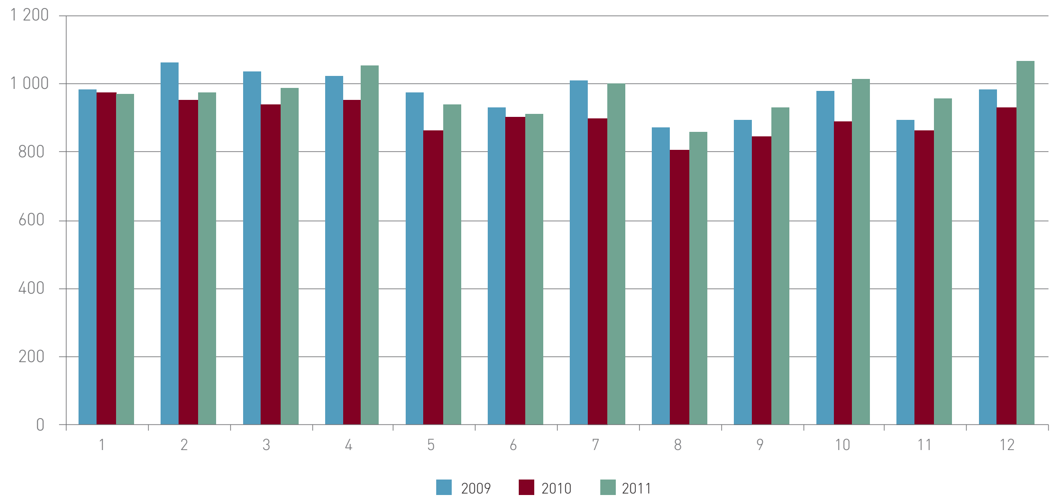
Domestic payments

In 2011, participants in TARGET2-LU exchanged a monthly average of 20 773 payments (compared to 19 379 in 2010) for a value of € 103.2 billion (compared to € 87.9 billion in 2010). 15 049 or 72.4 % of these payments were retail payments. Their value represented a monthly average of € 7.0 billion or 6.8 % of the domestic value exchanged.

The decreases in volume of TARGET2-LU triggered by the financial crisis of 2008 continued until 2010. In comparison to 2010, an increase in volume by 7.2 % occurred in 2011; this increase pushed volumes up to pre-crisis levels of 21 015 payments per month. The value exchanged increased by 17.4 %.

The following chart illustrates the development of average daily volumes in domestic payments.

Chart 14:
Domestic payments: development of average daily volumes



Source: BCL

In 2011, participants in TARGET2-LU sent a monthly average of 47 820 payments towards other countries of the EU (45 774 payments in 2010) for an average value of € 808.4 billion (€ 570.6 billion in 2010). The volume of retail payments increased by 14.3 % to reach a monthly average of 25 631 payments representing 53.6 % of the total cross-border volume. Their relative part increased by 5 %. After their strong increase by 20 % in 2010, the volume of interbank payments decreased by 5 % to reach a monthly average of 22 189 transactions in 2011.

Customer payments amounted to a monthly average value of € 17.7 billion representing 2.2 % of the total cross-border value. The monthly value of interbank cross-border payments increased by 42.8 %, reaching € 790.7 billion. The increase was largely triggered by transfers related to overnight deposits with the BCL.

Cross-border payments increased by 4.5 % in volume and by 41.7 % in value within one year. The average value per transaction sent was € 16.9 million (compared to € 12.5 million in 2010). The average value of an interbank payment increased from € 23.7 million to € 35.6 million.

With a monthly average of 36 858 payments, participants in TARGET2-LU received 10 962 payments less than they sent. The value of the payments received exceeded that of the payments sent by 22 %.

The following charts display the development of average daily volumes and values in cross-border payments sent by Luxembourgish participants.

Chart 15:
Cross-border payments sent: development of average daily values (million euros)

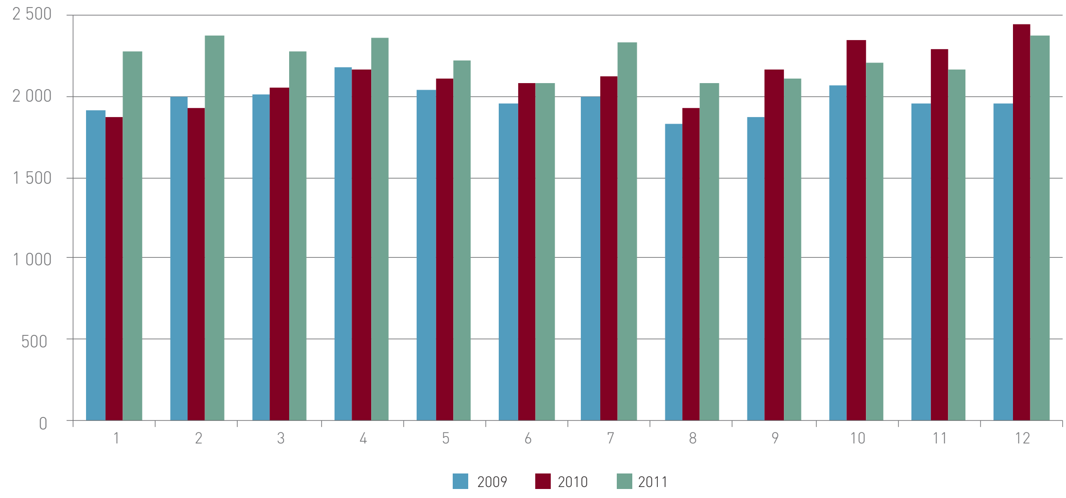
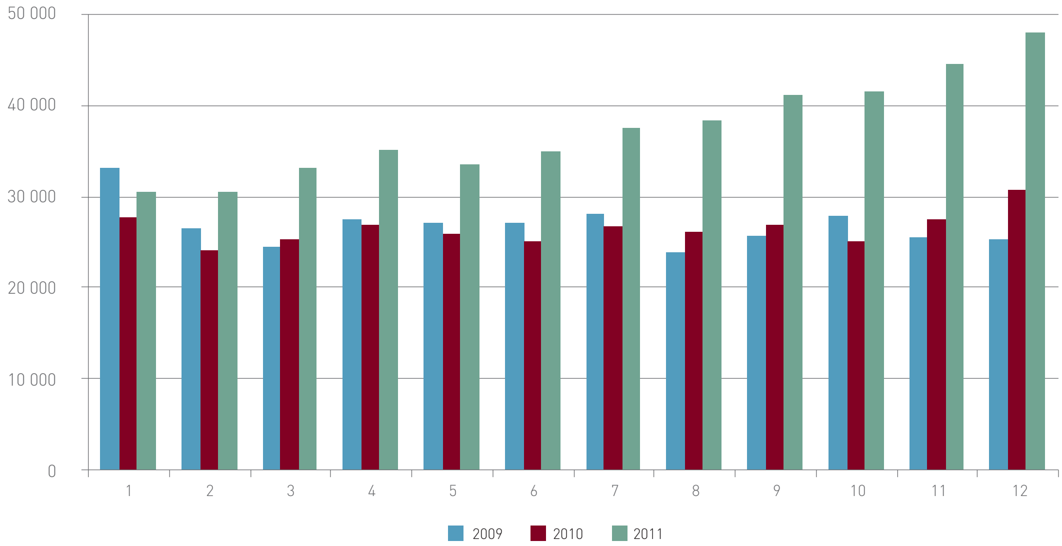


Chart 16:
Aggregated figures of domestic and cross-border payments



The total number of payments sent by participants in TARGET2-LU in 2011 amounted to 823 113 transactions (781 838 in 2010, an increase of 5.3 % in one year). 488 153 or 59.3 % of all payments were retail payments.

Table 2 provides a global overview of average daily volumes of payments per year since 2009. In 2011, all categories displayed increased figures in comparison to 2010.

Table 2: Volumes of payments in daily averages

	Domestic		Cross-border sent		Total sent	Cross-border received	
	Volume	(% volume sent)	Volume	(% volume sent)	Volume	Volume	(% volume sent and received)
2009	970	(32.9 %)	1 981	(67.1 %)	2 951	1 616	35.4 %
2010	893	(29.8 %)	2 107	(70.2 %)	3 000	1 704	36.2 %
2011	970	(30.3 %)	2 233	(69.1 %)	3 203	1 722	35.0 %
Variation 2010-2011	+8.6 %		+6.0 %		+6.8 %	+1.1 %	

Source: BCL

The average monthly value of all payments sent was € 911.6 billion of which € 24.7 billion (2.7 %) represented retail payments.

TARGET2-LU compared to other systems participating in TARGET2

Including transactions with ancillary systems, all national systems participating in TARGET2 transferred a monthly average of 7.35 million payments in 2011 representing a 1 % increase compared to 2010. Luxembourg accounted for 1 % of this volume. The average monthly value exchanged totalled € 69 421 billion, 2.6 % of which was yet again accounted for by Luxembourg.

In 2011, all national components of TARGET2 executed a monthly average of 4.87 million domestic transactions (4.98 million in 2010) for an average monthly value of € 34 427 billion. Luxembourg represented 0.9 % of this in volume and 2.4 % of this in value terms.

In addition, on a monthly average 2.59 million cross-border payments (2.40 million in 2010) for a value of € 16 651 billion (€ 15 226 billion in 2010) were executed. Luxembourg contributed 1.9 % to the volume and 5.9 % to the value.

The volume of retail payments in 2011 was 1.52 million transactions, about the same level as in 2010. By contrast, the volume of interbank payments increased by 0.5 % reaching 4.85 million transactions (4.83 million in 2010). Payments initiated within TARGET2-LU represented 1.5 % of all retail payments and 0.8 % of all interbank payments.

The average value of a TARGET2 payment was € 9.4 million (ancillary system transactions included). In TARGET2-LU, this value was € 25.5 million.

The daily maximum of payments sent in TARGET2 was 515 253 transactions (31 January 2011). In 2010, the maximum was reached in June with 496 079 payments. For Luxembourg, the daily maximum for 2011 was on 26 April with 4 722 payments. In 2010, the maximum was reached in April with 4 372 payments sent.

Availability and performance of TARGET2

In 2009 and 2010, the availability of the TARGET2 platform, and hence of TARGET2-LU, was 100 %. Following an incident at the opening of the day-trade phase on 25 July 2011, the SSP was unavailable for about three hours. The activation of the contingency module guaranteed the execution of all highly urgent payments during its unavailability time. In 2011, the availability of the TARGET2 platform was 99.89 %.

The SSP received a daily average of 346 328 payment instructions. 99.85 % were settled within five minutes (99.74 % in 2010) and 0.08 % within 15 minutes. For 0.07 %, the settlement took more than 15 minutes.

1.6.2 Retail payments in Luxembourg

Excluding notes and coins, the most used payment instruments in Luxembourg are payment cards, credit transfers and direct debits.

The use of cheques has been decreasing for several years.

Credit transfers and standing orders

The settlement of credit transfers can be processed internally in banks, on a bilateral basis between the concerned banks or through a payment system (for instance TARGET2 or STEP2[3]). The bulk of Luxembourg credit transfers and standing orders are processed on the pan-European platform STEP2.

In 2011, Luxembourgish participants sent 78 820 transactions to STEP2 for a total value of € 229 million on a daily average. Domestic[4] transactions accounted for 65 % in volume (around 51 519 operations per day) and 59 % in value (€ 135 million).

The payments sent by the Luxembourgish community in STEP2 increased in 2011, respectively by 5 % in volume and by 16 % in value. The yearly growth of domestic activity reached 4 % in volume and 13 % in value.

Table 3: Annual variation of the activity in STEP2

Annual variation	2010/2011	2009/2010
Total volume	5 %	4 %
Total value	16 %	20 %
Domestic volume	4 %	0.1 %
Domestic value	13 %	17 %

Source: BCL

Direct debits

Until the European direct debit (see below, SEPA Direct Debit) takes off, direct debits are domestic payments that are cleared either via the DOM-Electronic system or bilaterally by banks.

In 2011, the volume of direct debits amounted to 16.71 million for a value of € 7 656 million.

Payment cards in Luxembourg

There are two main categories of payment cards: debit cards and credit cards.

Bancomat, the domestic debit card scheme, ceased operations on 31 December 2011. Luxembourgish banks now issue debit cards in international schemes. The number of debit cards issued on 31 December 2011 reached 782 000 (compared to 600 000 in 2010). The strong increase is due to the concomitant use of Bancomat and newly issued cards during the changeover period at the end of 2011.

Credit cards issued in Luxembourg are mainly branded Visa and MasterCard. At the end of December 2011, the total volume of credit cards issued by banks in Luxembourg and managed by the Cetrel[5] was in excess of 533 000 units (505 000 in 2010).

3 STEP2 is managed by the Euro Banking Association (EBA)

4 A credit transfer or a direct debit is considered as domestic when both the payer and the payee have their payment account with a Luxembourgish institution.

5 Centre de Transferts Electroniques; http://www.cetrel.lu

In 2011, the number of transactions[6] with Luxembourg-issued[7] debit cards totalled 44.92 million (42.92 in 2010) for a value of € 3.48 billion (3.36 in 2010). The number of credit card transactions amounted to 24.77 million (22.48 in 2010) worth € 2.66 billion (2.39 in 2010).

As for the transactions processed in Luxembourg on cards issued in Luxembourg or abroad, the volume on debit cards was 40.91 million (39.92 in 2010) for a value of € 2.91 billion (2.86 in 2010) and the volume on credit cards was 22.50 million (21.28 in 2010) worth € 2.01 billion (1.90 in 2010).

Until 31 October 2011, MiniCash served as the Luxembourgish e-money purse. It was built on a memory chip inserted in a Bancomat debit card on which the cardholder could transfer a certain amount of money immediately exchanged in e-money. In 2011, there were 0.60 million transactions for a total amount of € 1.13 million (compared to 1.71 million transactions for a value of € 3.90 million in 2010).

The implementation of the SEPA project for non-cash payments:

The SEPA (Single European Payments Area) project aims at achieving a single euro payment area in which all payments are considered as domestic, without any distinction between national and cross-border transactions.

With SEPA, a common set of payment instruments will be available and governed by a harmonised legal framework. The SEPA area encompasses 32 countries and territories, where users can make and receive payments in euro from a single account with the same ease and on the same conditions for domestic transactions.

The SEPA project is being implemented by the European banking industry through the European Payments Council (EPC)[8]. The Eurosystem and the European Commission are the catalysts of this project.

The set of SEPA payment instruments are:
- the SEPA Credit Transfer (SCT), which was launched on 28 January 2008.
- the SEPA Direct Debit (SDD), which was launched on 1 November 2009.
- the payment cards: according to the SEPA Cards framework, every cardholder should be able to use their card in the SEPA area and every merchant should be able to accept all SEPA compliant cards, as far as it is economically justified. Common processing and security standards are being elaborated at the European level.

Banks in Luxembourg have already widely adopted the European credit transfer for retail operations. However, the European direct debits uptake remains low.

1.6.3 The general framework of eligible collateral in the Eurosystem credit operations

1.6.3.1 The list of eligible assets

All credit operations of the ECB and national central banks are based on "adequate collateral"[9]. Consequently, each counterparty of the Eurosystem guarantees the credit received from a Eurosystem central bank by providing assets as collateral. These assets have to fulfil specific eligibility criteria specified by the Eurosystem in the General Documentation on Eurosystem monetary policy instruments and procedures. The list of eligible assets is published on the website of the ECB. This single list for Eurosystem credit operations comprises two different asset classes, marketable assets (securities) and non-marketable assets (in particular credit claims).

Eligible assets can be used throughout the whole euro area in order to collateralise credit operations with the Eurosystem. According to the nature of the assets and to the country in which they are settled,

6 Payment transactions and cash withdrawals at ATMs. Data from the main cards processor.

7 Domestic (in Luxembourg) and international (abroad) transactions.

8 www.europeanpaymentscouncil.eu

9 Article 18 of the Statute of the ESCB and the ECB, article 22 of the founding law of the BCL.

counterparties use different channels and procedures to mobilise collateral. Non-marketable assets are either mobilised via appropriate handling procedures developed by each NCB (domestic mobilisation) or via the intermediation of a correspondent central bank (cross-border mobilisation). The mobilisation of marketable assets requires the involvement of one or of several securities settlement systems.

Following a Governing Council decision of 2010, the Eurosystem has applied a schedule of graduated valuation haircuts to assets rated in the BBB+ to BBB- range (or equivalent) since 1 January 2011. This new framework for graduated valuation haircuts takes into account the maturities of the marketable assets, their liquidity categories as well as the credit quality of the concerned assets as revised. More detailed information on this haircut schedule is published on the website of the ECB.

Concerning asset-backed securities (ABS), and according to a Governing Council decision of 2009, the rule of the "second best rating" has been applied to all ABS independently of their date of issuance since 1 March 2011. This rule implies that not only the best, but also the second best rating available must comply with the minimum threshold applicable to ABS.

On 31 March 2011, the Governing Council suspended, until further notice, the application, in the case of marketable debt instruments issued or guaranteed by the Irish government, of the minimum credit rating threshold in the collateral eligibility requirements for the purpose of the Eurosystem's credit operations. This decision arose from the positive evaluation made by the Governing Council concerning the economic and financial adjustment programme, which had been negotiated with the European Commission and the IMF, in collaboration with the ECB, and approved by the Irish government, and the strong commitment of the Irish government to fully implement the aforementioned programme.

On 29 April 2011, corresponding to the decision made on 16 December 2010 to gradually establish in the Eurosystem collateral framework loan-by-loan information requirements for asset backed securities, the Governing Council introduced specifications applicable to commercial mortgage-backed securities and small- and medium-size enterprise (SME) transactions. These specifications and their detailed contents to be used for residential mortgage-backed securities are available on the website of the ECB.

On 7 July 2011, the Governing Council suspended, until further notice, the application, in the case of marketable debt instruments issued or guaranteed by the Portuguese government, of the minimum credit rating threshold in the collateral eligibility requirements for the purpose of the Eurosystem's credit operations. This decision arose from the positive evaluation made by the Governing Council in response to the economic and financial adjustment programme, which had been negotiated with the European Commission and the IMF, in collaboration with the ECB, and approved by the Portuguese government, and the strong commitment of the Portuguese government to fully implement the concerned programme.

On 21 September 2011, the Eurosystem published an updated and consolidated version of its General Documentation applicable to monetary policy operations. The changes have been applied since 1 January 2012. This consolidation however does not concern non-conventional measures.

The eligibility criterion of the General Documentation (section 6.2.1.5 and 6.2.1.6), according to which debt instruments issued by credit institutions, other than covered bank bonds, are only eligible if they are admitted for trading on a regulated market, is not applicable to securities acquired in the framework of non-conventional measures. Moreover, the risk control measures for marketable assets (Section 6.4.2) have been amended. The Eurosystem has reduced the limit of the use of unsecured instruments issued by a credit institution or by any other entity with which the credit institution has close links. Such assets may only be used as collateral as long as their value does not exceed 5% of the total value of collateral submitted, instead of 10%.

On 8 December 2011, the Governing Council adopted a decision on additional temporary measures concerning the refinancing operations of the Eurosystem and collateral eligibility. In particular, in the field of collateral eligibility, the decision allows for the admission of certain other asset-backed securities and credit claims. The specific requirements pertaining to these measures are available on the website of the ECB.

1.6.3.2 The Eurosystem as a user of securities settlement systems

Selection of central securities depositories at the domestic level

For the mobilisation of securities by its counterparties, the Eurosystem has selected securities settlement systems operated by central securities depositories. A securities settlement system of a national CSD is eligible if it obtains, after verification of its compliance with the evaluation criteria established by the Eurosystem (the User Standards), the formal approval of the Governing Council. In this context, the Eurosystem assesses securities settlement systems and links between different securities settlement systems. In Luxembourg, the systems operated by Clearstream Banking S.A. (CBL) and by VP Lux S.à r.l. are eligible for the mobilisation of securities by the Eurosystem's counterparties.

Cross-border use of collateral

Besides using eligible domestic securities settled via the national depository, counterparties can receive credit from their national central bank by using collateral issued in a depository located elsewhere in the euro area. The Eurosystem sets two procedures for such cross-border use of collateral. Counterparties may use:
- the CCBM[10]; and
- links established between securities settlement systems of CSDs.

Currently two types of links are eligible, direct links and relayed links:
- In a given securities settlement system located in a country of the euro area, direct links make securities issued in a system of another euro area country available, thanks to bilateral accounts that the two systems maintain with each other.
- Relayed links enable the transfer of securities between two systems without bilateral accounts by using a third intermediary system.

Links have to be approved by the Governing Council before being used for collateralisation of central bank credit operations. In 2011, Luxembourg counterparties had the possibility to use the direct links between CBL and Clearstream Banking A.G. Frankfurt, Euroclear Bank, the SSS operated by the National Bank of Belgium, Monte Titoli (Italy), OeKB (Austria), Euroclear Netherlands, Euroclear France, KDD (Slovenia), and BOGS (Greece).

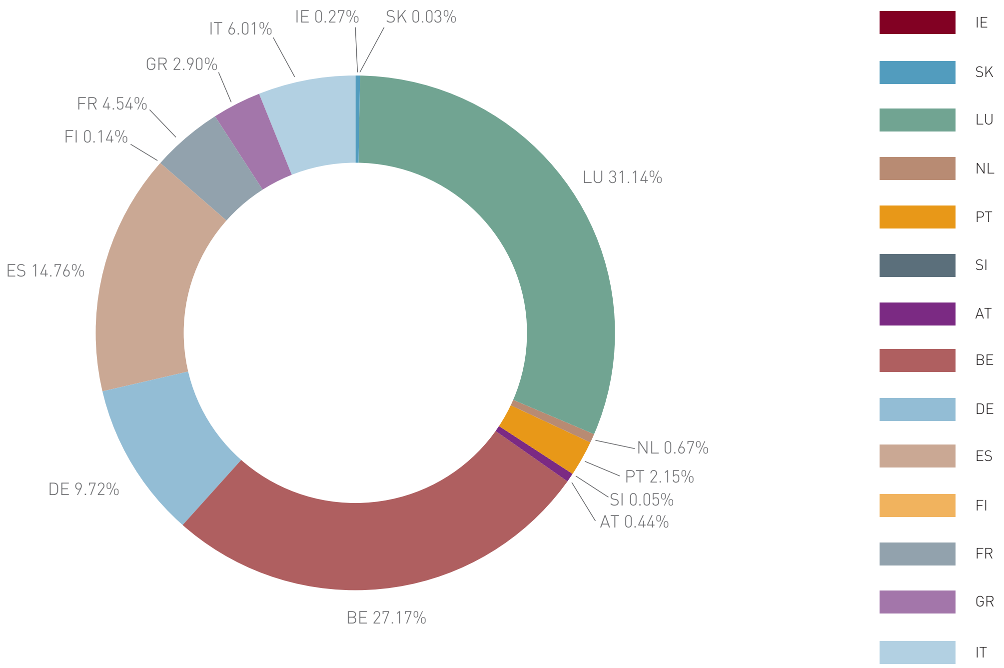
1.6.4 Correspondent Central Banking Model (CCBM)

The main objective of the CCBM is to enable counterparties of the Eurosystem to use securities on a cross-border basis even if there is no eligible link between the national depository and the foreign depository in which the counterparty holds securities. For this purpose, in the CCBM each national central bank acts on behalf of the other central banks as a custodian for securities held at the national depository. This procedure involves first of all a central bank called a correspondent central bank (CCB), which differs from the central bank granting the credit to the counterparty. The CCB holds the account at the CSD in which the deposited securities are registered. The home central bank (HCB) grants the credit to its counterparty based on the confirmations it receives from the CCB.

The CCBM remains the main channel for the cross-border mobilisation of collateral used in the Eurosystem's credit operations. In terms of value, the most active correspondent central banks in 2011 were those of Luxembourg (31.1 %), Belgium (27.2 %), Spain (14.8 %), and Germany (9.7 %). The most active home central banks were those of Germany (33.0 %), France (15.7 %), Greece (13.9 %), and Ireland (9.5 %).

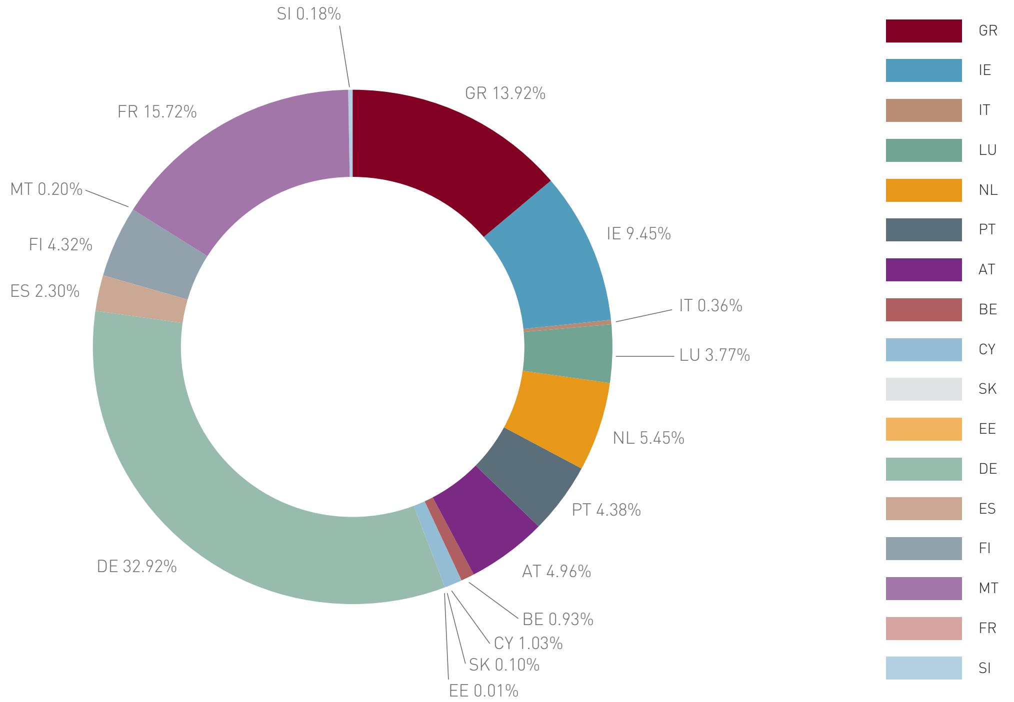
10 Correspondent Central Banking Model, see section 1.6.4.

Chart 17:
Correspondent Central Bank – 2011



Source: Eurosystem

Chart 18:
Home Central Bank – 2011



Source: Eurosystem

1.6.5 Future collateral management of the Eurosystem

The Eurosystem continued in 2011 its work aimed at enhancing collateral management, both for the Eurosystem and for counterparties. Besides the analysis of functional and technical specifications for a centralised platform in the future concerned with the management of collateral, the Eurosystem began the task of incorporating certain significant enhancements in the general collateral framework which had been requested by market participants. In particular, certain counterparties suggested to abandon the need to repatriate[11] eligible securities from the investor SSS to the issuer SSS in order to use them in the CCBM, as well as to allow the cross-border use of triparty services in the mobilisation of collateral. The incorporation of these two measures into the CCBM framework will require the ECB to define more harmonised operational procedures of the Eurosystem towards its counterparties.

1.6.6 TARGET2-Securities

TARGET2-Securities (T2S) is a Eurosystem project aimed at developing a single pan-European securities settlement platform in order to organise settlement operations in and between all participating Central Securities Depositories (CSDs) in a centralised and harmonised way. The platform will accomodate both the securities side as the cash side of transactions and provide DVP settlement in central bank money (CeBM) accordingly. This initiative is part of a more general process of financial markets integration in Europe, leading to a streamlining of procedures and to a substantial reduction of costs and risks.

2011 saw the conclusion of the negotiations concerning the Framework Agreement that applies to the development and migration of the platform and defines the rights, responsibilities and governance between all stakeholders taking part in the project (Eurosystem, central securities depositories and non euro area national central banks). The signature of the Framework Agreement by all these actors is expected to take place between April and June 2012. The ECB Governing Council confirmed that T2S is to become operational in June 2015.

In October 2011, the final T2S technical specifications were published. They will allow all actors to assess the feasibility and technical efforts needed for their organisation to participate in the initiative.

Under the lead of the T2S Advisory Group and National User Groups, efforts were pursued to clarify harmonisation initiatives needed in the participating countries in order to allow T2S to be used to its maximum potential. These initiatives could for example result in new market practices or regulatory changes.

2012 is expected to see the signature of the Framework Agreement by all interested stakeholders, the implementation of a new governance structure as well as clarifications in terms of implementation and migration procedures.

1.6.7 LuxCSD

LuxCSD, Luxembourg's central securities depository, was created jointly by the BCL and Clearstream International on the basis of an equal shareholding in 2010. It provides securities settlement services in central bank money. The Clearstream Group is the operator of LuxCSD, allowing it to benefit from operational synergies and a functional IT platform.

LuxCSD was technically established in 2011 and 2012 should be the first year of its commercial deployment. In that respect, LuxCSD will provide the following services:

- the settlement of securities transactions in central bank money;
- the settlement of free of payment transactions;
- securities issuance services with settlement in central bank money or free of payment;
- securities custody services;
- the routing of orders in investment funds shares;
- direct settlement against Clearstream Banking counterparties;
- upon its availability, a national access point to T2S.

11 In the terminology of the Eurosystem and its counterparties, this is the "removal of the repatriation requirement".

Securities eligible in LuxCSD will be debt securities, equities or investment funds shares, whether they are domiciled in Luxembourg or not.

In 2011, LuxCSD was designated by the BCL as a "securities settlement system" and notified to the European Commission as well as to the ESMA. LuxCSD is in the process of being assessed by the Eurosystem. The BCL will open an account in LuxCSD to collect collateral for monetary policy operations.

LuxCSD also formally confirmed to the ECB its interest in joining TARGET2-Securities. This interest will be reiterated in the first half of 2012 through the signature of the T2S Framework Agreement.

The LuxCSD Board is composed of three members, one of them mandated by BCL while the two others are mandated by Clearstream Banking.

1.7 FINANCIAL STABILITY AND PRUDENTIAL SUPERVISION

In addition to their main mission to maintain price stability, the Eurosystem and the BCL contribute to financial stability and prudential supervision. An unstable financial system hampers an efficient allocation of financial resources to the economy and affects the transmission of monetary policy.

According to the Eurosystems` definition, financial stability describes a situation in which the financial system, i.e. intermediaries, markets and infrastructures, are able to withstand shocks including sufficient buffers and are able to cope with their consequences. Ultimately, the aim is to reduce the occurrence of disturbances affecting the process of financial intermediation thereby fostering balanced and sustainable growth.

The financial stability mandate attributed to the BCL is based on the Treaty on the functioning of the European Union through its participation in the Eurosystem, and on national legislation. At the European level, article 127 of the Treaty on the functioning of the European Union entrusts the Eurosystem, in addition to its central task of conducting monetary policy, the responsibility of contributing to a well supervised and stable financial system. At the national level, article 2(6) of the organic law of the BCL stipulates the need for the BCL to cooperate with the government and the supervisory agencies in order to ensure financial stability. In addition, given its expertise in the matter, the legislator has entrusted the BCL with the supervision of payment and securities settlement operations.

1.7.1 Macro-prudential supervision

Macro-prudential supervision is designed to contribute to the efficient allocation of resources in the economy by minimising the build-up of vulnerabilities that could potentially destabilise the financial system. On the one hand the aim is to avoid the build-up of systemic risk while on the other hand it is intended to buttress the resilience of the system through the fine-tuning of buffers in the financial system.

This approach completes micro-prudential supervision by adding a macro-prudential perspective while taking into account the set of financial intermediaries and other components of the financial system and infrastructure. Macro-prudential supervision is based on the notion of systemic risk which is defined as "a risk of disturbances in the financial system which could have important consequences on the internal market and on the real economy."

With the tendency for systemic risk to behave in a cyclical manner, it is important to asses the evolution of risk at the level of the system. Consequently, macro-prudential analysis has to take the build-up of endogenous risk into account (i.e. resulting from the behaviour of financial intermediaries) as well as exogenous risk. By contrast, at the micro level, risk is considered as external (market risk, exchange rate risk, credit risk, …) and the extent of endogenous risk carried by an institution can be overseen. Among the tasks of macro-prudential supervision, is the need to recognise the degree of common exposures across institutions and their correlations as is the need to recognise the risks concerning employment and resources.

As a result, the relevant perimeter for macro-prudential supervision will be the entire set of financial intermediaries, markets and infrastructures that could represent a certain systemic importance.

Systemic risk has many dimensions which makes its analysis a complicated task. Furthermore, the dynamic developments in the financial sector allow for the potential of systemic risk to develop and change quickly. These principles demand the need for macro-prudential supervision to be comprehensive and continuous. This warrants for taking all risks into account including low-probability high-impact tail risks which by definition are difficult to predict.

Systemic risk is most commonly described in its cross-sectoral and temporal dimensions. As no single indicator can capture the multiple facets of risk, macro-prudential frameworks tend to use a series of risk indicators including early warning indicators (EWI) and financial soundness indicators (FSIs).

The cross-sectoral dimension requires the measurement of the correlation of exposures across financial institutions. This may give indications of the interconnectedness of the system and of common channels of contagion. While this analysis is limited by the amount of data available, a multitude of analytical tools exist to evaluate the links between financial institutions.

The temporal dimension focuses on the issue of pro-cyclicality in the financial system. Pro-cyclicality leads to an accumulation of risk over time due to the interaction of the financial and real sectors of the economy. Pro-cyclicality can be analysed using indicators on the credit cycle, asset prices, leverage and maturity mismatches.

1.7.1.1 Macro-prudential supervision in Luxembourg

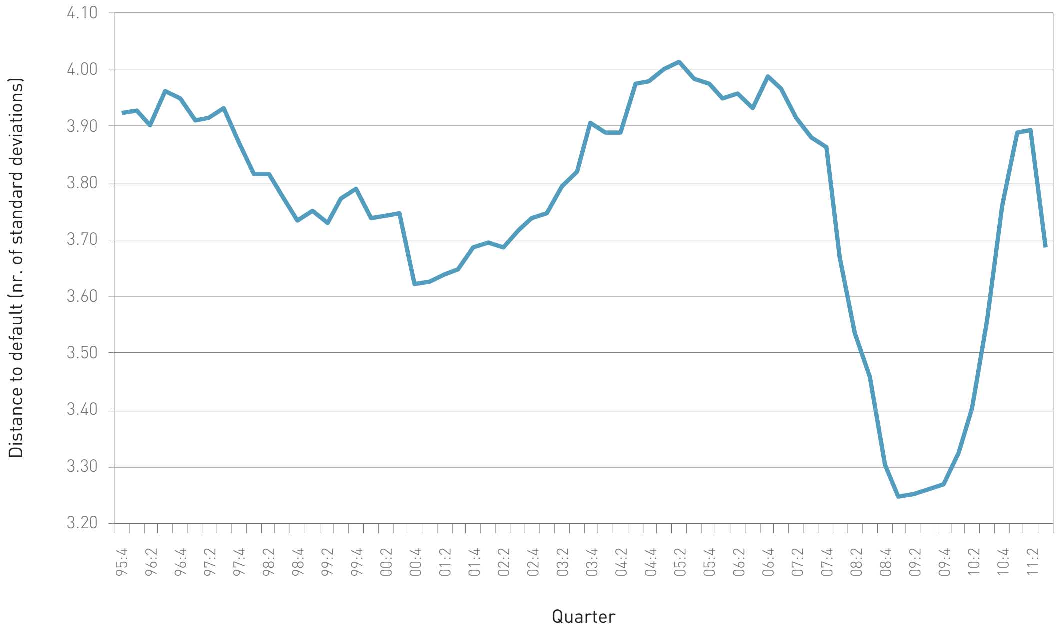
The BCL relies on multiple indicators to assess systemic risk. The BCL has developed indicators for probabilities of default of individual banks and their counterparties, aggregate z-scores, vulnerability indices and specific indicators to monitor liquidity.

Preliminary estimations of the probabilities of default of Luxembourgish banks exhibit a stabilisation of the dispersion as compared to 2010. This result applies to the median (0.01 %) and the maximum level which hovers inside a narrow band (10-12 %). This indicator points at a stabilisation in the financial sector in Luxembourg. Nevertheless, vulnerabilities remain for individual banks which, however, does not imply a systemic risk due to limited interconnectedness found on the national level. In aggregate these results are confirmed by calculations of the z-score and the BCL vulnerability index. The z-score increased between 2009Q4 and 2010Q4 after a decline between end-2007 and early 2009. A resurgence of vulnerability, nevertheless, occurred in 2011 when the trajectory of the z-score was reversed and its dispersion increased as well. This negative development mainly reflects the impact of distressed European sovereigns. In aggregate, the level of the indicator remains at a level which is compatible with the requirements for a stable financial system.

The BCL also engages in determining the link between finance and the real economy and in liquidity stress-testing. A number of indicators developed at the BCL take a forward-looking approach. In order to anticipate rising vulnerabilities in the banking sector, the BCL applies a special weight to its synthetic financial vulnerability indicator and to the macro-prudential stress tests.

The vulnerability indicator makes use of a host of variables from bank balance sheets, profit and loss accounts, macro-financial variables and the structure of the Luxembourgish banking sector. In order to keep track of medium term vulnerabilities in the Luxembourgish banking sector, the indicator is set for up to two years (while taking Eurosystem macro conditions into account). Predictions for 2012 and 2013 display a convergence of vulnerability in historic averages. In addition, over this time period, the index remains below a certain level thus, indicating a certain degree of vulnerability. In regard to the estimates, confidence intervals still remain thus also revealing an increased degree of uncertainty.

Chart 19:
The z-score index for Luxembourgish banks: 1995q1 - 2011q3



Source: BCL

The BCL also carries out regular top-down stress tests which attempt to quantify the impact of severe but plausible exogenous shocks on the stability of individual components of the financial system. Such stress tests can be followed up with the use of additional risk indicators to enrich the results. These indicators can subsequently help inform the prudential response of the outcome of the stress tests. In this context a new stress-testing framework[12] is being developed at the BCL which manages to accommodate better for tail events in credit risk distributions.

During the second half of 2011, the BCL analysed the impact of certain sovereign risks on the solvency ratios of Luxembourgish banks. This contributed in determining additional capital required in case of a further deterioration in European sovereign debt markets. The importance of these issues for the Luxembourgish fund industry was also analysed.

A number of specific studies were also carried out in the context of the changing regulatory environment. The impact of the new Basel III liquidity requirements on Luxembourgish credit institutions was analysed.[13] A paper was also produced on the leverage ratios of banks as an indicator for banks' external funding needs.[14] Furthermore, a common project between the BCL and the Luxembourg School of Finance (LSF) with financing from the *Fonds National de la Recherche* (FNR) focusing on stability in the Luxembourgish financial sector and on the construction of macro-prudential tools has been running since early 2011.[15]

The use of its security-by-security database permitted the BCL to continuously monitor the evolution of exposures of Luxembourgish banks and investment funds to distressed sovereigns. Network analysis are also carried out on interbank links making use of the available data like e.g. the risk concentration tables. Furthermore, the Basel Committee on Banking Supervision's (BCBS) framework was used to determine

12 Guarda, P., A. Rouabah et J. Theal. (Octobre 2011), "MVAR: A framework for capturing extreme events when conducting a macro-prudential stress test", Cahier d'études de la BCL n°63.

13 Giordana G., Schumacher I. (Juin 2011), "The Impact of the Basel III Liquidity regulations on the Bank Lending Channel: a Luxembourg Case Study", Cahier d'études de la BCL n°61.

14 Giordana G., Schumacher I. (Octobre 2011), "The leverage cycle in Luxembourg's banking sector", Cahier d'études de la BCL n°66.

15 X. Jin et F. Nadal de Simone, (Octobre 2011), "Market and book based models of probability of default for developing macro-prudential policy tools", Cahier d'études de la BCL n°65.

systemically important institutions in Luxembourg. The framework is based on a series of indicators including the size of an institution, its interconnectedness and its substitutability in case of default.

Regarding macro-prudential supervision, the BCL contributes to a number of committees and working groups at the level of the ESCB, inter alia the Financial Stability Committee (FSC) and its substructures. The BCL is also involved in a research network focusing on macro-prudential issues (Macro-prudential research network MaRs) which involves central banks of the EU. This initiative revolves around three main pillars including (i) the development of macro-financial models linking financial stability concerns to the performance of the economy, (ii) the evaluation of contagion risks and their transmission channels and (iii) the elaboration of a set of systemic risk indicators. The macro-prudential role of the BCL has evolved considerably since the inception of the ESRB and related structures, i.e. the Advisory Technical Committee (ATC).

1.7.1.2 The European Systemic Risk Board (ESRB)

The ESRB was created by the European regulation n°1092/2010, issued by the European Parliament and the Council on November 24, 2010, which deals with the macro-prudential surveillance of the financial system in the European Union.

The ESRB represents the macro-prudential pillar of the new European system of financial supervision. The ESRB's inaugural meeting was held on January 20, 2011. This new independent institution is responsible for the systemic risk surveillance at the EU level. Its mandate is the supervision and evaluation of systemic risk during normal times in order to mitigate the exposure of the system to the failure of systemic institutions as well as to increase the system's resilience to shocks. The ESRB can issue warnings on identified risks and relay recommendations aimed at tackling the risks if it is deemed necessary. In this regard, the scope of ESRB action covers the whole financial system and contributes to the mitigation of potential negative effects on the real economy.

The ESRB includes more than 70 institutions (central banks, national and European financial supervision authorities, the European Commission …) and consists of a General Board and a Steering Committee. The technical work is performed by an Advisory Technical Committee (ATC) implicating experts from the member institutions, and by an Advisory Scientific Committee involving experts from academia.

This new structure calls for new responsibilities, specifically for central banks, in regard to their expertise and responsibility in sustaining financial stability. Central banks thereby, play a major role in the European macro-prudential surveillance. The governor of the BCL is a voting member of the ESRB General Board, which is the unique decision body of the institution. The national micro-prudential supervisory authorities are part of the General Board, although as non-voting members. Given the BCL's responsibilities as a liquidity supervisor and according to a rotation principle agreed upon by the other national supervisory authorities, the BCL also finds itself represented on the General Board in matters concerning this issue. Furthermore, the BCL contributes to the technical and analytical works performed by the ESRB substructures, thereby providing its analytical expertise regarding macroeconomic, financial, monetary and statistical issues.

The inception of the ESRB should allow for the improvement of the ability to identify macro-prudential risks at the level of the whole financial system. Likewise, it provides a mechanism to issue clear warnings and recommendations which should trigger prompt action by the concerned national authorities (given the "comply-or-explain" principle).

After a short initial period aimed at implementing the institutional and organisational framework, the ESRB General Board started holding its plenary meetings at a minimum of four times per year. The ESRB has been mainly working on the following five subjects:
- the identification and assessment of general systemic risk, as well as the actions needed to deal with it;
- the analysis and study of macro-prudential actions towards specific risks which have triggered, for example, the issuing of recommendations regarding loans in foreign currencies (ESRB/2011/1) and the foreign currency funding of financial institutions in Europe (ESRB/2011/2);
- the analysis of macro-prudential aspects of ongoing European legislative developments, namely those regarding the transposition into European law of the Basel III rules within the Capital Requirements

Directive and the new Regulation for banks and other credit institutions (CRDIV/CRR), as well as the Central Counterparties legislation (EMIR);
- the identification of common principles for the implementation of macro-prudential national mandates and tools; the ESRB has issued a recommendation regarding national macro-prudential mandates (ESRB/2011/2);
- the identification of the analytical tools that the ESRB will develop further in the near future in order to study systemic risk.

1.7.2 Micro-prudential supervision

1.7.2.1 Liquidity supervision

The liquidity supervision of market operators was entrusted to the BCL by a modification of its organic law on 24 October 2008. The liquidity supervision of market operators principally aims at assessing the liquidity situation and the management of the liquidity risk of individual operators. The flaws in the liquidity risk management of certain operators having been one of the principal causes of the financial turbulences of 2008, management of liquidity and related risks were in the focus of attention of supervisory authorities at the international level over the last few years.

Regulation of liquidity is important for a central bank because, on the one hand, the central bank acts as a supplier of liquidity to the financial system in normal times-as in times of stress, and, on the other hand, it can detect or indeed prevent a failure chain on the markets, thus limiting systemic risk. This materialised again in 2011, marked by strong turbulences on financial markets that also affected the Luxembourg financial centre.

Liquidity supervision also constitutes an important support function for analyses conducted in the field of financial stability and in the analysis of systemic risks, by providing micro-prudential analysis as an input. In this context, the framework of supervision of the BCL is essentially based on two pillars, namely the permanent off-site monitoring carried out internally on the basis of data collected via the regular statistical and prudential reporting and on the on-site inspections of market operators.

After the issuance of the BCLs` Regulation of 2009/n°4 on 29 April 2009 defining basic principles for the supervision of liquidity, its scope of application, market operators' responsibilities and daily statements in the years 2009 and 2010, 2011 was marked by:
- the off-site monitoring of market operators;
- on-site visits, and
- the monitoring of work carried out on an international level, in relation to the definition and setting-up of new liquidity standards in the framework of Basel III as well as in the context of their transposition at the European level.

The off-site monitoring of market operators is based on a regular analysis of qualitative and quantitative information of an individual as well as on an aggregated level. In order to have a better monitoring of the liquidity position of the market operators, the BCL notably developed daily statements of the liquidity position of credit institutions. These reports apply to a sample of credit institutions and were introduced in May 2010. It allows the BCL to assess the liquidity position of these entities on a day-to-day basis.

In 2011, the BCL developed, based on historical data from these daily statements, a tool that allowed the assessment of the structural liquidity position of these credit institutions and the assessment of the individual evolution of their liquidity position over time..

It also pursued the development of the Liquidity Monitoring Framework (LMF) as a tool for liquidity supervision. This tool allows for the assessment of the vulnerability of individual credit institutions in terms of liquidity as well as for the identification of liquidity risks at an aggregated level. The LMF was thus subjected to methodological and technical improvements. These two tools add an additional dimension to the supervisory mission carried out by the BCL.

In 2011, the BCL also intensified the on-site visits with regard to liquidity supervision. These assessments are used in order to fully understand the framework and the procedures that individual operators have in place, in order to assess the appropriateness of the framework for the liquidity risk management of operators. The BCL mainly targets the credit institutions that are the most vulnerable to liquidity risk or that participate as a counterparty in monetary policy operations. The BCL carried out nine on-site visits in 2011. As a general rule, these on-site visits are coordinated and carried out in cooperation with the CSSF. The BCL is in regular contact with other institutions in the context of its surveillance mission.

The on-site visits revealed that the credit institutions are reinforcing their framework for liquidity risk management to align themselves with the recommendations in this regard, but some weaknesses remain, mostly at the level of performing stress tests.

These weak points also appear in the impact studies carried out in the context of the implementation of the new Basel III standards for liquidity. In the course of 2011, the BCL conducted, in cooperation with the CSSF, two impact studies on a representative sample of credit institutions for the financial centre, in order to determine the current positions of these banks with regard to the new liquidity standards.

The last study showed that, based on the figures of 30 June 2011, eight credit institutions out of 59 succeeded in respecting the two standards for funding liquidity, i.e. the LCR (Liquidity Coverage Ratio) and the NSFR (Net Stable Funding Ratio). Nevertheless these standards will only come into force from 2015 and 2018 onwards respectively. The monitoring of these liquidity ratios will continue in 2012.

As a supervisor in charge of liquidity, the BCL is also involved in the work of several supervisory colleges. With the majority of the credit institutions being affiliates of groups having their head office abroad, participation in these colleges allows for a better apprehension of the activity and risk profile of Luxembourgish entities in the context of their group. At the end of 2011, the BCL was a member of six supervisory colleges.

Since 2008, the BCL has also exercised the liquidity supervision of the European Investment Bank, the latter being admitted as an eligible counterparty for monetary policy operations of the Eurosystem. The contract governing the supervision was renewed in December 2011.

With regards to the monitoring of regulatory developments at the international level, the BCL is participating in the working groups dedicated to liquidity issues at the level of the Basel Committee and the European Banking Authority. Beyond the working groups dedicated to liquidity aspects, the BCL is also a member of the Board of Supervisors of the European Banking Authority as well as of other committees and subgroups that are of relevance in the context of its supervisory mission. As a general rule the implication in these committees and working groups is done jointly with the CSSF. As a supervisory authority, the BCL also participates in the work of the ESRB (European Systemic Risk Board).

1.7.2.2 Oversight

The oversight of payment and settlement infrastructures is an essential task for the central banks of the Eurosystem. The objective is to contribute to the security and efficiency of these infrastructures, especially in the light of the importance of a smooth functioning of the systems for the economy, the implementation of monetary policy, the preservation of financial stability and of public confidence in the currency.

According to the BCL's organic law, the BCL is in charge of promoting the security and the efficiency of payment and securities settlement systems, as well as the security of payment instruments. In this context, in conformity with BCL regulation 2010/n°6 of 8 September 2010 as amended by BCL regulation 2011/n°10 of 14 July 2011, the oversight of systems and instruments is applied to operators and issuers, participants, as well as services provided by technical agents or third party entities. The annex to the BCL regulation 2010/n°6 lists the principles and specific standards adopted by the Eurosystem, upon which the BCL bases its evaluation of the functioning of the systems and the instruments falling under its oversight. In this context, the operators and issuers shall follow the applicable principles and put in place an organisation, adequate rules and a risk management framework aimed at reducing the risks associated to the system.

The oversight and the assessments performed by the BCL are based on regular and ad hoc statements of qualitative and statistical information provided by relevant entities. This information, completed with regular contacts and specific on-site inspections, relates in particular to the development of the infrastructures' activities, their performance, their governance and the management of certain risks.

In regard to payment systems, the BCL, through its participation in certain working groups at the European level, contributed to discussions related to the cooperative oversight of TARGET2 (including its Luxembourg component TARGET2_LU), Euro1 and CLS. In 2011, these systems showed a stable and robust functioning. Moreover, the BCL performed an appreciation of the decentralised aspects of TARGET2, these aspects being mainly linked to the BCL's own connection to the system and to the ancillary services offered by the BCL to the Luxembourg participants.

In regard to securities settlement systems, the BCL pursued its oversight activities related to the systems operated by Clearstream Banking S.A. and by VP Lux S.à.r.l. Furthermore, the scope of the BCL's oversight of securities settlement systems was extended to the system operated by LuxCSD S.A. In application of articles 109 and 110 of the law of 10 November 2009, the BCL designated on 3 October 2011 the system operated by LuxCSD S.A. as a securities settlement system. In this regard, the BCL performed an assessment of the adequacy of the rules of the system, in line with legal requirements in this field.

In the course of 2011, the functioning of securities settlement systems was generally stable and resilient. Besides regular oversight activities, the BCL followed the implementation by Clearstream of certain recommendations issued in the context of the assessment of the system against the ESCB-CESR standards in 2010. Similar assessments of the systems operated by VP Lux S.à.r.l. and LuxCSD against the same ESCB-CESR standards are also being performed.

In addition, the compliance of the system operated by Clearstream with the principles issued by the CPSS-IOSCO Committee was assessed in 2011. This assessment, performed by the IMF in the context of the Financial sector assessment program (FSAP), in cooperation with the relevant national authorities, concluded to a high degree of compliance of the system with these principles.

In 2011, the BCL followed the development by the CPSS-IOSCO Committee of new principles to be applied to different types of financial market infrastructures of systemic relevance, e.g. central counterparties, payment systems, central securities depositories, securities settlement systems and trade repositories. Moreover, the work of the European Commission on the European Market Infrastructure Regulation (EMIR) and the discussions on a regulation relating to central securities depositories were paid particular attention.

Concerning payment instruments, the BCL contributed, at the Eurosystem level, to the definition of oversight standards for electronic money schemes. These standards, which are being finalised, follow a similar approach to the one adopted by the Eurosystem for payment cards, credit transfers and direct debit schemes. They target legal, financial, operational and reputational risks which these schemes are exposed to and shall be used as a basis for the assessments by central banks in this context.

Finally, the BCL actively contributed to the initiatives of the SecurePay forum established in 2011 which is composed of members of European central banks and banking supervisors. The ongoing work concerns the definition of security standards for Internet payments with payment cards and for electronic payments through web-banking applications.

1.8 REGULATORY AND LEGISLATIVE DEVELOPMENTS

1.8.1 European legislation

The BCL follows with a particular interest developments on economic governance and financial stability at the European and international level.

1.8.1.1 Economic governance

Primary law

Modification of Article 136 of the Treaty on the Functioning of the European Union (TFEU)

On the occasion of the European Council of 28 and 29 October 2010 the Heads of State or Government agreed on the need for Member states to establish a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole.

In accordance with the simplified revision procedure under Article 48(6) of the Treaty on the European Union, the European Council adopted on 25 March 2011 the Decision n°2011/199/EU amending Article 136 TFUE on the establishment of a stability mechanism for Member states whose currency is the euro. Consequently, the following paragraph was added:

"*The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.*"

In accordance with the national procedures for approval this new provision is intended to enter into force on 1 January 2013.

In Luxembourg, a draft approving act was deposited by the Parliament on 27 September 2011.

International Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (fiscal compact)

Following the Statement by the Heads of State or Government of the euro area on 9 December 2011, an international treaty on Stability, Coordination and Governance in the Economic and Monetary Union was endorsed by 25 Member States of the EU on 30 January 2012. This treaty reinforces fiscal discipline, particularly through the introduction of a permanent binding balanced budget rule, preferably to be introduced at the constitutional level and ensuring enhanced surveillance of Member States that are subject to an excessive deficit procedure. This treaty was signed by the Heads of State or Government on 2 March 2012.

European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM)

On 11 July 2011, the Finance Ministers of the 17 Member states of the euro area signed an intergovernmental treaty establishing a European Stability Mechanism that refers to a modification of Article 136 TFUE. This treaty was submitted to a ratification procedure by the signing Member states. Initially, it was foreseen that the European Stability Mechanism should be able to intervene as of July 2013, in view of replacing the European Financial Stability Facility[16].

Table 4: The European Stability Mechanism

Name	Legal basis	Duration	"Firepower" (origin and amount)
ESM European Stability Mechanism	International organisation established in Luxembourg on the basis of an intergovernmental treaty signed by the 17 Member States of the euro area. The treaty relies on the foreseen modification of Article 136(3) TFUE.	Same activities as the EFSF, starting operations in July 2012, then replaces the EFSF as from July 2013.	€ 500 billion (capital markets' funding with € 700 billion of subscribed share capital of which € 80 billion are paid-in from member states' budgets).

16 The EFSF has been incorporated as a joint-stock company (*société anonyme*) under Luxembourg law.

In addition, following the meeting of the euro area Finance ministers on 20 June 2011 and the Euro summit of 21 July 2011, the EFSF Framework Agreement was modified by a Supplemental Amendment Agreement to the EFSF Framework Agreement. Modifications aimed to increase the amount of guarantees given by shareholder Member states so as to bring them up to a total of € 780 billion, thus allowing the EFSF to have an effective lending capacity of € 440 billion. The modifications also aimed to allow Estonia, a new Member state of the euro area since 1 January 2011, to adhere to the intergovernmental treaty and, finally, to provide new intervention tools.

These additional tools enable the EFSF either to provide loans, to act on the basis of a precautionary programme, to finance the recapitalisation of financial institutions (by loans to governments of these member states, including non programme countries), to provide facilities for intervening in the secondary bond market, or to intervene in the debt primary market (all these tools are considered as a "financial assistance").

The amendments of the EFSF Framework Agreement entered into force on 18 October 2011. On 29 November 2011, the Eurogroup approved the modalities for the strengthening of the intervention framework of the EFSF with two approaches: first, with the creation of a special purpose entity aimed at enhancing primary sovereign bond issues with a partial coverage in case of the default of payment of a Member state (option 1) and, second, with the creation of a special purpose entity allowing a co-investment with external investors (option 2). These two special purpose entities were designed as companies governed by Luxembourg law, similarly to the EFSF. The BCL decided to support the EFSF by providing a registered office to the entity established under option 1.

During the summit held on 9 December 2011, the Heads of State and Government decided to increase the combined lending capacity of the EFSF and the ESM so as to reach € 500 billion. Finally, on 2 February 2012, Heads of State and Government signed the treaty bringing forward the ESM's starting of operations to 1 July 2012.

Table 5: The European Financial Stability Facility (EFSF)

Name	Legal basis	Duration	"Firepower" (origin and amount)
EFSF European Financial Stability Facility	A joint-stock company (*société anonyme*) under Luxembourg law whose capital share and scope of activities are defined in an intergovernmental treaty signed by the 17 Member States of the euro area titled "EFSF Framework Agreement", amended by a supplemental agreement that entered into force on 13 October 2011.	Activity foreseen to last until 2013. Survival of the legal entity until the maturity of securities issued.	€ 440 billion (capital markets' funding with € 780 billion of state guarantees taken from national budgets of Member states that are shareholders)
Optimisation of its firepower with:			
	"Option 1" Credit enhancement of new issuances of sovereign debt by a concomitant issuance of "Sovereign Bond Protection Certificates" by a special purpose vehicle incorporated in Luxembourg.		Coverage of 20 % to 30 % of the nominal value of new issuances guaranteed.
	"Option 2" Setting up of one or several co-investment funds (CIF) allowing a combination of public and private funding so as to increase the funding possibilities for the EFSF's financial instruments.		The funding capacity of the CIF is to be determined depending on who will be the external investors.

Secondary law

The six legislative proposals of the European Commission of 29 September 2010, concerning the reinforcement of economic governance in the EU and the euro area were adopted by the European Parliament on 28 September 2011 and by the Council on 8 November 2011 thus allowing for their entry into force on 13 December 2011.

The objective was to broaden and enhance the surveillance of fiscal policies, but also of macroeconomic policies and structural reforms in the light of the shortcomings of the existing legislation revealed on the occasion of the economic and financial crisis.

The adopted legislative package comprises six different legislative acts[17]: four legislative acts on fiscal aspects aiming notably at reinforcing the Stability and Growth Pact and the national fiscal frameworks of the Member States and two legislative acts aiming at detecting and correcting macroeconomic imbalances in the EU and the euro area. This implies a reform of the preventive and corrective part of the Stability and Growth Pact and the introduction of a new procedure on the prevention and correction of macroeconomic imbalances.

The "European semester", a new tool adopted by the European Council in 2010 and reflected in the amended Council Regulation (EC) n°1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, was applied for the first time in 2011. It enables an enhanced coordination of economic and fiscal policies according to a coordinated cycle.

The Eurosystem welcomed the agreement between the European Parliament and the Council, considering however that the agreed package fell short of the "quantum leap" in economic governance that the Eurosystem had long advocated for in the euro area.

In view of reinforcing the economic governance reform in the euro area beyond the aforementioned legislative package, 23 Member states, including Member states with a derogation (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) agreed on a "Euro Plus Pact" on the occasion of the informal meeting of the Heads of State or Government of the euro area of 11 March 2011 as endorsed by the European Council on 24 and 25 March 2011. In this context the signatories committed to even stronger economic coordination with annual assessments and monitoring by the Heads of State or Government.

On the basis of the aforementioned legislative package the Commission published two new proposals for Regulations[18] on 23 September 2011, whose adoption are pending. One of the proposals sets out provisions introducing a system of progressive surveillance, which complements the existing provisions of the Stability and Growth Pact and strengthens surveillance of fiscal discipline in the Member States whose currency is the euro. These provisions provide for the introduction of common fiscal rules in line with the budgetary objectives set at Union level as well as for enhanced monitoring of those Member States whose currency is the euro that are subjected to an excessive deficit procedure. The implementation of these rules should be done by the introduction of binding rules, preferably of a constitutional nature, in order to show the rigorous adhesion of national authorities to the Stability and Growth Pact. In addition, a common budgetary timeline is proposed in view of ensuring the efficiency of the European semester as well as independent fiscal councils in place at the national level who are to be in charge of monitoring the implementation of national fiscal rules.

1.8.1.2 Secondary legislation drafts

In 2011, several drafts for new regulations in the financial sector at the European level were proposed by the Commission. However, only few proposals were adopted as legislative acts.

The BCL followed with interest the developments related to the European proposal for the creation of a crisis management framework that should combine with its own proposal to set up a bank resolution fund in Luxembourg. Nevertheless, the Commission's proposal, initially expected to be presented at the beginning of the summer 2011, was not released during the year under review.

17 (i) Regulation (EU) n°1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area; (ii) Regulation (EU) n°1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area; (iii) Regulation (EU) n°1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) n°1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; (iv) Regulation (EU) n°1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances; (v) Council Regulation (EU) n°1177/2011 of 8 November 2011 amending Regulation (EC) n°1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure; (vi) Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

18 Proposal for a Regulation of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area and Proposal for a Regulation of the European Parliament and of the Council on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area.

Furthermore, on 20 July 2011, the Commission presented proposals for a directive and for a regulation with the goal of strengthening the legislation on capital requirements for banks in accordance with the agreement of Basel III. These two texts aim at updating and replacing the current capital requirement directives (2006/48 and 2006/49). The proposal for a directive is related to the access and to the activity of collecting deposits in the public, while the proposal for a regulation is related to prudential requirements that institutions need to abide by in particular, as regards liquidity ratios. This package is also known as the "CRD IV" proposal.

Among legislative acts adopted in 2011, it is worth mentioning Regulation (EU) n°513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) n°1060/2009 on credit rating agencies which specifies the role of the new European Supervisory Authority (European Securities and Markets Authority) over credit rating agencies registered in the Union. On 15 November 2011, the Commission presented a new proposal for a directive and for a regulation aiming at strengthening the latter regulation and at filling certain gaps.

1.8.2 National legislation

1.8.2.1 Draft law n°6327 on dematerialised securities

On 12 September 2011, the draft law on dematerialised securities[19] (the "draft law") was tabled with the Chamber of Deputies. It aims at governing the dematerialisation of securities, which Luxembourg law applies, whether they consist of capital, debt securities issued by companies incorporated under Luxembourg law, or debt securities issued under Luxembourg law by companies incorporated under foreign law. Dematerialised securities are designed as an additional category of securities, in addition to the possible issuance of such stock and debt securities in bearer or registered form. The draft law introduces a procedure governing the conversion of existing securities in bearer or registered form into dematerialised securities as well as the issuance of new securities in dematerialised form.

Securities listed on regulated markets may only be dematerialised by liquidation bodies. Securities settlement systems operating in Luxembourg and subject to the BCL's oversight, pursuant to the law of 10 November 2009 on payment services, are considered as such liquidation bodies. In consequence, no additional authorisation procedure shall apply to liquidation bodies, which as duly authorised securities settlement systems are automatically authorised as liquidation bodies. It may be recalled that the BCL intervenes alone in the designation process of the securities settlement system to the Ministry being in charge of the financial sector, which then notifies such a system to the European Commission.

Non-listed issues may be dematerialised, either within a liquidation body, or within a central account keeper having received a specific authorisation from the CSSF. Securities that have been dematerialised within a liquidation body or a central account keeper may circulate freely, including within the accounts maintained by account keepers; account keepers are defined as any person authorised under Luxembourg law to maintain securities accounts, including national or international bodies of a public nature established in Luxembourg and operating in the financial sector.

The draft law also modernises the framework in the law of 1 August 2001 on the circulation of securities and other fungible instruments (hereinafter the "law of 2001") that governs the holding and circulation of securities held in accounts located in Luxembourg, irrespective of their form and place of issuance. The draft law aligns the law of 2001 with the *Unidroit* Convention on substantive rules for intermediated securities of 9 October 2009, and with the expected Union harmonisation of securities law.

19 Draft law on dematerialised securities and amending:
- the law of 5 April 1993 on the financial sector, as modified;
- the law of 23 December 1998 creating a financial sector supervisory commission, as modified;
- the law of 10 August 1915 on commercial companies, as modified;
- the law of 3 September 1996 on the involuntary dispossession of bearer securities, as modified;
- the law of 1 August 2001 on the circulation of securities and other fungible instruments, as modified;
- the law of 20 December 2002 on collective placement bodies, as modified;
- the law of 17 December 2010 on collective placement bodies;
- the law of 13 February 2007 on specialized investment funds, as modified;
- the law of 22 March 2004 on securitisation, as modified.

Moreover, the draft law introduces three new provisions in order to strengthen the protection of the security holders' rights. First, it provides that, on bringing liquidation proceedings against an account keeper, the affected holders of the securities accounts immediately acquire the rights to the securities that have been credited to the securities account of the account keeper, without having to wait for the crediting of such securities to their own securities accounts. Second, without prejudice to the separately regulated irrevocability and finality rules, failure by one party to deliver or settle vis-à-vis its counterparty, confirmed on the date and under the terms and conditions applicable in the relevant market or fixed by an agreement between the parties or the rules of a securities settlement system, discharges the affected counterparty of its corresponding delivery or payment obligations, without prejudice to the liability of the defaulting party (Article 16 of the law of 2001). Third, if the relevant account keeper proceeds to deliver the securities or to pay the price in place of the defaulting account holder, such an account keeper acquires ownership by way of guarantee of the securities or funds received from the counterparty as compensation (Article 15 of the law of 2001).

In its opinion of 24 January 2012 concerning the draft law (CON/2012/3), the ECB welcomes the amendments to the law of 2001, which strengthen the protection and enforcement of the rights of the securities holders which maintain securities in a securities settlement system, a liquidation body, a central account keeper or an account keeper in Luxembourg. The ECB also welcomes the amendment of Article 16 concerning the law of 2001 which allows for the mitigation of the credit risk taken by the financial intermediary financing the acquisition of securities by its customers. The ECB considers that such an amendment is of particular relevance to the TARGET2-Securities (T2S), the Eurosystem's future settlement platform. Furthermore, the ECB understands that the amendment to Article 15 of the law of 2001 is supposed to address specific situations encountered in the present financial crisis where transfer orders duly entered into a system, in respect of a counterparty against which insolvency proceedings were subsequently brought, remained unsettled and suspended in the said system, as the insolvent counterparty did not discharge its obligations and the parties could not immediately agree on the bilateral cancellation of such a transfer order. In this respect, the ECB recommends, in its opinion, to clarify the impact of the newly introduced provision as well as its relationship with the settlement irrevocability granted by the Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems. The ECB also recommends that the draft law elaborate on how the proposed statutory discharge of obligations can be aligned with the rules of the operator of a securities settlement system.

Box 1

ADOPTION OF FISCAL RULES IN LUXEMBOURG

An international treaty on Stability, Coordination and Governance in the Economic and Monetary union was endorsed by 25 Member States of the EU on 30 January 2012. This treaty reinforces fiscal discipline, particularly through the introduction of a balanced budget rule to be of binding force and permanent character, preferably at the constitutional level, and ensures enhanced surveillance of Member States that are subject to an excessive deficit procedure. This treaty was signed by the Heads of State or Government on 2 March 2012.

Different Member states adopted or are about to adopt fiscal rules at a national level. Such a reform has currently not been carried out in Luxembourg.

The legislative framework in Luxembourg on public finance should be amended. It should be fully aligned with the Union's objectives of multilateral surveillance, in particular the European semester, in compliance with the aforementioned treaty and the recent reform of the Stability and Growth Pact (more specifically with Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States as well as with Regulation (EU) 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) n°1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies).

Different options as mentioned hereinafter exist for achieving such a reform in Luxembourg.

Amendment of the law of 8 June 1999 on the budget, the accounting and treasury of the State

In compliance with Article 3(2) of the draft treaty on Stability, Coordination and Governance in the Economic and Monetary Union (and considering hereby Article 4 of the Commission proposal of 23 November 2011 for a Regulation of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits of the Member States in the euro area) a fiscal rule should be foreseen in national legislation, more specifically in the law of 8 June 1999 on the budget, the accounting and treasury of the State.

Such an option would have the advantage of implementing the European requirements within a short time period. It would nonetheless imply the disadvantage that these provisions might subsequently be amended or annulled easily. A special legislation on public finance would also be needed to ensure a multiannual fiscal planning and compliance with the European rules and policies (with the introduction of a two-third majority vote by the members of Parliament (*Chambre des Députés*) as far as the rules on the establishment and implementation of public accounts and budgets are concerned).

In order to ensure that the fiscal rule is based, in accordance to European law, on a reliable and independent analysis and that it is in view of ensuring a proper and well-timed monitoring of compliance with the fiscal rules, an independent body such as a committee of experts should be put in place in Luxembourg. It would need to be endowed with at least functional autonomy vis-à-vis the minister having fiscal policy and legislation within its field of competence. It could be envisaged to have recourse to the different existing institutions having expertise in this domain.

Amendment of the Constitution

In compliance with Article 3(2) of the draft treaty on Stability, Coordination and Governance in the Economic and Monetary Union it could be envisaged to introduce a fiscal rule in the Constitution of the Grand-Duchy of Luxembourg, even though the draft treaty does not impose it formally[1]. Such provision would need to be accompanied by a special legislation on public finance ensuring the multiannual fiscal planning and compliance with the European rules and policies (with introduction of a two-third majority vote by the members of Parliament as far as the rules on the establishment and implementation of public accounts and budgets are concerned).

Such an option would have the advantage of stability by creating legal constraints ensuring that a subsequent amendment would only take place with the benefit of the required hindsight and reflection. Reference to an independent body could also be made in this context. Like in certain Member States (Austria, Germany, France) it could be envisaged to amend Article 95ter of the Constitution[2] in order to extend the competences of the Constitutional Court by enabling the latter to rule henceforth, in an abstract manner, on the compliance of laws with the fiscal rule. Such an amendment would however imply an innovation likely to deeply amend the legislative system of Luxembourg.

1 Reference is made to "binding rules, preferably of a constitutional nature".

2 Article 95ter stipulates:

(1) The Constitutional Court decides, by way of judgment, on the conformity of the laws with the Constitution.

(2) The Constitutional Court is seized, in a prejudicial manner, pursuant to the modalities to be determined by the law, by any court to decide on the conformity of the laws, save the laws approving treaties, to the Constitution.

(3) The Constitutional Court is composed of the President of the Superior Court of Justice, the President of the Administrative Court, two counselors of the "*Cour de Cassation*" and five magistrates nominated by the Grand Duke, upon the joint opinion of the Superior Court of Justice and Administrative Court. The provisions of Articles 91, 92, and 93 apply to them. The Constitutional Court comprises a chamber sitting with five magistrates.

(4) The organisation of the Constitutional Court and the manner in which it exercises its competences are regulated by the law."

1.8.3 BCL Regulations

In 2011, the BCL issued four regulations.

In regards to statistical data, the BCL issued the following regulations:

- Regulation BCL 2011/n°7 of 4 April 2011 in relation to the statistical data collection of the payment systems and financial services of the Post and Telecommunications company
- Regulation 2011/n°8 of 29 April 2011 concerning the statistical data collection of companies contracting loans or issuing debt or derivative products derived for the accounting of associated societies.

The Regulation BCL 2011/n°9 of 4 July 2011 aims to collect the statistics concerning the instruments and operations of payment systems.

Finally, the Regulation BCL 2011/n°10 of 4 July 2011 aims to renew certain dispositions of the BCL regulation 2010/n°6 of 8 September 2010 concerning the task of overseeing systems and payment instruments and securities settlement systems in Luxembourg.

1.8.4 Legal rate of interest

The rate was fixed at 3.50 % for the year 2011 by a grand-ducal regulation issued on 1 February 2011 (published in the Mémorial A n°22 of 9 February 2011, page 174). For 2012, this rate remains unchanged following the grand-ducal regulation of 8 December 2011 (published in the Mémorial A n°255 of 16 December 2011, page 4305). It is observed that this rate does not correspond to a specific rate of reference of the money markets.

1.9 COMMUNICATION

1.9.1 Publications

As required by its statutes, the BCL publishes each year a report on its activities. This annual report is published in French and in English.

In 2011 the BCL also published three Bulletins and one Financial Stability Review.

In its working papers the BCL publishes the results of research conducted by its staff. Each working paper contains a non-technical summary. 21 working papers were published in 2011.

1.9.2 Training at the BCL

The BCL furthered its cooperation with the University of Luxembourg, where a staff member gave lectures on institutional aspects of the Eurosystem. Other staff members gave economics and law lectures at the University of Luxembourg and the Catholic University of Louvain as well as foreign exchange risk management lectures at the Strasbourg Institute of Political Studies, and econometrics and time series analysis lectures at the University of Metz.

The BCL also organised ad hoc presentations for various groups of students (Catholic University of Louvain, ULB-Solvay). In Berlin, on 13 April 2011, the BCL Governor gave a speech for students of the *Freie Universität Berlin* on the following subject: "*Europa nach der Krise – Balance zwischen Markt und Staat*". On 16 June 2011 he received a group of 40 students of the *Hochschule für Politik München*, for a discussion on "*Die Rolle des EU bei der Bewältigung der internationalen Finanz-, Wirtschafts- und Schuldenkrise*".

The BCL is a shareholder of the *Agence de Transfert de Technologie financière* (ATTF). This agency, established in 1999 at the initiative of the Luxembourg government, shares with mainly emerging countries, Luxembourg's know-how in financial matters. In May 2011, in the context of a BCL-ATTF joint seminar, the BCL held lectures for a delegation of the People's Bank of China. Presentations were organised in favour of a delegation of Uzbekistan and of a high-level delegation of the National Development and Reform Commission of the People's Republic of China.

The BCL organises presentations on the Eurosystem and the BCL for high-school students following economics classes (usually in the course of their last two years of studies). Students are received, along with their economics teachers, at the auditorium of the Monterey building, for an educational and interactive presentation of the organisation and the missions of the BCL and the Eurosystem. Other topics can also be tackled according to teachers' requests and students' questions.

1.9.3 The BCL's website

The BCL's website, www.bcl.lu, provides information about the Bank's activities and services, its internal organisation, as well as statistics concerning Luxembourg and the Eurosystem. It also contains links to the ECB's website and to websites of other central banks of the ESCB. Based on its search engine and its configurable mailing list, the site offers each visitor a clearly structured information package, suitable for professionals as well as private individuals.

All BCL publications can be viewed and downloaded from the Publications and media section. Hard copies are available at the BCL on request, as long as in stock.

The website exists in English and French. Publications are displayed in their original language (English, French and German).

Overall, 120 249 people visited the website in 2011 (154 346 in 2010), with more than 15 000 000 hits. The numismatic programme witnessed more than 25 000 downloads.

The numismatic products electronic shop (eshop.bcl.lu), directly accessible through the BCL website, attracted more than 54 000 visitors in 2011.

1.9.4 The library

The library, opened in 2005, uses the ALEPH library management system as do a number of other central banks. The system is electronically linked with the other public libraries in Luxembourg.

The library's publications mainly deal with economics and law. Publications stem from international organisations (World Bank, IMF, OECD, BIS, European Commission), but also from national central banks, and mainly tackle monetary, financial, economic and law issues concerning the euro area. Publications usually consist of regulations, statistics, reviews and surveys on the Luxembourg financial centre.

The library is open to the public upon request, either by fax (+352 4774 4910) or by e-mail (bibliotheque@bcl.lu).

The library is open on Monday, Wednesday and Friday from 9am to 12pm and from 3pm to 5pm.

1.9.5 Press relations

The Governor of the BCL gave 15 interviews to the international and national press. Six press conferences were held, on the occasion of the presentation of the BCL's financial accounts, of the Annual Report and of the BCL's Bulletins and Financial Stability Review.

In total, 113 press releases were published.

1.9.6 The BCL research programme

BCL research activities are organised in six main research fields:

- Financial Stability;
- Monetary analysis, credit and financial markets;
- Business cycles and long-term trends;
- Competitiveness and productivity;
- Labour markets;
- Other subjects and current events.

1.9.6.1 Research activities

BCL research output is regularly disseminated through its working paper series or the BCL Bulletin and the Financial Stability Review. Several studies were published in peer-reviewed scientific journals (Empirical Economics, Oxford Bulletin of Economics & Statistics, Journal of Economic Dynamics and Control, Journal of Housing Economics). The list of BCL research publications appears in an annex to this report.

BCL researchers also presented their work in seminars and workshops organised, among others, by the University of Luxembourg, the Eurosystem, the European University Institute, the International Finance & Banking Society, the European Workshop on Efficiency & Productivity Analysis, the German Economic Association and the Netspar Network for Studies on Pensions, Ageing & Retirement.

Since June 2010, the BCL has participated in the European central bank research network called MaRs (macro-prudential research network). In this context, BCL staff is involved in two work-streams: one on macro financial models, with a focus on the link between financial stability and economic performance, and the other focusing on early warning systems and systemic risk measures.

In March 2011, the BCL organised an international conference in Luxembourg to mark the end of the multi-year research project Perfilux (performance of financial services in Luxembourg), partly financed by the *Fonds National de la Recherche* (FNR). This project involved a collaboration between BCL researchers, the Luxembourg School of Finance (University of Luxembourg) and the STATEC. The BCL also collaborated with the Luxembourg School of Finance on a second FNR project named RISKADBS (Measuring financial stability in Luxembourg: risk adjusted balance sheets).

1.9.6.2 Fondation BCL

Incorporated in 2011, the *Fondation BCL* aims at promoting research and university education in the BCL's fields of activity. The *Fondation*'s byelaws were approved by a Grand-ducal regulation on 12 March 2011.

The Board of Directors of the *Fondation* is constituted of the following members:

Mr. Yves Mersch, President of the Council of the BCL – President

Mr. Serge Kolb, member of the Council of the BCL and Director at the BCL – Managing Director

Mr. Hans Helmut Kotz, Senior Fellow at the Center for Financial Studies, Goethe University, Frankfurt, Honorary Professor at the Fribourg University (D) and former member of the Deutsche Bundesbank's Board of Directors- Director

Mr. Jacques Poos, member of the Council of the BCL – Director

Mr. Patrice Pieretti, Professor at the Luxembourg University and former member of the Council of the BCL – Director

Mr. Romain Schintgen, member of the Council of the BCL – Director

Mr. Henri Sneessens, Professor at the Luxembourg University – Director

Mr. Christian Wolff, Professor at the Luxembourg University, Director of the Luxembourg School of Finance – Director

Mr. Jean-Pierre Zigrand, Professor at the London School of Economics – Director

The Board of Directors of the *Fondation* set as a priority for 2011-2012 research in the field of financial stability, a timely topic for researchers as well as for decision-makers in economic policy. The *Fondation* budgeted in 2011 € 5 000 for a scholarship for doctoral research in the area of financial stability and € 2 000 for the best doctoral thesis defended in 2011. With the collaboration of the CEPR/Euro Area Business cycle Network, the *Fondation BCL* prepares the organisation of an international conference in Luxembourg in 2012.

1.9.7 Conferences and events

The following conferences and events took place in 2011:

- Following the launch of the ECB charity initiative at the end of 2010, the BCL's Governor made a donation of € 6 250 to Mr. Michel Colin, President of the Luxemburg association of assistance to cardiac children, in the context of a ceremony organised at the BCL on February 18. This association, created in January 2002, aims at supporting children and their relatives with the help of cardiologists. The donation results from funds received over the last few years within the framework of the external activities of members of the ECB's Executive Board and of other members of staff of the ECB and are equally distributed in the national central banks of the Eurosystem.

- Conference entitled "Banking, Productivity and Growth" organised on March 28 and 29 at the Chamber of Commerce. This conference resulted from a 3 year research project, partially financed by the *Fonds National de la Recherche Luxembourg* and led by a consortium composed of the BCL, the Luxembourg

School of Finance (University of Luxembourg) and the STATEC. The conference ended with a round table chaired by Professor Paul Wachtel, professor of New York, and with the participation of the BCL's Governor as well as Mr. Serge Allegrezza, Director of the STATEC.

- Seminar and annual conference of the European Supervisor Education Initiative (ESE), which were both organised in Luxembourg. The seminar, from April 5 to April 7, dealt with the subject "Case studies on the development and review of Internal Rating Based models", whereas the annual conference, on September 28 and 29, addressed the following theme: "Financial Crises and the Challenge of Supervision". The European Supervisor Education Initiative association, which the BCL has been a member of since 2010, aims at training supervisors in Europe and at promoting the convergence of practices related to micro-prudential supervision in Europe.

- Organisation, by the association of The Bridge Forum Dialogue, of a round table on the theme "A world without oil?" on April 13 at the European Commission. Mr. Nobuo Tanaka, Executive director of the International Energy Agency, gave his institution's views on the subject. The conference was chaired by Mr. da Silva Caldeira, Vice-president of The Bridge Forum Dialogue.

- A Seminar was organised on the occasion of the presentation of the BCL's Financial Stability Review on April 28, in the presence of several central bank governors and high-level guests and representatives of the Luxembourg and European financial sectors as well as of the academic world. The press conference was followed by a presentation by the Governor of the Bank of Portugal, Mr Carlos da Silva Costa, on the economic and financial situation in Portugal. The seminar consisted of a session on liquidity and leverage and of a panel discussion about financial regulation.

- The 8th annual Summit of the Islamic Financial Services Board (IFSB) took place in Luxembourg from May 10 to May 13. Central bank governors participating in the Summit included the President of the IFSB, H.E. Faris A. Sharaf (Central Bank of Jordan), H.E. Rasheed Mohammed Al Maraj (Central Bank of Bahrain), H.E. Dr Zeti Aziz Akhtar (Bank Negara Malaysia), H.E. Dr Sanusi Lamido Sanusi Aminu (Central Bank of Nigeria) and H.E. Suwaidi Nasser bin sultan Al (Central Bank of United Arab Emirates).

- Contribution to the reflection works on the new financial regulation in Europe during the 6th European Lawyers' forum, which was held in Luxembourg from May 19 to May 21. The BCL's Governor was the Chairperson of the working session on "Crisis management and financial stability" within the topic: "Financial regulation: European law put to the test". Other panellists were: the Minister of Finances Luc Frieden, Professor Helmut Siekmann, from Frankfurt University, Klaus Regling, General Manager of the FESF, Diego Devos, General Counsel of the BIS, and Lars Heikensten, former Governor of the Swedish central bank and General Manager of the Nobel foundation.

- The Seventh Pierre Werner lecture organised by the BCL at the *Centre Culturel de Rencontre Abbaye de Neumünster* on 7July. Mr. Jaime Caruana, General Manager of the Bank for International Settlements, made a speech on the theme: "Regulatory reform: remaining challenges".

- The Bridge Forum Dialogue, organised a round table on the theme "Innovation and competitiveness in Europe" on 6 October at the European Commission. Chaired by Mr. Richard Pelly, Vice-president of the association "The Bridge Forum Dialogue", the conference gave the floor to Mrs Máire Geoghegan-Quinn, as European Commissioner for research, innovation and science.

1.10 EUROPEAN ACTIVITIES

1.10.1 Activities at the level of the ECB

In 2011, the Governor of the BCL participated in 22 meetings of the Governing Council and in the four meetings of the General Council. When making decisions, the members of the Governing Council do not act as national representatives but in their personal capacity, which is reflected in the principle "one member, one vote".

The Governing Council meetings are held twice a month at the ECB's headquarters in Frankfurt. While the first meeting is exclusively devoted to the analysis of economic and monetary evolutions and to monetary policy decisions, the second meeting deals with issues related to the other missions of the Eurosystem. In 2011, more than 500 Executive Board's proposals were adopted by the Governing Council by written procedure; amongst these proposals were many opinions relating to draft laws at the European or national level, according to article 127 paragraph 4 of the Lisbon Treaty.

The General Council meetings, that gather the ECB President, the ECB Vice-President, and the ESCB Governors together, are also held in Frankfurt, four times a year.

Committees assist the decision-making bodies of the ECB in the fulfilment of their tasks. The Governing Council or the Executive Board can ask Committees to carry out analyses on precise topics. The Committees report to the Governing Council through the ECB Executive Board.

Committees were created by the enforcement of article 9.1 of the ECB's rules of procedure. There are currently 17 committees, which are essentially composed of members of the Eurosystem, but can also include, for some issues, ESCB members. Each member is appointed by the Governor of his/her national central bank or, in special cases, by the ECB's Executive Board. Under the aegis of Committees, working groups or task forces are established, with specific objectives, but in conformity with their Committee's mandate. The Governing Council also created High Level Groups to help solve particular issues.

1.10.2 Enlargement of the euro area

On January, 1, 2011, exactly two years after Slovakia, Estonia introduced the euro, bringing the number of member states having adopted the single currency up to 17.

1.10.3 Economic and financial committee (EFC)

A BCL representative participates in meetings of the Economic and Financial Committee (EFC). The EFC is composed of representatives of the finance ministries and central banks of EU Member sates, the European Commission and the ECB. According to the treaty, one of the tasks of the EFC is to "review the economic and financial situation of the Member states and of the Community and to report regularly from there onwards to the Council and to the Commission".

In 2011, the EFC continued to analyse the evolution of financial stability in the EU, including the recapitalisation of the banking sector under the aegis of the new EBA (European Banking Authority) - and the developments in the context of the sovereign debt crisis.

The EFC also handles cases relative to the economic policy discussed in the informal meetings of the ECOFIN Council, in which the BCL Governor participates.

1.10.4 The committee on monetary, financial and balance of payments statistics (CMFB)

In the context of the mission of the Statistical Office of the European Communities (Eurostat), the Committee of Monetary, Finance and Balance of Payments Statistics (CMFB) works on the development and coordination of statistical categories that are required under the policy implemented by the Council, the Commission and various committees assisting them. Central Banks, National Statistics Institutes as well as the Commission and the ECB are represented in the CMFB. Under the leadership of this Committee, different "task forces" operate with specific duties assigned to them.

The BCL actively contributed in 2011 to this framework. Progress was made in particular in terms of financial accounts, balance of payments, financial services and public finance statistics as well as national accounts.

1.10.5 Other activities at the European level

On February 11, Michel Barnier, European Commissioner in charge of the internal market and services, paid a working visit to the BCL. Discussions focused on ongoing reforms in financial regulations, the revival of the European market and the economic situation of Luxembourg.

1.11 NATIONAL AND EXTERNAL ACTIVITIES

1.11.1 National activities

1.11.1.1 Relations with the Parliament

On 8 November, the Governor of the BCL presented the opinion of the Bank on the state budget motion to the Financial and Budget Commission of the Luxembourg Parliament.

1.11.1.2 BCL Committees

The Statistics Committee

The Statistics Committee was set up by the BCL to ensure a constant dialogue between the actors of the financial centre of whom statistical statements are required and of the main users of the concerned data. The Statistics Committee is regularly consulted in the framework of the definition of the reports conducted on the different entities in the financial sector.

Banking and monetary statistics consultative commission (BMSCC)

The BMSCC, put in place by the BCL, aims to ensure an efficient collection of banking and monetary statistics on behalf of the BCL and to ensure dialogue with commercial banks. In 2011, the BMSCC was informed and consulted about conceptual issues related to the modification of the statistics collection, towards security by security statements and to the revision of the statistics collection towards the interest rates practiced by commercial banks.

Balance of payments statistics consultative commission (BPSCC)

The Balance of payments statistics consultative commission acts as an advisory group and assists the BCL in its mission to collect data in the areas of balance of payments and international investment positions. The Commission ensures an efficient organisation of data collection in order to avoid redundancies and to limit the workload for the entities requested to submit statistical data. In 2011, the BPSCC was informed and consulted about the principles to be applied in the field of the new balance of payments statistics. The aforementioned commission presented its opinion on the BCL 2011/n°7 regulation of 4 April 2011 concerning the collection of statistics with banking institutions and with the *Entreprise des Postes et Télécommunications*' finance department.

Economic and financial statistics consultative commission (EFSCC)

The EFSCC has been set up by the BCL to ensure an efficient collection of economic and financial statistics and to establish a dialogue between financial actors and the BCL. The commission was not consulted in 2011 due to the absence of new significant projects.

The Lawyers' committee (*Comité des Juristes*)

The Lawyers' Committee met six times during the year. The Committee provided assistance to the BCL on its examination of the draft law pertaining to dematerialised securities presented in this report, on a preliminary draft law amending the BCL's organic law, on a pre-draft law amending the law of 5 April 1993 relating to the financial sector with respect to its provisions on banks issuing mortgage bonds, on an internal working paper aiming at the creation of a resolution fund in Luxembourg, as well as general assistance on the draft regulations issued by the BCL. It examined the European Economic Governance rules and contributed to a proposal of the BCL for the implementation of the European budgetary rules at the national level.

1.11.1.3 External committees

The Economic Committee (*Comité de conjoncture*)

The Economic Committee acts on the basis of the legislation which authorises the government to take measures in order to stabilise employment. The Committee, therefore, provides a framework for the examination of business cycle fluctuations in the country's economy and for the monitoring of economic policy issues when they arise.

The BCL's contribution to the Economic Committee is two-fold: first, the BCL collects information on Luxembourg's cyclical position and secondly, it contributes to the Committee's work by monitoring and commenting on the latest developments in monetary areas and in the financial sector.

The Consumer Price Index Commission

The BCL has an observer status at the meetings of the Consumer Price Index Commission (CPIC), which is in charge of advising and assisting the STATEC in the preparation of consumer price indices. This Commission also issues technical opinions on the design of the monthly consumer price index and supervises the compliance of this index with national and European regulations. The BCL presents its inflation projections for Luxembourg to the CPIC and provides explanations on the BCL's work in the area of consumer prices.

Banking accounting committee *(Comité "Comptabilité bancaire")*

This committee, set up by the *Commission de surveillance du secteur financier* (CSSF), aims to ensure an exchange of views between the supervisory authority, the BCL and the actors of the Luxembourg financial centre. The committee is consulted during the preparation by the CSSF of circulars concerning bank accounting issues.

Higher Council for Statistics of Luxembourg

The Higher Council for Statistics carries out advisory functions on behalf of the STATEC and is mandated to appraise the STATEC's annual programme.

The BCL's contribution to the work of the Higher Council for Statistics is two-fold: on the one hand, the BCL provides its opinion on the documents elaborated during meetings and submitted to it and, on the other hand, it also provides the STATEC with data collected on the financial centre to enable the latter to achieve its work Programme.

XBRL Luxembourg asbl

XBRL (eXtensible Business Reporting Language) is a financial reporting standard based on XML, whose main objective is to improve the correct character, transparency and efficiency of internal and external statements. The non-profit association XBRL Luxembourg asbl includes some twenty organisations using XBRL and/or providing services related to XBRL technology. The role of the association is to promote the XBRL standard within Luxembourg's economy. The BCL, as a founding member of XBRL Luxembourg, will analyse the potential to adopt the XBRL standard in the context of the statistical statements it collects from companies in the Luxembourg financial sector.

The Operational Crisis Prevention Group (OCPG)

The BCL established the Operational Crisis Prevention Group (OCPG) with the intention of enhancing the financial sector's preparation with regards to large-scale operational disruptions. Members include the ABBL, the CSSF and critical market participants. The group met twice in 2011.

1.11.2 External activities

1.11.2.1 The BCL's multilateral activities

Activities at the level of the IMF

The BCL handles Luxembourg's financial transactions with the IMF. It therefore manages Luxembourg's assets and liabilities vis-à-vis the IMF in both the general account and the Special Drawing Rights (SDR) account. As of 31 December 2011, Luxembourg's quota, recorded in full on the BCL's balance sheet, amounted to SDR 418.7 million, in comparison with SDR 279.1 million at the end of 2010. On this same date, the reserve position (the difference between Luxembourg's total quota at the IMF and the euro-denominated assets held by the IMF at the BCL) represented 37.57 % of Luxembourg's quota.

The IMF's operational budget defines the currencies to be made available by its members on a quarterly basis and the distribution of reimbursements among its members. Thus, during 2011, the BCL granted credits amounting to SDR 71.6 million. At the end of the year, the credits granted by Luxembourg according to the New Arrangements to Borrow (NAB) reached SDR 66.8 million.

At the end of the year 2011, Luxembourg held SDR 243.83 million, that is, 98.87 % of its SDR allocation, in comparison to 98.67 % at the end of 2010. The BCL Governor, being also the Alternate Governor for Luxembourg at the IMF, attended the Annual Meeting of the IMF and the meetings of the International Monetary and Financial Committee (IMFC). A BCL member is on secondment with the IMF.

Activities at the level of the IILM

The International Islamic Liquidity Management Corporation (IILM) is an international institution created in October 2010 by twelve central banks and two multilateral organisations from Asia and Africa.

The BCL co-established this organisation in order to participate in the creation of short-term sharia-compliant financial securities, thus facilitating the cross-border management of liquid assets of institutions offering sharia-compliant financial services and, more generally, contributing to the strengthening of financial stability. The BCL Governor was appointed Vice-president of the IILM's Board of Directors, the IILM's main decision-making body consisting of the governors of the main founding members. The Board of Directors is responsible for defining the strategic vision and for the approval of the operational guidelines for the IILM's development.

In this context, the BCL Governor participated in the Board meetings and in the General Meeting that took place in the course of 2011.

The BCL's membership to the Bank for international settlements (BIS)

On the occasion of the Annual General Meeting of the Bank for International Settlements (BIS), the BCL was invited to become a member of the BIS, according to article 8.3 of the statutes of the BIS.

Established in 1930, the BIS, which has its headquarters in Basel, is the oldest international financial institution. It promotes the cooperation between central banks and contributes to the establishment of international standards in banking areas. The BIS has at present about sixty members from advanced and emerging countries.

This membership also allows the BCL to be more closely associated with the activities of the various committees and working groups of the BIS. Besides its participation in the Committee on the Global Financial System (CGFS) and in the Annual General Meeting of the BIS, the BCL was also represented by its Governor in the meeting on the world economy (Global economy meeting) and in the meeting of governors (Governors' meeting), which both take place once every two months in Basel.

Activities at the level of the Financial Stability Board (FSB)

The Financial Stability Board was established to coordinate the work of the national financial authorities and the organisations elaborating standards in the field of financial stability.

In 2011, the FSB established regional consultative groups thus bringing the authorities of the financial sector, who are members of FSB, and some non-member jurisdictions together, in order to exchange views on the vulnerabilities which may affect financial systems as well as on present and future initiatives to promote financial stability.

The regional consultative Group for Europe is co-chaired by the BCL Governor, who was elected by the non-members of the FSB, and by Mr. Tom Scholar, the Second Permanent Secretary of the UK Treasury, who was appointed by the members of the FSB. The regional consultative Group for Europe held its inaugural meeting on December 6 in Luxembourg. During this meeting, members discussed the work plan and the priority themes of the FSB, as well as the main reforms concerning financial supervision and their potential repercussions, financial vulnerabilities and financial stability at the regional level.

Participation in seminars or high-level conferences

- Participation in the *Official Monetary and Financial Institutions Forum* (OMFIF), organised at *De Nederlandsche Bank*, on March 24 and 25, on the theme: "Europe's place in the world economy". The BCL Governor gave a speech on the future of Europe.

- Participation of the BCL Governor in the "Conference on The State of the Union", organised on 9 and 10 May in Florence. At this two-day conference, organised in the context of Europe's day, participated, among others, José Manuel Barroso, President of the European Commission, Jerzy Buzek, President of the European Parliament, Franco Frattini, Italian Minister of Foreign Affairs and Lorenzo Bini Smaghi, member of the ECB Executive Board. During the session entitled "The Euro and Global Economic Governance", the BCL Governor gave a speech on the state of EMU.

- Speech of the BCL Governor during a conference organised in Zurich on May 23, under Gérard Philipps' patronage, Ambassador of Luxembourg in Switzerland, and introduced by Philipp Hildebrand, President of the Swiss National Bank, on the theme: "International Financial Centres after the Crises".

- Participation of the BCL Governor in the "Economic Ideas Forum" (EIF), in London, on May 26. The forum, organised by the *Center of European studies*, gathers high-level governmental representatives, managers of companies and other influential actors of Europe and of the United States together. The BCL Governor participated in this context in a panel of discussion chaired by Tom Spencer, Executive Director, European Center for Public Affairs, tackling the following theme: "Allies or Competitors? Cooperation across the Atlantic - Reforming Financial Services".

- Speech of the BCL Governor in the *Bankhaus Joh. Berenberg, Gossler and Co. KG*, in Hamburg, on June 16, on the theme: *Der Euro nach der Krise - geld-, währungs- und europapolitische Herausforderungen* (The euro after the crisis - challenges for monetary- and European policy).

- Participation of the BCL Governor in the symposium organised by the Federal Reserve of Kansas City, in Jackson Hole, on August 26 and 27. The discussions addressed, in particular, conditions for global economic growth.

Multilateral activities with the Government

The BCL Governor went to Washington from April 15 to April 17 and from September 22 to September 25 on the occasion of the Spring Meetings and the Annual Meetings of the IMF and the World Bank. He participated in theses meetings along with the Luxembourg Prime Minister and the Minister of Finance.

1.11.2.2 Bilateral relations

The BCL Governor accompanied the economic mission in Qatar, chaired by H.R.H. the Hereditary Grand Duke and led by the Minister of Economy and Foreign Trade, Jeannot Krecké, on November 23. On this occasion, the BCL Governor signed a Memorandum of Understanding with H.E. the Sheikh Abdullah Bin Saud Al Thani, Governor of the Central Bank of Qatar. The memorandum strengthens the cooperation between both central banks, in particular through exchanges of information in the fields of financial stability, payment systems and research.

The signing ceremony took place on the premises of the Central Bank of Qatar, in the presence of H.R.H. the Hereditary Grand Duke and the Minister of Economy and Foreign Trade. A working visit with the Minister of Finance of Qatar, Youssef Hussain Kamal, also took place.

02

THE BCL AS AN ORGANISATION

2
THE BCL AS AN ORGANISATION

2.1 CORPORATE GOVERNANCE

2.1.1 The Council

Article 6 of the Organic Law of 23 December 1998 defines the powers of the Council of the BCL. In 2011, the Council consisted of the following members:

President: Yves Mersch
Members: Pierre Beck
Pit Hentgen
Serge Kolb
Yves Nosbusch
Jacques F. Poos
Romain Schintgen
Michel Wurth
Claude Zimmer

In 2011, the Council held six meetings. Within the framework of monitoring the financial situation of the Bank, the Council approved the financial accounts of 31 December 2010, the budgetary trends and, subsequently, the budget for the 2012 financial exercise.

The Council also observed and commented on economic and financial developments on a national and international basis and was kept informed of the decisions taken by the Governing Council of the ECB.

From l. to r.: Mr. Claude Zimmer, Mr. Yves Nosbusch, Mr. Pierre Beck, Mr. Pit Hentgen, Mr. Yves Mersch (Président), Mr. Jacques F. Poos, Mr. Serge Kolb, Mr. Michel Wurth, Mr. Romain Schintgen.

The Audit Committee

Since 2001, the Audit Committee has assisted the Council in selecting the statutory auditor which is then proposed to the Government, in specifying the scope of potential specific controls to be performed by the statutory auditor and in approving the financial accounts by the Council. It is kept informed of the developments of the internal audit plan.

The Audit Committee may invite the head of the internal audit unit and the statutory auditor of the Bank to participate in its work.

At its meeting on 15 December 2011, the Council nominated the non-executive members of the Audit Committee for 2012: Messrs Jacques F. Poos, Romain Schintgen and Claude Zimmer. Mr Yves Mersch is an *ex officio* member in his function of President of the Council. In 2011, the Audit Committee was chaired by one of its non-executive members, Mr Jacques F. Poos, and held six meetings.

2.1.2 The Board of Directors

The Executive Board is the superior executive authority of the BCL. It makes decisions and draws up the measures necessary for the BCL to be able to carry out its tasks. Without prejudice to the independence of the Governor with regard to all instructions in his capacity as a member of the Governing Council of the ECB, the decisions of the Executive Board are taken collectively.

The Executive Board consists of a Director General (or Governor) and two Directors:

Director General: Yves Mersch
Directors: Serge Kolb
Pierre Beck

The members of the Executive Board receive a salary according to the wage scale in the public sector as well as different allowances. They receive, in accordance with the legal provisions of the law of 22 June 1963 determining the salary scheme for civil servants, a family allowance depending on their domestic situation and a thirteenth month's allowance.

Mr. Serge Kolb, Mr. Yves Mersch, Mr. Pierre Beck

The remuneration components are subject to the current legal tax rates in Luxembourg. The thirteenth month's allowance as well as the representation and the BCL's Council allowances are excluded from pensionable earnings. The basic salary paid to the Executive Board members is as follows:

	Salary
Yves Mersch (Director General)	165 691 €
Serge Kolb (Director)	154 044 €
Pierre Beck (Director)	154 044 €
Total	**473 779 €**

Besides, in relation to their function within the Bank, board members are also entitled to the payment of a representation allowance (for a total amount of € 73 641 in 2011) and to a BCL's Council allowance (for a total amount of € 34 524 in 2011).

2.1.3 Organisational Chart

DIRECTOR GENERAL
2 Directors

Heads of General Departments

Internal Audit and Risk Prevention
Internal Audit Section
Risk Prevention Section

Financial Risk and Collateral Management Division
Collateral Management Section
Financial Risk Management Section

Eurosystem Procurement Co-ordination Office

General Secretariat
Governor's Office Section
Legal Services Section
External Relations and Communication Section

Infrastructures and Payment Systems Section

Economics and Research Department
Business Cycle Section
Research Section

Statistics Department
Banking and Monetary Statistics Section
External Statistics Section
Economical and Financial Statistics Section

Operations Department
Monetary Policy Implementation Section
Front Office - Asset Management Section
Back Office Section
Payments Section

Currency and Numismatics Department
Currency Operations Section
Currency Handling Control Section
Numismatics Section

Financial Stability and Prudential Surveillance Department
Financial Stability Division
Financial Stability Section
Prudential Surveillance and Oversight Division
Liquidity Surveillance Section
Oversight Section

Internal Finance and Strategy Department

Information Technology Department
Infrastructure Section
Software and Development Section
Planning and Support Section

Human Resources Department

Corporate Services Department
Procurement Section
Facilities Section
Security Section

(as from 1 January 2011)

2.1.4 Internal control and risk management

The BCL's internal control system is based on generally accepted principles in the financial sector and on the ESCB considerations of the BCL's specific needs as a central bank.

The Executive Board has defined the general framework and principles of the internal control system. The management of the BCL and their staff are responsible for the proper functioning of the internal control system. Functional reviews are carried out by specific administrative units, ensuring an adequate segregation of duties. These units are the Financial risk management and Collateral management sections, the Risk Prevention section as well as the Controlling function within the Internal Finance and Strategy department.

The Financial risk management section is in particular in charge of the analysis of financial risks, of the surveillance of the implementation of decisions made by the internal committees and by the Executive Board, of the surveillance of compliance with established limits and of the production of regular reports in this area. In order to consider the increasing importance of risks in the field of the management of collateral, a section "Collateral management" was constituted as of 1 January 2011 within the Financial risk and Collateral management division.

The Risk Prevention section is in charge of the surveillance of operational risks, of risks related to information systems and of non-compliance risks.

Whereas departments are responsible for identifying the risks linked to their fields of activities and for taking appropriate actions to mitigate these risks, the Risk Prevention section has the following responsibilities:
- Establish a common methodology for risk analysis;
- Provide assistance in the identification and evaluation of risks;
- Ensure a periodical reporting.

The Risk Prevention section is also in charge of coordinating the Business Continuity Plan and the related testing.

The purpose of the Compliance function is to identify, evaluate and monitor the Bank's risk of non-compliance. The risk of non-compliance is defined as the risk of judicial, administrative or disciplinary sanctioning, of financial losses or reputational damage which could harm the BCL in the event that it would not comply with the laws, regulations, professional and ethical standards or internal instructions.

The Executive Board of the BCL identified several areas of intervention for the Compliance function, in particular:

- anti-money laundering (AML) and financing of terrorist activities;
- professional code of ethics;
- prevention of insider trading and market abuse;
- conflict of interests;
- professional secrecy and confidentiality;
- privacy and protection of personal data;
- regulation of public markets.

The Internal Audit unit ensures a second layer of control which consists of the independent and objective assessment of the internal control system and its functioning. This unit analyses and evaluates, on the basis of predefined objectives and a specified methodology, the adequacy and effectiveness of the existing internal control system. The Internal Audit is independent of the BCL's other administrative units and reports directly to the President of the Council. When performing its tasks, the work of the Internal Audit unit is based on internationally accepted professional standards, applied at the level of the ESCB.

The internal annual audit plan comprises audit commitments on a national level, as well as audit objects that are coordinated by the Internal Auditors Committee of the ESCB in compliance with the ESCB audit policy. The Internal Audit unit is in charge of following-up on the recommendations issued during its audit activities.

Finally, the Audit Committee is informed of the organisation of internal controls, of their risk management as well as their functioning.

2.1.5 External control

In accordance with article 15 of the BCL's organic law, the Bank's financial accounts are audited by an external auditor nominated for five years by the Government. The mandate of the external auditor includes the verification and the certification of the BCL's financial accounts. Moreover, the external auditor is mandated by the Bank's Council to perform additional reviews and specific controls on an annual basis.

At the European level, the BCL's external auditor is approved by the Council of Ministers upon recommendation of the Governing Council of the ECB. In this context, the external auditor is also entrusted with the performance of a certain number of specific commitments at the Eurosystem level.

The statutes of the ESCB and of the ECB provide that National Central Banks act in accordance with ECB guidelines and instructions. The respect of these provisions is monitored at the European level by the Governing Council of the ECB which may request any additional information.

2.1.6 Code of Conduct

A Code of Conduct defines the internal and external rules of conduct applicable to all staff members. The Code is valid without prejudice to the rules defined by the public services legislation, the social legislation as well as existing contractual commitments. It prescribes ethical standards of non-discrimination, solidarity, efficiency, and independence, to which the BCL's staff has to adhere to strictly.

Moreover, the European Central Bank requires individual adherence by Governing Council members to its own Code of Conduct, which demands particularly strict adherence in terms of professional ethics.

The members of the Governing Council are required to display honesty, independence, impartiality, and discretion. They are asked to not take their personal interests into consideration and to avoid any situation that may lead to a conflict of interests. These obligations extend to one year after the termination of their function. The conditions concerning participation in conferences, receptions or cultural events are also specified in the Code of Conduct.

Members of the Governing Council are invited to be particularly careful regarding individual invitations. The same rules apply to their spouses or partners who are equally obliged to respect the generally accepted rules concerning international relations, as well as to events taking place outside the ESCB. Finally, members of the Governing Council must neither disclose nor make use of confidential information when executing financial transactions on a private basis, either directly or indirectly via intermediaries.

2.2 THE BCL'S STAFF

2.2.1 Quantitative evolution

In the course of 2011, the BCL staff increased by 7.1 % to reach a total of 287 staff members on December 31, 2011, equivalent to 272.75 full-time positions. Staff members are of 17 different nationalities, thus contributing to the diversity of the human capital and to its cultural enrichment.

On December 31, 2011, 32 staff members worked part-time:
- Part-time work (50 %): 9 staff members
- Part-time work (75 %): 9 staff members
- Leave for half-time work: 14 staff members

No staff member was on parental leave on December 31, 2011.

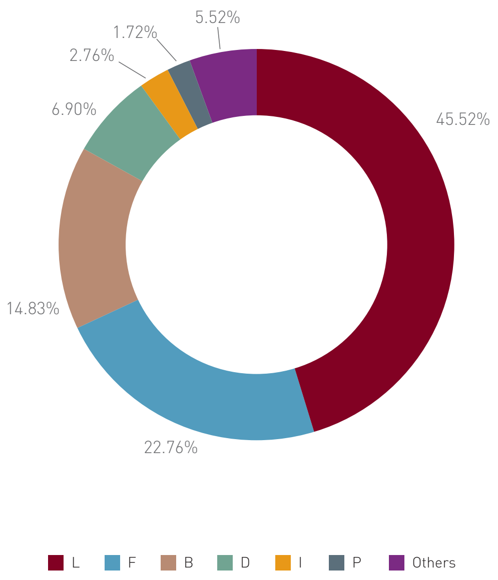
Five staff members were on unpaid leave on this date and two staff members were on special leave.

The average number of staff members working at the BCL in 2011 was 279 persons or 260 full-time equivalents (FTE).

The overall approved headcount cap for the year 2011 was 286.75 full-time equivalent positions.

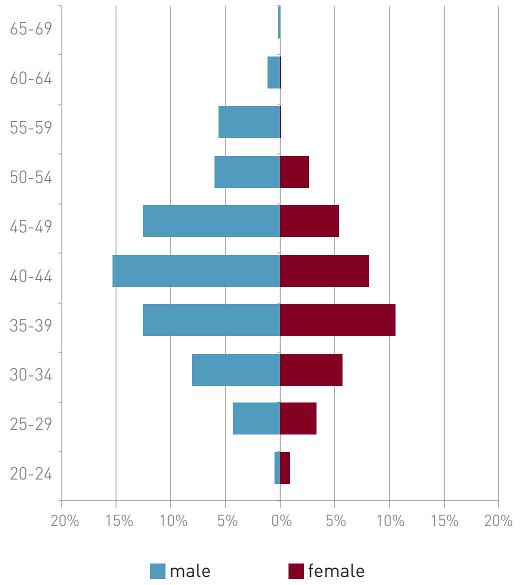
During the year 2011, 12 staff members left the bank. On the other hand, 31 new staff members joined the bank during that same period.

Chart 20:
Staff members by nationality



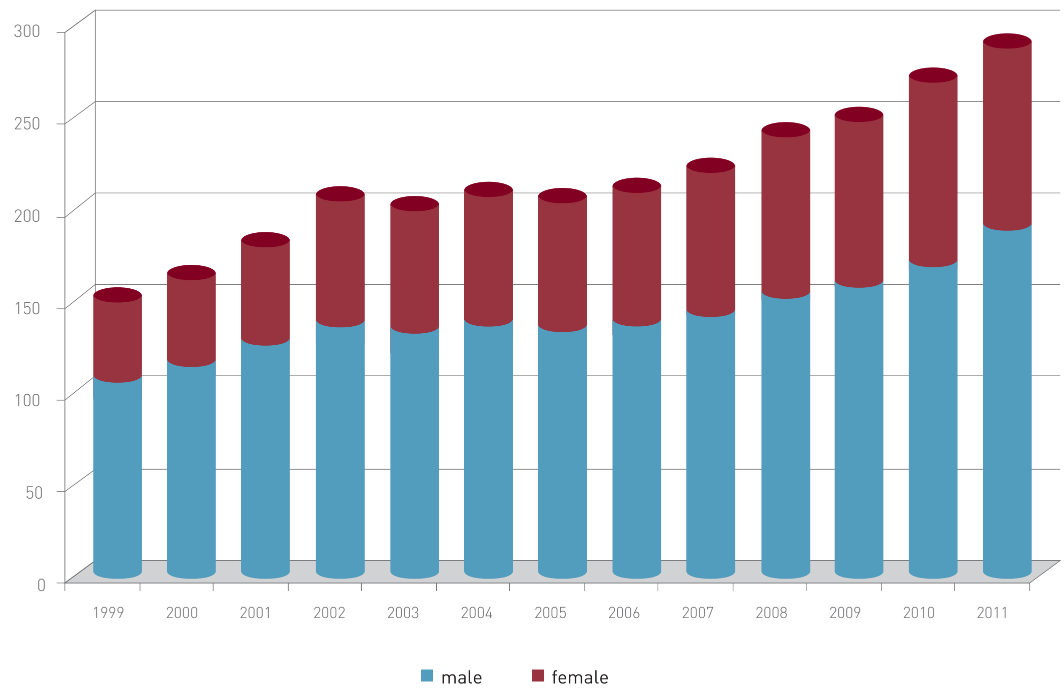
Source: BCL

Chart 21:
Age pyramid



Source: BCL

Chart 22:
Headcount evolution (male, female)



Remark: All charts figures comprise the three Board members.

Source: BCL

2.2.2 The pension fund

Article 14 of the Organic Law of 23 December 1998 provides that legal pension entitlements of BCL agents are determined by their status: civil servant, State employee, private employee or worker.

Paragraph 4(b) of this article provides that: "The pensions of the Bank's agents shall be paid by the Bank. These costs shall be financed by a pension fund of the Bank. The pension fund shall be financed on the one hand by statutory deductions from agents' salaries in accordance with the rules governing the pension scheme which is linked to an individuals status, and on the other hand by contributions made by the Bank itself."

The BCL's pension fund, which started operating in 2001, is governed by a set of internal rules and two committees, one executive and one consultative.

The executive committee is the *Comité directeur* composed of the BCL's Board of Directors, two elected representatives from the staff, two co-opted members acting as delegated managers and one member designated by the Staff Committee. The consultative committee is the Tactical Benchmark Committee.

2.3 LOGISTICS

2011 was essentially marked by public tenders for the benefit of the following activities:
- Cleaning of buildings;
- Exchange of an absorption unit by a « turbocor » machine;
- Maintenance of the technical installations of the BCL premises.

The project to replace an absorption unit by a « turbocor » machine is part of the environmental concept of the BCL, which focuses on the following three pillars:
- Increased efficiency in waste management;
- Reduction of energy consumption as well as of CO_2 emissions;
- Staff awareness concerning the efficient use of energy.

It is also planned to supply the BCL with «green» electricity in order to improve its environmental footprint. In 2011, gas consumption was reduced by about 130 000 m^3. Electricity consumption stabilised on a downward trend.

The staff entrance was transformed to allow easy access to headquarters for disabled people. The departure of one of the tenants in the Monterey building freed office space for staff increases in 2012.

2.4 INTERNAL FINANCE AND STRATEGY

2.4.1 Accounting and reporting

The BCL continued to update its accounting system and its procedures in order to meet its internal quality standards and those of the Eurosystem. The BCL continued to take part in the working group relating to the operations on the Eurosystem's financial matters and adopted these accounting techniques in the BCL's systems.

The Eurosystem requires the daily reporting of balance sheet data according to harmonised rules. The controlling systems in place proved to be effective during the year.

The BCL regularly checks the development of balance sheet, off-balance-sheet and profit and loss items. Investments, revenues and expenses are particularly closely monitored with special attention given to signing powers.

The monthly balance sheet of the Bank is published on its website.

The management information system allows following the Bank's activities. It is based on a set of indicators, which are calculated daily, weekly, monthly, quarterly and annually. These tables include all activities of the Bank. The Bank strictly controls the development of the interest margin and compares the profitability of its investments to benchmarks.

The Bank performs static and dynamic assessments of its long-term financial situation. It carries out prospective analyses of external factors like interest rates, exchange rates and other variables of the Eurosystem and of the economic situation. The Bank's decision-making bodies are regularly informed of the results in order to be in a position to decide on the future directions and on the actions to be taken.

The selection process concerning new software relating to the portfolio of securities was finalised in 2011. The go-live should become effective in 2012.

2.4.2 Budget

Budget preparation, in accordance with the Organic Law of the BCL, is part of the multi-year planning process of the Bank whose primary purpose is to ensure long-term financial stability. The annual budget determines the upper limit of operating expenditure and investment the Bank may incur during a given exercise. Furthermore, the BCL's budget is based on the corporate values of the Bank, notably:

- Professionalism;
- Quality in all its services;
- Stability provided by a long term vision of all its activities;
- Objectivity, resulting from the establishment of precise rules that are uniformly applied;
- Integrity, guaranteed by the transparency of its internal operation and by respect for professional ethics.

The BCL's 2011 budget was established under the terms of the budgetary procedure CI99011 and guidelines set by the Bank's Council dated 14 July 2010. The 2011 budget was approved by the BCL's Council on 11 February 2011.

The 2011 budget takes the following elements into account:

For years, the number of tasks assigned to the BCL at both the national and European level has been in constant rise. The continuous assignment of new tasks and the persisting crises implies a necessary reinforcement of the Bank's staff in both operational and support units. This trend holds for 2011.

Taking the ongoing financial crisis into account , the low interest rates and the fact that the BCL still lacks appropriate own funds, decision-making bodies of the BCL have intensified the existing economy measures. These efforts have helped to reduce the operating budget (excluding staff costs) of 3.1 % compared to 2010, despite a simultaneous increase in employment.

The BCL continues to implement internal and European projects, with a direct impact on the overall budget size.

The Internal Finance and Strategy Department supervises the execution of the budget and prepares quarterly reports for the Executive Board of the Bank. At the end of each fiscal year, a detailed analysis of initial budget vs. actual expenditure is prepared. This analysis is submitted to the Executive Board and to the Council of the Bank for information and approval. Finally, conclusions drawn from this comparison are taken into account for the preparation of future budgets. The actual expenditure for operational and investment charges as of 31 December 2011 remained within the boundaries established by the budget.

2.4.3 Strategic planning and management control

Management control aims at enhancing efficiency and accountability within the Bank, allowing the Executive Board to limit its regular involvement in operational tasks and to concentrate on management and decision-making on a strategic level. Consequently, management control helps the Executive Board of the Bank by providing quantitative and qualitative analyses, thus facilitating and supporting an efficient decision-making process. Furthermore, since end 2010 management control has been entrusted with coordinating and monitoring the Bank's internal projects.

In 2011, the BCL reinforced its project coordinating activities. Based on a recently revised internal procedure on the management of internal projects, management control has issued regular project monitoring reports and offered secretariat services to the BCL's project steering committee. Furthermore, representatives of the BCL have participated in a series of project controlling activities at the ESCB/Eurosystem level related to the preparation and monitoring of common IT projects. In 2011, these ESCB/Eurosystem controlling activities saw a significant increase. This trend is likely to continue in the following years.

Cost accounting, as part of the BCL's management control function, serves as a method of identifying, analysing and monitoring activity-related costs (Activity Based Costing). Furthermore, it establishes the financial figures for the invoicing of services. The applied cost accounting methodology follows the common rules adopted by the Eurosystem. It consists of allocating the BCL's operational expenses according to their destination, i.e. according to the respective sections and units, and it permits to allocate the costs of each of the Bank's activities.

In order to facilitate the planning and monitoring of staff resources, in 2011 the BCL adopted a new analysis tool for measuring and evaluating internal resource allocation in regard to the various functions of a central bank. Together with an enhanced cost accounting system this shall allow senior and higher management to improve the monitoring of the operational performance of the Bank. Moreover, regular reports containing both financial and operational indicators will facilitate the alignment of tasks and activities with strategic orientations and identified objectives of the Bank.

As the BCL continues to grow, the strengthening of medium and long-term planning remains a core requirement. Consequently, the BCL reinforced in 2011 its management control team to assist the "strategic planning" function of the Bank.

2.5 THE EUROSYSTEM PROCUREMENT COORDINATION OFFICE (EPCO)

In December 2007 the ECB Governing Council selected the BCL to establish and host a new coordination entity, the Eurosystem Procurement Coordination Office (EPCO) from 1 January 2008 for a period of five years (EPCO's first mandate).

The objective of EPCO is to ensure a better coordination of the joint procurement of goods and services by those ESCB Central Banks that have committed themselves to participate in EPCO's activities during the first mandate ("EPCO central banks"[1]), as well as to further improve best practices in the field of public procurement.

The procurement experts of the EPCO central banks met six times in 2011. The activity of exchange of best practices served to build up the reference set of information regarding public procurement procedures for all these banks.

The third joint procurement plan of EPCO was implemented in 2011 and made significant progress in a number of areas. The joint procedures on air transport for ESCB meetings and global hotel agreements were renewed and the joint procurement on IT systems consultancy services was concluded. In addition, eight other procurements (including in the areas of market data, ratings data, IT - also covering statistical software products) progressed significantly. Furthermore, EPCO coordinated a number of studies identifying potential joint procurement areas including IT products, office supplies and banknote-related services.

Following the approval of the ECB Governing Council of the "Mid-term Review of EPCO's activities", which provided an analysis of EPCO's functioning during the first half of its mandate and provided recommendations for the second half, EPCO was given a more ambitious role in the area of joint procurement procedures. Henceforth, the BCL, as host central bank, may take, with EPCO's support, the role of "Lead Central

1 In 2011, in addition to the Eurosystem Central Banks, the Central Banks of Romania (Banca Nationala a României), Hungary (Magyar Nemzeti Bank) and Poland (Narodowy Bank Polski) were the EPCO Central Banks.

Bank" in joint procurement procedures. In 2011, this was the case for the joint procedure on global hotel agreements.

Furthermore, in 2011, EPCO collaborated and provided support in procurement-related activities on two common ESCB projects to the Eurosystem central banks leading these projects: the Common Eurosystem Pricing Hub (CEPH) and TARGET2-Securities (T2S).

To the benefit of all EPCO central banks, and based on the work carried out by the Working Group of Legal Experts of EPCO central banks, the latter has developed a document on "General terms and conditions for EPCO joint procurements".

The ECB Governing Council approved EPCO's Annual Activity Report for 2010 in June 2011. This report confirmed that the outcome of the 2010 budget was € 316 313 below the initially budgeted amount, and fixed the distribution of EPCO's operational costs between the participating central banks in line with the new cost-sharing mechanism approved by the Governing Council in December 2010.

In December 2011, the ECB Governing Council approved the procurement plan of EPCO for 2012 ("EPCO Procurement Plan – Update 2012") as a multi-annual procurement plan. This procurement plan widened the scope of EPCO activities for 2012, to include a total of fifteen joint procurement procedures, as well as three areas for study and strengthened the coordination of future joint procurements of the EPCO central banks, without prejudice to developments deriving from EPCO's first mandate.

In December 2011, the ECB Governing Council approved a € 1.67 million budget for EPCO for 2012.

2.6 FINANCIAL STATEMENTS

2.6.1 Key figures as of year-end (in euro unless otherwise indicated)

Preamble

Only the French version of the present financial statements has been reviewed by the Independent Auditor. Consequently, the financial statements only refer to the French version of the financial statements; other versions result from a meticulous translation made under the responsibility of the Board of Directors. In case of differences between the French version and the translation, the French version is binding.

	2011	2010	Change in % 2011/2010
Total assets	127 206 165 402	79 719 605 521	60 %
Banks' current accounts	51 222 835 819	9 641 729 532	431 %
Claims on credit institutions	5 198 700 000	2 768 600 000	88 %
Own funds [1], revaluation accounts, administrative provisions and specific banking risks	813 457 921	784 541 974	4 %
Net result of banking activities [2]	201 723 709	128 340 403	57 %
Total net revenues	56 848 734	48 612 237	17 %
Administrative expenses	51 879 107	42 723 146	21 %
Net profit	1 015 713	1 719 034	-41 %
Cash Flow [3]	159 664 100	170 892 549	-7 %
Staff	287	268	7 %
BCL's part in the capital of the ECB	0.1747 %	0.1747 %	
BCL's part in the Eurosystem's monetary policy operations	0.602 %	0.506 %	

[1] Capital, reserves, provisions for general banking risks and net profit to be affected to the reserves
[2] Net ajusted interest income, net result from fees and commissions, net result on financial operations
[3] Net profit plus depreciation of tangible / intangible assets and write-downs on financial assets, as well as net transfers to administrative provisions and provisions for banking risks

2.6.2 Report of the *Réviseur d'Entreprise agréé*

To the Council of the BCL
To the Government
To the Chamber of Representatives

We have audited the accompanying financial statements ("*les comptes financiers*") of the BCL, which comprise the balance sheet as of December 31, 2011 and the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the preparation and presentation of the financial statements

The financial statements are under the responsibility of the Directors and are approved by the Council. The Directors are responsible for the preparation and fair presentation of these financial statements in accordance with generally accepted accounting principles and those defined by the European System of central banks. The Directors are also responsible for the internal control they deem necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Responsibility of the Réviseur d'Entreprises agréé

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted for Luxembourg by the *Commission de Surveillance du Secteur Financier*. The standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the judgment of the *Réviseur d'Entreprises agréé*, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making these risk assessments, the Réviseur d'Entreprises agréé considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes the task of evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the BCL as of December 31, 2011, and of the results of its operations for the year then ended in accordance with generally accepted accounting principles and those defined by the European System of central banks.

Luxembourg, March 8, 2012

KPMG Luxembourg S.à r.l.
Cabinet de révision agréé

K. Riehl S. Chambourdon

2.6.3 Balance sheet as at 31 December 2011

ASSETS	Note	2011 EUR	2010 EUR
Gold and gold receivables	3	87 730 236	76 277 814
Claims on non-euro area residents denominated in foreign currency	4	695 481 591	559 565 189
- Receivables from the IMF		555 314 575	358 082 581
- Balances with banks, security investments,		140 167 016	201 482 608
Claims on euro area residents denominated in foreign currency	5	3 634 661 746	95 157 125
Claims on non-euro area residents denominated in euro	6	2 045 154 537	1 559 679 672
- Balances with banks, security investments and loans		2 045 154 537	1 559 679 672
Lending to euro area credit institutions related to monetary policy operations denominated in euro	7	5 198 700 000	2 768 600 000
- Main refinancing operations	7.1.	1 849 200 000	1 125 600 000
- Long-term refinancing operations	7.2.	3 349 500 000	1 643 000 000
Other claims on euro area credit institutions denominated in euro	8	1 120 880 261	1 014 440 661
Securities of euro area residents denominated in euro	9	4 193 925 411	4 004 164 315
- Securities held for monetary policy purposes	9.1.	643 439 782	430 742 233
- Other securities	9.2.	3 550 485 629	3 573 422 082
Intra-Eurosystem claims	10	109 438 006 356	67 999 926 986
- Participating interest in ECB	10.1.	21 608 286	18 696 620
- Claims related to the transfer of foreign reserves	10.2.	100 638 597	100 638 597
- Other claims within the Eurosystem	10.3.	109 315 759 473	67 880 591 769
Items in course of settlement		629	728
Other assets	11	791 624 635	1 641 793 031
- Tangible and intangible fixed assets	11.1.	52 300 903	55 197 792
- Other financial assets	11.2.	193 998 587	111 143 624
- Accruals and prepaid expenses	11.3.	187 326 773	151 721 511
- Sundry	11.4.	357 998 372	1 323 730 104
Total assets		**127 206 165 402**	**79 719 605 521**

The notes are annexed in section 2.6.6 "Notes to the financial statements as at 31 December 2011"

LIABILITIES	Note	2011 EUR	2010 EUR
Banknotes in circulation	12	2 039 401 260	1 935 513 110
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	13	51 222 835 819	9 641 729 531
- Current accounts (covering the minimum reserve system)	13.1.	10 844 067 972	6 435 590 706
- Deposit facility	13.2.	37 035 967 847	2 986 138 825
- Fixed-term deposit	13.3.	3 342 800 000	220 000 000
Liabilities to other euro area residents denominated in euro	14	702 053 478	347 975 936
- General government	14.1.	501 918 650	347 825 258
- Other liabilities	14.2.	200 134 828	150 678
Liabilities to non-euro area residents denominated in euro	15	1 397 788 044	1 230 361 599
Liabilities to euro area residents denominated in foreign currency	16	14 664	22 307 244
- Financial institutions		14 664	22 307 244
Liabilities to non-euro area residents denominated in foreign currency	17	187 606 132	74 676 245
Counterpart of special drawing rights allocated by the IMF	18	292 666 872	285 391 510
Intra-Eurosystem liabilities	19	69 994 510 855	64 974 757 810
- Net liabilities related to the allocation of euro banknotes within the Eurosystem	19.1.	69 994 510 855	64 974 757 810
Items in course of settlement	20	2 461 369	285
Other liabilities	21	358 065 654	209 863 308
- Off-balance sheet instruments revaluation differences		78 276 830	-
- Accruals and income collected in advance		242 423 410	175 407 214
- Sundry		37 365 414	34 456 094
Provisions	22	590 758 625	515 628 167
Revaluation accounts	23	233 292 285	297 706 144
Capital and reserves	24	183 694 632	181 975 598
- Capital	24.1.	175 000 000	175 000 000
- Reserves	24.2.	8 694 632	6 975 598
Profit for the year		1 015 713	1 719 034
Total liabilities		**127 206 165 402**	**79 719 605 521**

The notes are annexed in section 2.6.6 "Notes to the financial statements as at 31 December 2011"

2.6.4 Off-balance sheet as at 31 December 2011

	Note	2011 EUR	2010 EUR
Foreign exchange swap	25	3 464 666 510	-
Custody deposits	26	170 820 403 147	210 222 286 690
Foreign currency reserve assets managed on behalf of the ECB	27	326 078 364	304 680 837
Forward transactions	28	88 318 113	121 668 500
Numismatic collection		207 533	207 417
		174 699 673 667	**210 648 843 444**

The notes are annexed in section 2.6.6 "Notes to the financial statements as at 31 December 2011"

2.6.5 Profit and loss account for the year 2011

	Notes	2011	2010
Interest income	29	1 230 767 803	912 078 799
Interest expense	29	(1 024 583 562)	(730 475 431)
Net interest income	29	206 184 241	181 603 368
Realised gains / (losses) arising from financial operations	30	74 005 794	72 633 294
Write-downs on financial assets and positions	31	(62 326 679)	(112 132 569)
Transfer to/from provisions for risks	32	(64 236 535)	(67 668 179)
Net result of financial operations, write-downs and risk provisions		(52 557 420)	(107 167 454)
Fees and commissions income	33	14 440 461	16 984 552
Fees and commissions expense	33	(14 236 940)	(15 950 957)
Net result from fees and commissions	33	203 521	1 033 595
Income from participating interest	34	2 055 511	3 669 719
Net result of pooling of monetary income	35	(106 277 533)	(39 098 266)
Other income	36	7 240 115	8 571 273
Total net income		56 848 435	48 612 235
Staff costs	37	(31 290 909)	(28 075 491)
Other administrative expenses	38	(9 275 958)	(8 762 363)
Depreciation of tangible and intangible fixed assets	11.1., 39	(3 953 615)	(4 170 055)
Banknote production services	40	(678 543)	(811 372)
Other expenses	41	(10 633 697)	(5 073 920)
PROFIT FOR THE YEAR		**1 015 713**	**1 719 034**

The notes are annexed in section 2.6.6 "Notes to the financial statements as at 31 December 2011"

2.6.6 Notes to the financial statements as at 31 December 2011

NOTE 1 – GENERAL

The Banque centrale du Luxembourg ("BCL" or "Banque centrale") was founded in accordance with the law of 22 April 1998. The Founding Law of 23 December 1998 as modified on 24 October 2008 stipulates that the main task of the BCL shall be to contribute to the accomplishment of the tasks of the European System of Central Banks (ESCB) so as to achieve the objectives of the ESCB. The BCL is now also responsible for the oversight of the general market liquidity situation and the evaluation of the market operators in this respect. The BCL is authorised to take and sell participations as well as, in exceptional circumstances, to make short-term lending to counterparties with appropriate guarantees. The BCL is a public institution, endowed with legal personality and financial independence.

NOTE 2 – ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements are described below:

2.1 Layout of the financial statements

The financial statements of the BCL have been prepared and drawn up in accordance with the generally accepted accounting principles and the rules adopted by the ESCB.

2.2 Accounting principles

The following accounting principles have been applied:
- economic reality and transparency;
- prudence;
- recognition of post-balance sheet events;
- continuity of methods and comparability;
- relative significance;
- going concern concept;
- recording of charges and income in the accounting period they relate to.

2.3 Basic principles

The financial statements are based on historical cost and are adjusted to take account of the valuation at market prices of securities, financial instruments, gold and of all the elements, both on-balance sheet and off-balance sheet, denominated in foreign currencies.

Transactions in financial assets and liabilities are reflected in the accounts of BCL on their settlement date.

2.4 Gold, assets and liabilities in foreign currencies

Assets and liabilities denominated in foreign currencies (including gold) are converted into euro at the exchange rate in force on the balance sheet closing date. Income and expenses are converted at the exchange rate prevailing on the date of the transaction.

Foreign currencies are revalued on a currency by currency basis including on-balance sheet and off-balance sheet items.

Securities are revalued separately from the revaluation of foreign exchange for securities denominated in foreign currencies.

Gold is revalued on the basis of the euro price per fine ounce as derived from the quotation in US dollars established at the time of the London fixing on the last working day of the year.

2.5 Securities

Securities held for monetary policy purposes are classified as held-to-maturity. These securities are valued at amortised cost (purchase price adjusted by premiums and discounts) and write-downs are done in case of permanent impairment.

The other negotiable securities denominated in foreign currencies and in euro are valued at the market price prevailing on the balance sheet date. Securities held to maturity are valued at amortised cost (purchase or transfer price adjusted by premiums and discounts). Write-downs are applied to held to maturity securities in case of impairment.

The revaluation of securities takes place item-by-item on the basis of their ISIN code.

2.6 Recognition of gains and losses

Income and expenses are assigned to the financial year during which they are earned or incurred.

Realised gains and losses on foreign exchange transactions, securities and financial instruments linked to interest rates and market prices are taken to the profit and loss account.

At the end of the year, unrealised revaluation gains on foreign currencies, securities and financial instruments are not considered in the profit and loss account, but transferred to a revaluation account on the liabilities side of the balance sheet.

Unrealised losses are recognised in the profit and loss account when they exceed previous revaluation gains registered in the corresponding revaluation account. They may not be reversed against new unrealised gains in subsequent years. Unrealised losses regarding a specific security, financial instrument, currency or in gold holdings are not netted with unrealised gains in other securities, financial instruments, currencies or gold holdings.

In order to calculate the acquisition cost of securities or currencies that are sold, the average cost method is used on a daily basis. If any negative revaluation differences are taken to the profit and loss account, the average cost of the asset in question is adjusted downwards to the level of the current exchange rate or market price thereof.

For fixed-income securities, the premiums or discounts arising from the difference between the average acquisition cost and the redemption price are calculated and presented on a prorata basis as part of the interest positions and amortised over the remaining life of the securities.

2.7 Post-balance-sheet events

Assets and liabilities are adjusted to take account of events occurring between the balance sheet date and the date on which the BCL's Council approves the annual accounts if such events have a material effect on the assets and liabilities on the balance sheet date.

2.8 Banknotes in circulation

The ECB and the participating NCBs, which together comprise the Eurosystem, have issued euro banknotes as from 1 January 2002. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key.

The ECB has been allocated a share of 8 % of the total value of euro banknotes in circulation from 2002, whereas the remaining 92 % has been allocated to NCBs according to their weightings in the capital key of the ECB. The share of banknotes allocated to each NCB is disclosed under the balance sheet liability item "Banknotes in circulation".

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which incur interest, are disclosed under the sub-item "Intra-Eurosystem: Net claim/liability related to the allocation of euro banknotes within the Eurosystem".

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under "Net interest income."

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8 % share of euro banknotes allocated to the ECB, shall be partially distributed in 2011. The amount distributed is disclosed in the Profit and Loss account under "Income from participating interest".

2.9 Intra-Eurosystem claims and liabilities

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a net single asset or liability under "Net liability related to the allocation of euro banknotes within the Eurosystem".

Intra-Eurosystem claims and liabilities arising from TARGET2 balances and counterparties accounts are shown as a single net asset or liability on the balance sheet.

2.10 Treatment of tangible and intangible assets

The tangible and intangible assets are recorded at their acquisition cost less depreciation. Depreciation was calculated on a straight-line basis over the expected economic lifetime of the assets:

	Years
Buildings	25
Renovation of buildings	10
Furniture and equipment	3-5
Computer hardware and software	4

2.11 Pension fund

As at 1 January 1999, after the entry into force of the Founding Law of 23 December 1998, as modified, the pension claims of the BCL's staff members are fully supported by the BCL. The pension fund aims to cover the risks related to ageing, invalidity and survival, has been set up in 2000.

The actuarial method determines the pension fund's liability related to ageing, invalidity or survival for each agent. The model is based on each agent's personal and career data, on the level of inflation for the next 60 years as well as on an average rate of return generated by the fund's assets.

The BCL's liabilities related to pensions are shown in the account "Provisions for pensions". The provision increases as a result of regular transfers by the agent and by the BCL as employer and decrease by pension payments to retirees. At the year end, the provision is adjusted by the actuarial value. In addition, if necessary, periodic transfers from the account "Booking reserve of the pension fund", equivalent to the revenues generated by the fund's assets, to adjust the account "Provision for pensions" to its actuarial value are booked. In cases where transfers are insufficient cover the BCL's pension liabilities, the difference between the existing provision and the effective claim is covered by a special transfer to be supported by the BCL.

2.12 Provision for banking risks

In accordance with the prudence principle, the BCL's provision policy intends to cover specific and general risks resulting from the Bank's activities.

NOTE 3 – GOLD AND GOLD RECEIVABLES

As at 31 December 2011, BCL held 95.35 ounces of fine gold amounting to 0.12 million euro (272.61 ounces of fine gold amounting to 0.29 million euro as at 31 December 2010) and a top-rated gold bond issued by the International Bank for Reconstruction and Development purchased in 2002 and valued at 87.6 million euro (76.0 million euro as at 31 December 2010).

On the balance sheet date, gold is valued on the basis of the euro price per fine ounce derived from the quotation in US dollars established at the London fixing on 30 December 2011.

NOTE 4 – CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	2011 EUR	2010 EUR
Receivables from the IMF	555 314 575	358 082 581
Balances with banks, security investments, external loans and other external assets	140 167 016	201 482 608
	695 481 591	**559 565 189**

Under this item are recorded the BCL's foreign exchange reserve holdings with counterparties situated outside the euro area (including international and supranational institutions and non-Eurosystem central banks).

This item is broken down into two sub-items:

– receivables from the International Monetary Fund (IMF) are made up of reserve tranche position, SDR holdings and new arrangements to borrow. SDR are reserve assets created by the IMF and allocated by it to its members. A member's SDR holdings initially amount to the SDR allocated. Afterwards, SDR holdings are subject to fluctuations as a result of encashments and transactions with others SDR holders. The reserve tranche position corresponds to the net amount of the quota and the IMF's currency holding and takes into account the re-evaluation of the general account. The new arrangements to borrow are credit agreements between the IMF and the Government of Luxembourg.

- balances held on accounts with banks outside the euro area as well as securities, loans and other foreign currency assets issued by non-residents of the euro area. This sub-item includes in particular the US dollar securities portfolio which could be used, if needed, for monetary policy operations.

This portfolio, which amounts to 104.9 million euro as at 31 December 2011 (198.5 million euro as at 31 December 2010), mainly contains government bonds and bonds issued by international and supranational institutions denominated in US dollars. Securities are valued at market prices. As at 31 December 2011, their value at market prices included a negative net revaluation adjustment amounting to 1.8 million euro (positive net revaluation adjustment amounting to 1.7 million euro as at 31 December 2010).

Balances with banks amounted to 35.3 million euro as at 31 December 2011 (3.0 million euro as at 31 December 2010).

NOTE 5 – CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

This item contains mainly a claim arising from reverse operations with Eurosystem counterparties amounting to 3 462 million euro (nil as at 31 December 2010) in connection with the US dollar Term Auction Facility. Under this program, USD were provided by the Federal Reserve to the ECB by means of temporary reciprocal currency arrangement (swap line) with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously entered into back-to-back swap transactions with NCBs that have adopted the euro, which used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties. The back-to-back swap transactions between the ECB and NCBs resulted in intra-Eurosystem balances reported under "Other claims within the Eurosystem".

This item contains also balances in currency held by the BCL on accounts with euro area counterparties.

NOTE 6 – CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO

	2011 EUR	2010 EUR
Balances with banks	16 248 401	17 616 744
Securities	1 810 406 136	1 390 062 928
- marketable securities	1 810 406 136	1 287 801 478
- held-to-maturity securities	-	102 261 450
Deposits	218 500 000	152 000 000
	2 045 154 537	**1 559 679 672**

This item contains balances held on accounts with banks outside the euro area as well as securities, deposits, loans and other euro-denominated assets issued by non-residents of the euro area.

The securities portfolio recorded under this heading includes:

- The marketable securities portfolio contains government bonds and bonds issued by companies outside the euro area denominated in euro. Securities are valued at market prices. As at 31 December 2011, their value at market prices included a negative net revaluation adjustment amounting to 136.6 million euro (negative net revaluation adjustment amounting to 75.5 million euro as at 31 December 2010).
- The Held-to-maturity portfolio was created in 2007. These securities are intended to be held until maturity.

This portfolio is valued at amortised cost, purchase or transfer price adjusted by premiums, discounts and impairment. There were no purchases since 2007. Securities already in portfolios as at 31 December 2006 were transferred at accounting value as at 1 January 2007. Securities bought in 2007 were transferred at acquisition value. Securities held to maturity are valued as described and not at market price.

These securities matured in 2011. As at 31 December 2010 these securities amounted to 102.3 million euro.

NOTE 7 – LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

This balance sheet item represents the liquidity-providing transactions executed by the BCL with Luxembourg credit institutions.

The item is divided into various sub-items depending on the type of instrument used to provide liquidity to the financial sector:

	2011 EUR	2010 EUR
Main refinancing operations	1 849 200 000	1 125 600 000
Longer-term refinancing operations	3 349 500 000	1 643 000 000
Fine-tuning reverse operations	–	–
Structural reverse operations	–	–
Marginal lending facility	–	–
Credits related to margin calls	–	–
	5 198 700 000	**2 768 600 000**

The total Eurosystem holding of monetary policy assets amounts to 863 568 million euro of which BCL holds 5 199 million euro. In accordance with Article 32.4 of the Statute, any risks from monetary policy operations, if they were to materialise, should eventually be shared in full by the Eurosystem NCBs, in proportion to the prevailing ECB capital key shares.

7.1 Main refinancing operations

This sub-item records the amount of liquidity provided to credit institutions by way of weekly one-week tenders.

7.2 Long-term refinancing operations

This sub-item records the amount of credit extended to credit institutions by way of tenders with three, twelve or thirty six month maturities.

7.3 Fine-tuning reverse operations

This sub-item records open market operations carried out on a non-regular basis, intended primarily to meet unexpected fluctuations in market liquidity.

7.4 Structural reverse operations

These are open market operations carried out with the primary intention of bringing about a lasting change in the structural liquidity position of the financial sector vis-à-vis the Eurosystem.

7.5 Marginal lending facility

This sub-item records a standing facility enabling counterparties to obtain overnight credit from the Bank at a pre-specified interest rate, against eligible collateral.

7.6 Credits related to margin calls

This sub-item records additional credit extended to credit institutions and resulting from the increase in the value of the securities pledged as collateral for other credits extended to these same institutions.

NOTE 8 – OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

This item includes the BCL's current accounts and fixed-term deposits not related to monetary policy operation with credit institutions inside the euro area.

NOTE 9 – SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

	2011 EUR	2010 EUR
Securities held for monetary policy purposes	643 439 782	430 742 233
Other securities	3 550 485 629	3 573 422 082
- marketable securities	2 659 420 818	3 415 768 744
- held-to-maturity securities	891 064 811	157 653 338
	4 193 925 411	**4 004 164 315**

9.1 Securities held for monetary policy purposes

This item contains securities acquired by BCL within the scope of the purchase programme for covered bonds and the securities markets programme. These securities are classified as held-to-maturity.

These securities are valued at amortised cost and are subject to impairement tests.

The securities acquired by BCL within the scope of the purchase programme for covered bonds (first and second programme) amounted to 128.7 million euro as at 31 December 2011 (114.6 million for the first programme and 14.1 million for the second programme). The first programme was completed at the end of June 2010. The Governing Council announced on 6 October a second covered bond purchase programme, he started in November 2011 and should be completed in October 2012.

The total Eurosystem holding of SMP securities amounts to 211.0 billion euro, of which BCL holds 514.7 million euro. In accordance with Article 32.4 of the Statute, any risks from holdings of SMP securities, if they were to materialise, should eventually be shared in full by the Eurosystem, in proportion to the prevailing ECB capital key shares.

As at 31 December 2011 these securities held for monetary policy purposes amount to 643.4 million euro (430.7 million euro as at 31 December 2010).

There was no impairment on these securities.

9.2 Other securities

The securities portfolio recorded under this heading includes:

- The marketable securities portfolio in euro issued by residents of the euro area amount to 2 659.4 million euro as at 31 December 2011 (3 415.8 million euro as at 31 December 2010). This portfolio only contains government bonds in euro issued by Member States of the European Union and bonds issued by companies of the euro area. Securities are valued at market prices. As at 31 December 2011, their value at market prices included a negative net revaluation adjustment amounting to 116.9 million euro (negative net revaluation adjustment amounting to 179.9 million euro as at 31 December 2010).

- The Held-to-maturity portfolio which securities are intended to be held until maturity. This portfolio is valued at amortised cost, purchase or transfer price adjusted by premiums, discounts and impairment.

In 2011, 790.5 million euro securities were transferred from the marketable securities portfolio to the Held-to-maturity portfolio. Securities already in portfolios as at 31 December 2010 were transferred at accounting value as at this date; securities bought in 2011 were transferred at acquisition value in accordance with Eurosystem's booking rules.

9.3 Securities held within the scope of the purchase programme for covered bonds and the securities markets programme

Harmonised annual impairments tests on securities (for the purchase programme for covered bonds and the securities markets programme) are conducted in the Eurosystem on basis of the information available and recoverable amounts estimated as at the reporting date.

In this context, the Governing Council considered:

- The launch in 2011 of the so called Private Sector Involvement (PSI) initiative, proposing a restructuring of part of the debt issued by the Hellenic Republic, to secure debt sustainability in the long term and to ensure all contractual cash flows associated with the BCL's holdings on these securities.

- At the closing date, there was no evidence to assume that the PSI initiative was not going to be successfully implemented.

Therefore no impairment losses were recorded at year end.

In relation to the other securities in Held-to-maturity portfolio and securities held within the scope of the purchase programme for covered bonds and the securities markets programme, no impairment losses were recorded at year end.

Post-balance-sheet events

In February 2012 the Eurosystem central banks exchanged their holdings of Greek government bonds for new securities Issued by the Hellenic Republic. The newly acquired securities have the same characteristics as the old securities in terms of their nominal values, coupon rates, interest payment dates and redemption dates. The new securities were not included on the list of eligible securities that were subject to restructuring in the context of the PSI initiative.

NOTE 10 – INTRA-EUROSYSTEM CLAIMS

10.1 Participating interest in ECB

Pursuant to Article 28 of the ESCB Statute, the ESCB national central banks are the sole subscribers to the capital of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the ESCB Statute and which are subject to adjustment every five years.

The ECB increased its subscribed capital by 5 billion euro from 5 760 652 402.58 euro to 10 760 652 402.58 euro with effect from 29 December 2010. The NCBs of the euro area countries shall pay up their increased capital in three equal annual instalments. The first instalment was paid on 29 December 2010. The second instalment was paid on 28 December 2011. The last instalment will be paid at the end of 2012.

As a result, the subscribed and paid up capital of NCBs is as follow:

	Subscribed capital since 29 December 2010	Paid-up capital on 31 December 2010	Paid-up capital as at 1 January 2011	Paid-up capital since 28 December 2011
Banque Nationale de Belgique	261 010 384.68	180 157 051.35	180 157 051.35	220 583 718.02
Deutsche Bundesbank	2 037 777 027.43	1 406 533 694.10	1 406 533 694.10	1 722 155.360.77
Eesti Pank	19 261 567.80	722 308 79	13 294 901.14	16 278 234.47
Central Bank of Ireland	119 518 566.24	82 495 232.91	82 495 232.91	101 006 899.58
Banque de Grèce	211 436 059.06	145 939 392.39	145 939 392.39	178 687 725.72
Banco de España	893 564 575.51	616 764 575.51	616 764 575.51	755 164 575.51
Banque de France	1 530 293 899.48	1 056 253 899.48	1 056 253 899.48	1 293 273 899.48
Banca d'Italia	1 344 715 688.14	928 162 354.81	928 162 354.81	1 136 439 021.48
Central Bank of Cyprus	14 731 333.14	10 167 999.81	10 167 999.81	12 449 666.48
Banque centrale du Luxembourg	18 798 859.75	12 975 526.42	12 975 526.42	15 887 193.09
Central Bank of Malta	6 800 732.32	4 694 065.65	4 694 065.65	5 747 398.98
De Nederlandsche Bank	429 156 339.12	296 216 339.12	296 216 339.12	362 686 339.12
Oesterreichische Nationalbank	208 939 587.70	144 216 254.37	144 216 254.37	176 577 921.04
Banco de Portugal	188 354 459.65	130 007 792.98	130 007 792.98	159 181 126.31
Banka Slovenije	35 381 025.10	24 421 025.10	24 421 025.10	29 901 025 10
Národná banka Slovenska	74 614 363.76	51 501 030.43	51 501 030.43	63 057 697.10
Suomen Pankki – Banque de Finlande	134 927 820.48	93 131 153.81	93 131 153.81	114 029 487.14
Subtotal for euro area NCBs	***7 529 282 289.35***	***5 184 359 697.03***	***5 196 932 289.36***	***6 363 107 289.36***
Българска народна банка (Bulgarian National Bank)	93 467 026.77	3 505 013.50	3 505 013.50	3 505 013.50
Česká národní banka	155 728 161.57	5 839 806.06	5 839 806.06	5 839 806.06
Danmarks Nationalbank	159 634 278.39	5 986 285.44	5 986 285.44	5 986 285.44
Latvijas Banka	30 527 970.87	1 144 798.91	1 144 798.91	1 144 798.91
Lietuvos bankas	45 797 336.63	1 717 400.12	1 717 400.12	1 717 400.12
Magyar Nemzeti Bank	149 099 599.69	5 591 234.99	5 591 234.99	5 591 234.99
Narodowy Bank Polski	526 776 977.72	19 754 136.66	19 754 136.66	19 754 136.66
Banca Naţională a României	265 196 278.46	9 944 860.44	9 944 860.44	9 944 860.44
Sveriges Riksbank	242 997 052.56	9 112 389.47	9 112 389.47	9 112 389.47
Bank of England	1 562 145 430.59	58 580 453.65	58 580 453.65	58 580 453.65
Subtotal for non-euro area NCBs	***3 231 370 113.23***	***121 176 379.25***	***121 176 379.25***	***121 176 379.25***
Total	**10 760 652 402.58**	**5 305 536 076.26**	**5 318 108 668.61**	**6 484 283 668.61**

On 29 December 2010, BCL paid first annual instalment of 2 911 666.67 euro and on 28 December 2011, BCL paid second annual instalment of 2 911 666.67 euro.

As at 31 December 2011, the BCL's paid-up capital amount to 15 887 193.09 euro (12 975 526.42 euro as at 31 December 2010).

The share that the BCL held in the accumulated net profits of the ECB reflects the repayment of 5.7 million euro of ECB reserves (5.7 million euro as at 31 December 2010).

10.2 Claims equivalent to the transfer of foreign reserves

This sub-item represents the euro-denominated claims on the ECB in respect of the transfer of part of BCL's foreign reserves. The claims are denominated in euro at a value fixed at the time of their transfer.

They are remunerated at the latest available marginal rate for the Eurosystem's main refinancing operations, adjusted to reflect a zero return on the gold component.

As at 31 December 2011, the claim of the BCL amounts to 100 638 597 euro (no change compared to 2010).

10.3 Other claims within the Eurosystem

This sub-item represents the BCL's net claims towards the Eurosystem, mostly from transactions resulting from cross-border payments initiated for monetary or financial operations, made via the TARGET2 system, between the BCL and the other NCBs as well as the ECB. This claim amounts to 109.3 billion euro as at 31 December 2011 (67.9 billion euro as at 31 December 2010).

The net position vis-à-vis the ECB bears interest at the marginal interest rate applying to the main refinancing operations.

NOTE 11 – OTHER ASSETS

11.1 Tangible and intangible assets

Tangible and intangible fixed assets developed as follows:

	Buildings EUR	Furniture and equipment EUR	Software EUR	Other EUR	Total EUR
Cost as at 1 January 2011	92 952 290	13 855 586	5 896 725	338 782	113 043 383
Disposals/Refund	-	(798 149)	-	650 228	(147 921)
Acquisitions	239 612	63 314	124 140	752 618	1 179 684
Cost as at 31 December 2011	**93 191 902**	**13 120 751**	**6 020 865**	**1 741 628**	**114 075 146**
Accumulated depreciation as at 1 January 2011	40 235 560	11 942 560	5 667 471	-	57 845 591
Disposals	-	(24 963)	-	-	(24 963)
Depreciation	3 201 948	626 971	124 696	-	3 953 615
Accumulated depreciation as at 31 December 2011	43 437 508	12 544 568	5 792 167	-	61 774 243
Net book value as at 31 December 2011	**49 754 394**	**576 183**	**228 698**	**1 741 628**	**52 300 903**

The sub-item "Buildings" comprises the acquisition cost of the premises located on the 2, boulevard Royal, the costs incurred in relation to the reconstruction and transformation of the Pierre Werner building and the renovations made to the Siège Royal (main building). The building located on the avenue Monterey was completely written off in 2003, having been demolished in order to construct a new one. Construction of this new building was finished in 2006.

The Pierre Werner building and the Avenue Monterey building are considered as new buildings and are being amortised over a period of 25 years while the costs incurred in relation to the transformation of the Siège Royal are considered as renovations and are being amortised over 10 years.

11.2 Other financial assets

The components of this item are as follows:

	2011 EUR	2010 EUR
Other participating interests	84 990 668	3 045 952
Pension fund	109 007 919	108 097 672
	193 998 587	**111 143 624**

The other participating interests comprise the BCL's investments in Swift, ATTF, LuxCSD SA., BCL's Fondation, Islamic Liquidity Management Corporation and Bank for International Settlements.

The assets of the pension fund are recorded in the accounts under "Pension fund BCL". The balance of this account corresponds to the net asset value of the fund as calculated by the depositary bank as at 31 December 2011.

11.3 Accruals and prepaid expenses

Most of this item consists of the accrued interests on monetary policy operations, securities and receivables from the IMF.

Are also included under this item the commissions receivables, prepaid expenses (including salaries paid for January 2012) and other income receivable.

11.4 Sundry

	2011 EUR	2010 EUR
Others	357 998 372	1 323 730 104
	357 998 372	**1 323 730 104**

This item includes mainly the remaining outstanding claims against counterparties which defaulted in 2008 on refinancing operations undertaken by the Eurosystem.

This item consists also of the counterpart of the unrealised loss on SDR recorded in the financial statements of the BCL which is guaranteed by the Government according to the agreement signed in May 1999 establishing the financial relationship between the Government of Luxembourg and the BCL (4.0 million euro as at 31 December 2011).

NOTE 12 – BANKNOTES IN CIRCULATION

This item includes the BCL's share of the total euro banknotes put into circulation by the central banks of the Eurosystem according to their weightings in the capital of the ECB, which totaled 2 039.4 million euro (1 935.5 million euro as at 31 December 2010).

NOTE 13 – LIABILITIES TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

	2011 EUR	2010 EUR
Current accounts (covering the minimum reserves)	10 844 067 972	6 435 590 706
Deposit facility	37 035 967 847	2 986 138 825
Fixed-term deposits	3 342 800 000	220 000 000
Fine-tuning reverse operations	–	–
Deposits related to margin calls	–	–
	51 222 835 819	**9 641 729 531**

This item primarily comprises credit institutions' accounts held within the framework of the requirements of the minimum reserve system, deposit facilities as well as fixed-term deposits.

13.1 Current accounts (covering the minimum reserves)

This sub-item records accounts denominated in euro of credit institutions which mainly serve to meet minimum reserve requirements. These requirements have to be respected over an average unsettled period starting the Wednesday following the Governing Council's meeting when the interest rate is set.

13.2 Deposit facility

This sub-item records the standing facility allowing credit institutions to make overnight deposits with the bank at a pre-specified interest rate.

13.3 Fixed-term deposits

This sub-item records deposits made at the Bank for the purpose of absorbing market liquidity in connection with fine-tuning operation in the Eurosystem.

13.4 Fine-tuning reverse operations

This sub-item records other monetary policy operations aimed at tightening liquidity.

13.5 Deposits related to margin calls

This sub-item records deposits made by credit institutions to compensate for the decrease in the value of securities pledged as collateral for other credits granted to these same institutions.

NOTE 14 – LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

14.1 Liabilities to general government

This item records the amounts as follows:

	2011 EUR	2010 EUR
Current accounts	905 796	631 043
Account related to euro coins issued by the Treasury	221 012 854	207 194 215
Specific account	140 000 000	-
Fixed-term deposit	140 000 000	140 000 000
	501 918 650	**347 825 258**

The item current accounts records an amount of 905 796 euro owed to the Luxembourg Treasury.

In accordance with the amendment of 10 April 2003 to the agreement between the Government of Luxembourg and the BCL establishing their financial relationship, the "Account related to euro coins issued by the Treasury" corresponds to the amount of coins issued by the BCL in the name and for the account of the Treasury.

The specific account was opened for the State of Luxembourg in 2011 in order to realise operations with IMF until a final agreement between the parties is reached.

The fixed-term deposit, unchanged since 2010, relates to the above-mentioned agreement.

14.2 Other liabilities

This item contains mainly a remunerated current account held by a public enterprise offering financial services.

NOTE 15 – LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO

This item includes current accounts held by central banks, international and supranational institutions and other account holders outside the euro area.

NOTE 16 – LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

This item includes current accounts in foreign currency held by euro area resident credit institutions.

NOTE 17 – LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

This item includes current accounts in foreign currency held by central banks outside the euro area.

NOTE 18 – COUNTERPART OF SPECIAL DRAWING RIGHTS ALLOCATED BY THE IMF

The amount shown under this item represents the countervalue of SDR, converted to euro at the same rate as applied to the SDR assets, which should be returned to the IMF if SDR are cancelled, if the SDR Department established by the IMF is closed or if Luxembourg decides to withdraw from it. This liability, of unlimited duration, amounts to SDR 246.6 million, or 292.7 million euro as at 31 December 2011 (SDR 246.6 million, or 285.4 million euro as at 31 December 2010).

NOTE 19 – INTRA-EUROSYSTEM LIABILITIES

19.1 Net liabilities related to the allocation of euro banknotes within the Eurosystem

This item consists of the liabilities of the BCL vis-à-vis the Eurosystem relating to the allocation of euro banknotes within the Eurosystem. The net position bears interest at the marginal interest rate applying to the main refinancing operation.

NOTE 20 – ITEMS IN COURSE OF SETTLEMENT

This item contains cash desk's differences as at 31 December.

NOTE 21 – OTHER LIABILITIES

This item comprises mainly the negative revaluation differences on financial instruments linked to interest rates and market prices, accrued interest, including accrued interest on intra-Eurosystem liabilities, as well as miscellaneous expenses payable, including suppliers, and the Luxembourg banknotes not yet returned.

The Luxembourg banknotes still circulating as at 31 December 2011 amount to 5.1 million euro (5.2 million euro as at 31 December 2010).

NOTE 22 – PROVISIONS

Provisions developed as follows:

	2011 EUR	2010 EUR
Provisions for banking risks	467 299 918	405 906 211
Provisions for pensions	123 408 707	109 671 956
Other provisions	50 000	50 000
	590 758 625	**515 628 167**

22.1 Provisions for banking risks

Provisions for banking risks include the following items:

Provisions for specific banking risks	2011 EUR	2010 EUR
Provision covering credit and market risk	320 804 166	226 883 533
Buffer against counterparty risks in Eurosystem	2 144 550	4 987 379
Provision covering operational risk	18 280 000	20 480 000
Provision covering liquidity risk	16 026 903	15 433 443
Provision for doubtful debts	69 750 076	97 827 633
	427 005 695	**365 611 988**
Provisions for general banking risks	**2011 EUR**	**2010 EUR**
Provision for liabilities resulting from monetary agreements	32 341 954	32 341 954
Other provision for general banking risks	7 952 269	7 952 269
	40 294 223	**40 294 223**
	467 299 918	**405 906 211**

22.1.1 Provision covering credit and market risk

The provision of 320.8 millions euro (226.9 million euro as at 31 December 2010) corresponds to:

- 3.87 % of the BCL's own securities portfolio existing as at 31 December 2011 (3.35 % as at 31 December 2010) and participations other than the participating interest in the ECB;
- 3.87 % (3.35 % as at 31 December 2010) of the amount lent by the Eurosystem (main and long-term refinancing operations) as at year-end for monetary policy purposes multiplied by the BCL's capital key in Eurosystem including securities held in the framework of the Securities Markets Programme.

The BCL's aim is to target a rate of 4 % on all items in the medium term.

22.1.2 Buffer against counterparty risks in Eurosystem

In accordance with Article 32.4 of the ESCB Statute, a buffer was established against counterparty risks in monetary policy operations. This buffer was funded among all national central banks of participating Member States in proportion to their subscribed capital key shares in the ECB prevailing at the time of default. In accordance with the general accounting principle of prudence, the Governing Council of BCE reduced the buffer from 2 207 000 000 euro as at 31 December 2010 to 949 000 000 euro as at 31 December 2011. This decrease was due to revaluation of collateral and to principal payments received from the debtors.

For the BCL, the buffer decreased from 4 987 379 euro as at 31 December 2010 to 2 144 550 euro as at 31 December 2011.

22.1.3 Provision covering operational risk

This provision is intended to cover the risk of losses resulting from the inadequacy or fault attributable to procedures, to the human factor or to the BCL's systems or to external causes. Because of a lack of relevant statistics on the dimension of risk, the transfer to the provision is based on the Basic Indicator Approach described in the consultative working paper of the Basel Committee as being 15 % of the average for the last three years of the net banking product (including payments allocated on monetary income).

In 2011, the average has been based on previous years in accordance with the rules.

22.1.4 Provision for doubtful debts

The provision for doubtful debts covers non paid interests from counterparty and non paid debts amounting to 69.7 million euro as at 31 December 2011 (non paid interests from counterparty amounting to 97.8 million euro at 31 December 2010).

22.1.5 Provision for liabilities resulting from monetary agreements

The provision for liabilities resulting from monetary treaties created in order to face any future monetary liabilities monetary liabilities did not change in 2011.

22.1.6 Other provision for general banking risks

This provision, intended to cover non-specific risk of losses resulting from central bank's activities, did not change in 2011.

22.2 Provisions for pensions

Provisions for pensions include the following items:

	2011 EUR	2010 EUR
Provision for pensions	123 408 707	108 130 338
Provision for increase of PBO	-	1 541 618
	123 408 707	**109 671 956**

22.2.1 Provision for pensions

The pensions claims of its agents are fully supported by the BCL. The corresponding liability is calculated on the basis of the actuarial method described in note 2.11 in consideration of current factors and amounted to 123.4 million euro as at 31 December 2011 (108.1 million euro as at 31 December 2010).

The variance of the provision during the year results from:

- monthly deductions from the gross salaries of BCL agents (employee's part) as well as the employer's share;
- pension payments to retirees;
- periodic transfers from the account "Booking reserve of the pension fund" to adjust the account "Provision for pensions" to its actuarial value;
- a transfer, if needed, to adjust the account "Provision for pensions" to its actuarial value.

22.2.2 Provision for increase of Projected Benefit Obligation

This provision was intended to cover the liability (Projected Benefit Obligation or PBO) for new agents or the changes of present value of potential payments taking into account individual parameters and the actuarial method used. The provision was totally reversed in 2011.

NOTE 23 – REVALUATION ACCOUNTS

This item includes positive revaluation differences related to the spread between the exchange rate as at year-end and the average exchange rate of BCL's currency and gold positions, as well as positive revaluation differences related to the spread between the market value as at year-end and the amortised cost for securities positions.

NOTE 24 – CAPITAL AND RESERVES

24.1 Capital

The State of Luxembourg is the sole shareholder of the BCL's capital for an amount of 175 million euro (no change compared to 2010).

24.2 Reserves

The reserves amount to 8.7 million euro (7 million euro as at 31 December 2010). This amount was increased by 1.7 million euro in 2011 following the allocation of profit for 2010 according to the decision of the BCL's Council in application of its Founding Law (Article 31).

	Capital EUR	Reserves EUR
As at 1 January 2011	175 000 000	6 975 598
Profit allocation for 2010 (art 31)	-	1 719 034
As at 31 December 2011	**175 000 000**	**8 694 632**

NOTE 25 – FOREIGN EXCHANGE SWAP

As at 31 December 2011 this item included forward liabilities to the ECB which arose in connection with the US dollar Term Auction Facility established by the Federal Reserve (see also note 5 "Claims on euro area residents denominated in foreign currency"). In connection with the same programme, forward claims arising from swap transactions with Eurosystem counterparties for the provision of US dollar liquidity against euro cash, were also outstanding.

NOTE 26 – CUSTODY DEPOSITS

This item includes the securities given into custody by Luxembourg credit institutions to cover their liabilities related to refinancing operations, marginal lending facilities and intra-day credits.

This item also includes the securities given into custody in Luxembourg and used as a guarantee by commercial banks incorporated in other member states according to the Correspondent Central Banking Model (CCBM). This agreement allows commercial banks to obtain funding from their country of residence's central bank by using the securities held in another Member State as a guarantee.

As at 31 December 2011, the market value of these securities amounts to 170.8 billion euro (210.2 billion euro as at 31 December 2010).

NOTE 27 – FOREIGN CURRENCY RESERVE ASSETS ADMINISTRATED ON BEHALF OF THE ECB

This item includes the foreign currency reserves at market value managed by BCL on behalf of the ECB.

NOTE 28 – FORWARD CONTRACTS

BCL can be engaged in bond and stock index futures. These instruments are mainly held for hedging purposes of interest rate risks related to the securities portfolio and for the purpose of adjusting the duration of the existing portfolio depending on market conditions.

As at 31 December 2011, the total liabilities related to these forward contracts amount to 88.3 million euro (121.7 million euro as at 31 December 2010). One security has been given as a guarantee in order to cover the initial margin deposit. This security remains on the BCL's balance sheet for an amount of 10.0 million euro as at 31 December 2011, no change compared to 2010.

NOTE 29 – NET INTEREST INCOME

This item includes interest income, after deduction of interest expense, on assets and liabilities in foreign currency and in euro. Interest income and expense are as follows:

Composition of interest income	Amounts in foreign currency EUR 2011	Amounts in euro EUR 2011	Total EUR 2011
IMF	1 705 972	-	1 705 972
Monetary policy	-	51 055 590	51 055 590
Intra-Eurosystem claims	-	993 185 248	993 185 248
Securities	1 599 322	169 482 452	171 081 774
Gold	346 242	-	346 242
Other	1 445 909	11 947 068	13 392 977
Total	**5 097 445**	**1 225 670 358**	**1 230 767 803**
Composition of interest expense	**Amounts in foreign currency EUR 2011**	**Amounts in euro EUR 2011**	**Total EUR 2011**
IMF	(1 112 512)	-	(1 112 512)
Current accounts (including minimum reserves) and deposits related to monetary policy operations	-	(166 711 900)	(166 711 900)
Liabilities related to the reallocation of euro banknotes in the Eurosystem	-	(853 689 155)	(853 689 155)
Other intra-Eurosystem liabilities	-	(38 110)	(38 110)
Interests on term deposits	-	(712 639)	(712 639)
Other liabilities	(478 849)	(999 358)	(1 478 207)
Interest on swap operation	(841 039)	-	(841 039)
Total	**(2 432 400)**	**(1 022 151 162)**	**(1 024 583 562)**
Composition of interest income	**Amounts in foreign currency EUR 2010**	**Amounts in euro EUR 2010**	**Total EUR 2010**
IMF	978 950	-	978 950
Monetary policy	-	98 408 869	98 408 869
Intra-Eurosystem claims	-	654 827 812	654 827 812
Securities	2 974 410	146 313 241	149 287 651
Gold	363 558	-	363 558
Other	905 197	7 306 762	8 211 959
Total	**5 222 115**	**906 856 684**	**912 078 799**
Composition of interest income	**Amounts in foreign currency EUR 2010**	**Amounts in euro EUR 2010**	**Total EUR 2010**
IMF	(833 497)	-	(833 497)
Current accounts (including minimum reserves) and deposits related to monetary policy operations	-	(102 906 741)	(102 906 741)
Liabilities related to the reallocation of euro banknotes in the Eurosystem	-	(625 029 889)	(625 029 889)
Other intra-Eurosystem liabilities	-	(30 423)	(30 423)
Interests on term deposits	-	(357 847)	(357 847)
Other liabilities	(556 126)	(567 840)	(1 123 966)
Interest on swap operation	(193 068)	-	(193 068)
Total	**(1 582 691)**	**(728 892 740)**	**(730 475 431)**

NOTE 30 – REALISED GAINS / (LOSSES) ARISING FROM FINANCIAL OPERATIONS

This item includes the result from transactions in foreign currencies, from securities and from financial instruments linked to interest rates and market prices, i.e. gains realised minus loss realised on these transactions. In 2011, they amounted to 99.1 million euro (77.3 million euro as at 31 December 2010) and to 25.1 million euro (4.7 million euro as at 31 December 2010) respectively, making a net gain of 74.0 million euro (a net gain of 72.6 million euro as at 31 December 2010).

NOTE 31 – WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

This item includes revaluation losses on securities for 62.3 million euro (revaluation losses on securities for 110.6 million euro and on futures for 1.5 million euro in 2010).

NOTE 32 – TRANSFER TO/FROM PROVISIONS FOR RISKS

This item includes the transfers to and from provisions for banking risks excluding the buffer against counterparty risks in Eurosystem (see note 35).

NOTE 33 – NET RESULT FROM FEES AND COMMISSIONS

Fees and commissions income and expense are as follows:

	Fees and commissions income EUR		Fees and commissions expense EUR	
	2011	2010	2011	2010
Securities	13 311 915	15 784 915	(14 090 474)	(15 871 717)
Others	1 128 546	1 199 637	(146 466)	(79 240)
Total	**14 440 461**	**16 984 552**	**(14 236 940)**	**(15 950 957)**

NOTE 34 – INCOME FROM PARTICIPATING INTEREST

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8 % share of euro banknotes allocated to the ECB, shall be partially distributed in 2011. The amount distributed to BCL amounts to 1.6 million euro.

The Governing Council of the ECB also decided that the ECB's income on SMP securities shall be fully retained in 2011.

This non-distributed income was transferred to the ECB's provision for risks as at 31 December 2011.

This item includes also the BCL's part on ECB 2010's benefit, amounting to 0.4 million euro and paid in March 2011.

In total, this item amounts to 2.0 million euro as at 31 December 2011 (3.7 million euro as at 31 December 2010).

NOTE 35 – NET RESULT OF POOLING OF MONETARY INCOME

The monetary income of each Eurosystem NCB is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base. The liability base consists of the following items:

- banknotes in circulation;
- liabilities to credit institutions related to monetary policy operations denominated in euro;
- net intra-Eurosystem liabilities resulting from TARGET2 transactions;
- net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem.

Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The earmarkable assets consist of the following items:

- lending to euro area credit institutions related to monetary policy operations denominated in euro;
- intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB;
- securities held for monetary policy purposes
- net intra-Eurosystem claims resulting from TARGET2 transactions;
- net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem;
- a limited amount of each NCBs' gold holdings in proportion to its capital key.

Gold is considered as generating no income, and securities held for monetary policy purposes under decision of the Governing Council of 2 July 2009 and of 3 November 2011 on the implementation of covered bonds purchase programme are considered to generate income at the latest available marginal rate for the Eurosystem's main refinancing operations.

Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to that difference the marginal rate on main refinancing operations.

The monetary income pooled by the Eurosystem is allocated among NCBs according to the subscribed capital key (0.24968 % for the BCL in 2011).

This item includes the net monetary income allocated to BCL for 2011 representing an expense amounting to 109 120 361 euro (expense of 43 174 945 euro as at 31 December 2010).

As at 31 December 2011, this item also includes the amount of 2 842 828 euro due to the decrease of the buffer against counterparty risks in Eurosystem, as described in note 22.1.2. (decrease of this buffer amounting to 4 076 679 euro as at 31 December 2010).

NOTE 36 – OTHER INCOME

Other income includes revenue for services rendered to third parties, transfers from administrative provisions, income from "Monterey building" renting, income from numismatic activities and the recovered functioning costs of EPCO (Eurosystem procurement Co-ordination Office).

Other income includes also BCL's revenue from financial agreement between the Government of Luxembourg and BCL.

NOTE 37 – STAFF COSTS

This item includes the salaries and compensations as well as the employer's share of contributions to the pension and social security schemes. The compensations paid to the Board of Directors amounted to 547 420 euro for the year 2011 (537 165 euro for the year 2010).

As at 31 December 2011, the BCL employed 287 persons (268 as at 31 December 2010). The average number of persons working for the BCL from 1 January to 31 December 2011 was 279 (256 for the year 2010).

NOTE 38 – ADMINISTRATIVE EXPENSES

This item includes all general and recurring expenses, meaning leasing, cleaning and repair of buildings and equipment, small goods and materials, fees paid and other services and supplies as well as training expenses. The compensations paid to the members of the Council amounted to 84 493 euro in 2011 (78 439 euro in 2010).

NOTE 39 – DEPRECIATION OF TANGIBLE AND INTANGIBLE FIXED ASSETS

This item shows the depreciation applied on buildings, renovations on buildings, furniture and office equipment, computer hardware and software.

NOTE 40 – BANKNOTE PRODUCTION SERVICES

This item shows mainly the costs related to the production and issue of banknotes denominated in euro.

NOTE 41 – OTHER EXPENSES

In 2011, this item includes a net amount of 7.0 million euro corresponding to the adjustment of the pension fund's PBO for 8.5 million euro and to the reverse of the provision for increase of PBO for 1.5 million euro which is no more indicated. This item includes also costs related to numismatic activities, to administrative provisions and to consultancy.

In 2010, this item shows mainly costs related to numismatic activities and to consultancy.

03 ANNEXES

3 ANNEXES

1 LIST OF BCL REGULATIONS PUBLISHED IN 2011

2011/n°10 of 14 July 2011

BCL Regulation 2011/n°10 of 14 July 2011 modifying regulation 2010/n°6 of 8 September 2010 concerning the oversight of payment systems, securities settlement systems and payment instruments in Luxembourg.

Area: Statistics

2011/n°9 of 4 July 2011

BCL Regulation 2011/n°9 on payment instruments and operations

Area: Statistics

2011/n°8 of April 2011

BCL Regulation 2011/n°8 of 29 April 2011 concerning the collection of statistics from companies which grant loans or issue debt securities or derivative instruments to affiliates

Area: Balance of payments and International investment position

2011/n°7 of 4 Avril 2011

BCL Regulation 2011/n°7 of 4 April 2011 concerning the collection of statistics from credit institutions and the financial services of the Entreprise des Postes et Telecommunications

Area: Balance of payments and International investment position

For a complete list of regulations published by the Banque centrale du Luxembourg, please visit the BCL's website (www.bcl.lu).

2 LIST OF BCL CIRCULARS PUBLISHED IN 2011

For a complete list of circulars published by the Banque centrale du Luxembourg, please visit the BCL's website (www.bcl.lu).

3 LIST OF BCL PUBLICATIONS PUBLISHED IN 2011

3.1 BCL bulletins

- Bulletin BCL 2011/1, March 2011
- Financial Stability Review, April 2011
- Bulletin BCL, September 2011
- Bulletin BCL, December 2011

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3.2 BCL annual report

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- Annual Report 2010, August 2011

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3.3 BCL working papers

- Working paper n°70, October 2011
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  by Patrick Lünnemann and Thomas Y. Mathä

- Working paper n°69, October 2011
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  The leverage cycle in Luxembourg's banking sector,
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  by Paolo Guarda, Abdelaziz Rouabah and John Theal

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  Aging and Pensions in General Equilibrium: Labor Market Imperfections Matter,
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- Working paper n°60, February 2011
  Subprime Consumer Credit Demand: Evidence from a Lender's Pricing Experiment,
  by Sule Alan, Ruxandra Dumitrescu and Gyongyi Loranth

- Working paper n°59, February 2011
  Behavioural Characteristics and Financial Distress,
  by Yvonne McCarthy

- Working paper n°58, February 2011
  Household Sector Borrowing in the Euro Area: A Micro Data Perspective,
  by Ramon Gomez-Salvador, Adriana Lojschova and Thomas Westermann

- Working paper n°57, February 2011
  The Immigrant/Native Wealth Gap in Germany, Italy and Luxembourg,
  by Thomas Y. Mathä, Alessandro Porpiglia and Eva Sierminska

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  Wealth Mobility and Dynamics Over Entire Individual Working Life Cycles,
  by Stefan Hochguertel and Henry Ohlsson

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  Consumption and Initial Mortgage Conditions: Evidence from Survey Data,
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  by Thorsten Beck and Martin Brown

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3.4 BCL brochures

- La Banque centrale du Luxembourg – 2011
- The Banque centrale du Luxembourg – 2011
- Luxembourg numismatic products 2012

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3.5 Information material about the security features of Euro banknotes and coins

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3.6 Publications and external presentations of BCL Staff

3.6.1 BCL publications

- D. Igan, N. Tamirisa, A. Kabundi, F. Nadal de Simone, M. Pinheiro (2011): Housing, Credit, and Real Activity Cycles: Characteristics and Comovements. *Journal of Housing Economics* 20(3): 210-231.

- A. Kabundi and F. Nadal De Simone (2011): France in the global economy: a structural approximate dynamic factor model analysis. *Empirical Economics* 41(2): 311-342.

- P. Lünnemann and L. Wintr (2011): Price Stickiness in the US and Europe Revisited: Evidence from Internet Prices. *Oxford Bulletin of Economics and Statistics* 73(5):593-621.

- T. Mathä and O. Pierrard. (2011): Search in the Product Market and the Real Business Cycle. *Journal of Economic Dynamics and Control* 35: 1172-1191.

- Ph. Du Caju, C. Fuss and L. Wintr (2012): Downward wage rigidity for different workers and firms. *Brussels Economic Review* 55(1): forthcoming.

- Ph. Du Caju, C. Fuss and L. Wintr (2012): Sectoral differences in downward real wage rigidity: workforce composition, institutions, technology and competition. *Journal for Labour Market Research*, forthcoming.

3.6.2 External presentations

- Banking, Productivity and Growth, Perfilux Conference, Luxembourg, March 2011
- EUI-NOMICS, Florence, April 2011
- Spring Meeting of Young Economists, Groningen, April 2011
- Workshop on "Basic Income and Income Redistribution", Université du Luxembourg, April 2011
- Working Group on Econometric Modelling, Amsterdam, May 2011
- Financial Intermediation, Competition and Risk, Rome, June 2011
- XII European Workshop on Efficiency and Productivity Analysis, Verona (IT), June 2011
- Annual conference German Economic Association (Verein für Socialpolitik), Frankfurt, September 2011
- Netspar (Network for Studies on Pensions, Aging and Retirement) workshop on "Pensions, Savings & Retirement Decisions", Utrecht, October 2011
- CEPR/Euro Area Business Cycle Network Conference on Macro-Financial Linkages, Florence, October 2011.

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5 MONETARY, ECONOMIC AND FINANCIAL STATISTICS

1 Monetary policy statistics

- 1.1 Financial statement of the Banque central du Luxembourg
- 1.2 Luxembourg minimum reserve statistics

2 Monetary and financial developments in the euro area and Luxembourg

- 2.1 Aggregated balance sheet of the Luxembourg MFIs (excluding the Banque centrale du Luxembourg)
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6 LIST OF ABBREVIATIONS

ABBL	Association des Banques et Banquiers, Luxembourg
EBA	European Banking Authority
BCL	Banque centrale du Luxembourg
BIS	Bank for International Settlements
CBPP	Covered Bond Purchase Programme
CCBM	Correspondent central banking model
CETREL	Centre de transferts électroniques Luxembourg
CPI	Consumer Price Index
CSSF	Commission de surveillance du secteur financier
ECB	European Central Bank
ECG	Enlarged Contact Group on the Supervision of Investment Funds
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EIB	European Investment Bank
EMI	European Monetary Institute (1994-1998)

EMS	European Monetary System
EMU	Economic and Monetary Union
ESA 95	European System of Accounts 1995
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
EUR	euro
EUROSTAT	Statistical office of the European communities
FSB	Financial Stability Board
GDP	Gross domestic product
HICP	Harmonised Index of Consumer Prices
IADB	Inter American Development Bank
ICP	Index of Consumer Prices
IGF	Inspection générale des finances
IPP	Index of Production Prices
IMF	International Monetary Fund
IML	Institut Monétaire Luxembourgeois (1983-1998)
IOSCO	International Organisation of Securities Commissions
LIPS	Gross Luxembourg Interbank Payment System – Gross Settlement System
LIPS	Net Luxembourg Interbank Payment System – Net Settlement System
LTRO	Longer-term Refinancing Operations
LU	Luxembourg
MFI	Monetary Financial Institution
MRA	Maximum Risk Allowance
MRO	Main refinancing operation
NCB	National central bank
OECD	Organisation for Economic Cooperation and Development
OLS	Ordinary least squares
RTGS	Real-Time Gross Settlement system
SDR	Special Drawing Rights
SGP	Stability and Growth Pact
SMP	Securities Markets programme
STATEC	Institut National de la Statistique et des Etudes Economiques
SWIFT	Society for Worldwide Interbank Financial Telecommunication s.c.
TARGET system	Trans-European Automated Real-time Gross settlement Express Transfer system
TFEU	Treaty on the functioning of the European Union
UCI	Undertaking for Collective Investments
UCITS	Undertaking for Collective Investments in Transferable Securities
USD	US dollar

7 GLOSSARY

Base effect: When analysing business cycles, the evolution of annual variation rates of a variable are often explained by "base effects". A base effect occurs when the evolution of a variable's annual rate from month t+1 varies because of the evolution of the variable's level 12 months before and not because of the variation of the variable's level between month n and month n+1.

Balance of payments (b.o.p.): a statistical statement that summarises, for a specific period of time, the economic transactions of an economy with the rest of the world. The transactions considered are those involving goods, services and income; those involving financial claims on, and liabilities to, the rest of the world; and those (such as debt forgiveness) that are classified as transfers.

Central counterparty: an entity that interposes itself between the counterparties to the contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer.

Central government: the government as defined in the European System of Accounts 1995, but excluding regional and local governments (see also general government).

Central securities depository (CSD): an entity that i) enables securities transactions to be processed and settled by book entry, and ii) plays an active role in ensuring the integrity of securities issues. Securities can be held in physical (but immobilised) or dematerialised form (i.e. so that they exist only as electronic records).

Collateral: assets pledged or otherwise transferred (e.g. by credit institutions to central banks) as a guarantee for the repayment of loans, as well as assets sold (e.g. by credit institutions to central banks) under repurchase agreements.

Consolidated balance sheet of the MFI sector: a balance sheet obtained by netting out inter-MFI positions (e.g. inter-MFI loans and deposits) in the aggregated MFI balance sheet. It provides statistical information on the MFI sector's assets and liabilities vis-à-vis residents of the euro area not belonging to this sector (i.e. the general government and other euro area residents) and vis-à-vis non-euro area residents. It is the main statistical source for the calculation of monetary aggregates, and it provides the basis for the regular analysis of the counterparts of M3.

Correspondent central banking model (CCBM): a mechanism established by the European System of Central Banks with the aim of enabling counterparties to use eligible collateral on a cross-border basis. In the CCBM, NCBs act as custodians for one another. Each NCB has a securities account in its securities administration for each of the other NCBs (and for the European Central Bank).

Council of the European Union (EU Council): the institution of the EU made up of representatives of the governments of the EU Member States, normally the ministers responsible for the matters under consideration, and the relevant European Commissioner (see also ECOFIN Council).

Counterparty: the opposite party in a financial transaction (e.g. any party transacting with a central bank).

Covered bond purchase programme (CBPP): euro-denominated covered bonds issued in the euro area, in support of a specific financial market segment that is important for the funding of banks and was particularly affected by the financial crisis. The purchases under the programme were for a nominal value of € 60 billion, and they were fully implemented by 30 June 2010. On 6 October 2011 the Governing Council decided to launch a second covered bond purchase programme, CBPP2. This programme allows the Eurosystem to purchase euro-denominated covered bonds issued in the euro area for an intended nominal value of € 40 billion. The purchases are conducted in both the primary and secondary markets.

Credit institution: 1) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or 2) an undertaking or any other legal person, other than those under (1), which issues means of payment in the form of electronic money. The most common types of credit institutions are banks and savings banks. See also electronic money (e-money).

Credit risk: the risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes replacement cost risk and principal risk. It also includes the risk of the failure of the settlement bank.

Debt (general government): the total gross debt (currency, deposits, loans and debt securities) at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government.

Debt security: a promise on the part of the issuer (i.e. the borrower) to make one or more payment(s) to the holder (the lender) on a specified future date or dates. Such securities usually carry a specific rate of interest (the coupon) and/or are sold at a discount to the amount that will be repaid at maturity.

Debt-to-GDP ratio (general government): the ratio of debt to gross domestic product at current market prices. It is the subject of one of the fiscal criteria laid down in Article 126(2) of the Treaty to define the existence of an excessive deficit.

Deficit (general government): the general government's net borrowing, i.e. the difference between total government revenue and total government expenditure.

Deficit-debt adjustment (general government): the difference between the general government budget balance (deficit or surplus) and the change in debt.

Deficit ratio (general government): the ratio of the deficit to gross domestic product at current market prices. It is the subject of one of the fiscal criteria laid down in Article 126(2) of the Treaty to define the existence of an excessive deficit (see also excessive deficit procedure). It is also referred to as the budget deficit ratio or the fiscal deficit ratio.

Deposit facility: a standing facility of the Eurosystem which counterparties may use to make overnight deposits, remunerated at a pre-specified interest rate, at an NCB (see also key ECB interest rates).

Direct investment: cross-border investment for the purpose of obtaining a lasting interest in an enterprise resident in another economy (assumed, in practice, for ownership of at least 10% of the ordinary shares or voting power). Included are equity capital, reinvested earnings and other capital associated with inter-company operations.

ECOFIN Council: the EU Council meeting in the composition of the ministers of economy and finance.

Economic analysis: one pillar of the European Central Bank's framework for conducting a comprehensive analysis of the risks to price stability, which forms the basis for the Governing Council's monetary policy decisions. The economic analysis focuses mainly on the assessment of current economic and financial developments and the implied short to medium-term risks to price stability from the perspective of the interplay between supply and demand in goods, services and factor markets at those horizons. Due attention is paid to the need to identify the nature of shocks affecting the economy, their effects on cost and pricing behaviour, and the short to medium-term prospects for their propagation in the economy (see also monetary analysis).

Economic and Financial Committee (EFC): a consultative Community body which contributes to the preparation of the work of the ECOFIN Council and the European Commission. Its tasks include reviewing the economic and financial situation of the Member States and of the Community, and budgetary surveillance.

Economic and Monetary Union (EMU): the process that led to the single currency, the euro, and the single monetary policy in the euro area, as well as to the coordination of the economic policies of the EU Member States. This process, as laid down in the Treaty, took place in three stages. Stage Three, the final stage, started on 1 January 1999 with the transfer of monetary competence to the European Central Bank and the introduction of the euro. The cash changeover on 1 January 2002 completed the process of setting up EMU.

Effective exchange rate (EER) of the euro (nominal/real): a weighted average of bilateral euro exchange rates against the currencies of the euro area's main trading partners. The European Central Bank publishes nominal EER indices for the euro against two groups of trading partners: the EER-21 (comprising the 11 noneuro area EU Member States and 10 main trading partners outside the EU) and the EER-41 (composed of the EER-21 and 20 additional countries). The weights used reflect the share of each partner country in euro area trade and account for competition in third markets. Real EERs are nominal EERs deflated by a weighted average of foreign, relative to domestic, prices or costs. They are thus measures of price and cost competitiveness.

Electronic money (e-money): An electronic store of monetary value on a technical device that may be widely used as prepaid bearer instrument for making payments to undertakings other than the issuer, without necessarily involving bank accounts in the transactions.

EONIA (euro overnight index average): a measure of the effective interest rate prevailing in the euro interbank overnight market. It is calculated as a weighted average of the interest rates on unsecured overnight lending transactions denominated in euro, as reported by a panel of contributing banks.

Equities: securities representing ownership of a stake in a corporation. They comprise shares traded on stock exchanges (quoted shares), unquoted shares and other forms of equity. Equities usually produce income in the form of dividends.

ERM II (exchange rate mechanism II): the exchange rate mechanism which provides the framework for exchange rate policy cooperation between the euro area countries and the non-euro area EU Member States. ERM II is a multilateral arrangement with fixed, but adjustable, central rates and a standard fluctuation band of ±15%. Decisions concerning central rates and, possibly, narrower fluctuation bands are taken by mutual agreement between the EU Member State concerned, the euro area countries, the European Central Bank (ECB) and the other EU Member States participating in the mechanism. All participants in ERM II, including the ECB, have the right to initiate a confidential procedure aimed at changing the central rates (realignment).

EURIBOR (euro interbank offered rate): the rate at which a prime bank is willing to lend funds in euro to another prime bank, as reported by a panel of contributing banks, computed daily for interbank deposits with different maturities of up to 12 months.

Euro: The name of the European single currency adopted by the European council at its meting in Madrid on 15 and 16 December 1995 and used instead of the term ECU originally employed in the Treaty.

Euro area: the area encompassing those Member States which have adopted the euro as the single currency in accordance with the Treaty and in which a single monetary policy is conducted under the responsibility of the Governing Council of the European Central Bank. The euro area currently comprises Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland.

Eurogroup: an informal gathering of the ministers of economy and finance of the EU Member States whose currency is the euro.

European Central Bank (ECB): the ECB lies at the centre of the Eurosystem and the European System of Central Banks (ESCB) and has its own legal personality in accordance with the Treaty (Article 282(3)). It ensures that the tasks conferred upon the Eurosystem and the ESCB are implemented either through its own activities or through those of the NCBs, pursuant to the Statute of the ESCB. The ECB is governed by the Governing Council and the Executive Board, and, as a third decision-making body, by the General Council.

Europe 2020 strategy: the EU's strategy for employment and smart, sustainable and inclusive growth. It was adopted by the European Council in June 2010. Building on the earlier Lisbon strategy, it is intended to provide a coherent framework for EU Member States to implement structural reforms aimed at raising potential growth and for mobilising EU policies and instruments.

European Council: the institution of the EU consisting of the Heads of State or Government of the EU Member States and, as non-voting members, the President of the European Commission and the European Council's own President. It provides the EU with the necessary impetus for its development and defines the general political directions and priorities thereof. It does not have a legislative function.

European Financial Stabilisation Mechanism (EFSM): an EU facility, based on Article 122(2) of the Treaty, that allows the European Commission to raise up to € 60 billion on behalf of the EU for lending to EU Member States experiencing, or being threatened with, exceptional circumstances beyond their control. EFSM lending is subject to strong conditionality in the context of joint EU-IMF programmes.

European Financial Stability Facility (EFSF): a limited liability company established by the euro area countries, on an intergovernmental basis, for the purpose of providing loans to euro area countries in financial difficulties. Such financial assistance is subject to strong conditionality in the context of joint EU-IMF programmes. The EFSF has an effective lending capacity of € 440 billion, and its loans are financed through the issuance of debt securities, guaranteed by euro area countries on a pro rata basis.

European Monetary Institute (EMI): A temporary institution established at the start of stage two of Economic and Monetary Union on 1 January 1994. The two main tasks of the EMI were to strengthen central bank cooperation and monetary policy coordination and to make the preparations required for establishment of the European System of Central Banks, for the conduct of the single monetary policy and for the creation of a single currency in stage three. It went into liquidation upon the establishment of the European Central Bank on 1 June 1998.

European Stability Mechanism (ESM): an intergovernmental organisation established by the euro area countries on the basis of the Treaty establishing the European Stability Mechanism. It offers a permanent crisis management mechanism which will provide financial support to euro area countries if it is established that it is indispensable to safeguard financial stability in the euro area as a whole. It is foreseen that the ESM will enter into force on 1 July 2012. It will replace both the European Financial Stability Facility and the European Financial Stabilisation Mechanism, and will have an initial effective lending capacity of € 500 billion. ESM lending will be subject to strict conditionality.

European System of Accounts 1995 (ESA 95): a comprehensive and integrated system of macroeconomic accounts based on a set of internationally agreed statistical concepts, definitions, classifications and accounting rules aimed at achieving a harmonised quantitative description of the economies of the EU Member States. The ESA 95 is the Community's version of the world System of National Accounts 1993 (SNA 93).

European System of Central Banks (ESCB): composed of the European Central Bank (ECB) and the NCBs of all 27 EU Member States, i.e. it includes, in addition to the members of the Eurosystem, the NCBs of those Member States whose currency is not the euro. The ESCB is governed by the Governing Council and the Executive Board of the ECB, and, as a third decision-making body of the ECB, by the General Council.

European System of Financial Supervision (ESFS): the group of institutions in charge of ensuring the supervision of the EU's financial system. It comprises the European Systemic Risk Board, the three European Supervisory Authorities, the Joint Committee of the European Supervisory Authorities, and the national supervisory authorities of the EU Member States.

European Systemic Risk Board (ESRB): an independent EU body responsible for the macro-prudential oversight of the financial system within the EU. It contributes to the prevention or mitigation of systemic risks to financial stability that arise from developments within the financial system, taking into account macroeconomic developments, so as to avoid periods of widespread financial distress.

Eurosystem: the central banking system of the euro area. It comprises the European Central Bank and the NCBs of the Member States that have adopted the euro.

Excessive deficit procedure: the provision set out in Article 126 of the Treaty and specified in Protocol (n°12) on the excessive deficit procedure requires EU Member States to maintain budgetary discipline, defines the criteria for a budgetary position to be considered an excessive deficit and regulates steps to be taken following the observation that the requirements for the budgetary balance or government debt have not been fulfilled. Article 126 is supplemented by Council Regulation (EC) n°1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, which is one element of the Stability and Growth Pact.

Eurosystem's international reserves: These comprise the reserve assets of the European Central Bank (ECB) and the reserve assets held by the national central banks (NCBs) of the participating Member States. Reserve assets must 1) be under the effective control of the relevant monetary authority, whether the ECB or the NCB of one of the participating Member States, and 2) comprise highly liquid, marketable and creditworthy foreign (i.e. non-euro) currency-denominated claims on non-euro area residents, plus gold, special drawing rights and the reserve positions in the International Monetary Fund of the participating NCBs.

Executive Board: one of the decision-making bodies of the European Central Bank (ECB). It comprises the President and the Vice-President of the ECB and four other members appointed, since the entry into force of the Treaty of Lisbon, by the European Council, acting by a qualified majority, on a recommendation from the EU Council.

Fiduciary money: banknotes and coins having the status of legal tender.

Financial stability: condition in which the financial system – comprising financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unraveling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities.

Fine-tuning operation: an open market operation executed by the Eurosystem in order to deal with unexpected liquidity fluctuations in the market. The frequency and maturity of fine-tuning operations are not standardised.

Foreign exchange swap: Simultaneous spot and forward transactions exchanging one currency against another. The Eurosystem can execute open market operations in the form of foreign exchange swaps, where the national central banks (or the European central bank) buy or sell Euro spot against a foreign currency and, at the same time, sell or buy them back in forward transaction.

GDP deflator: gross domestic product (GDP) expressed in current prices (nominal GDP) divided by the volume of GDP (real GDP). It is also known as the implicit price deflator of GDP.

General Council: one of the decision-making bodies of the European Central Bank (ECB). It comprises the President and the Vice-President of the ECB and the governors of all the NCBs of the European System of Central Banks.

General government: a sector defined in the European System of Accounts 1995 as comprising resident entities that are engaged primarily in the production of non-market goods and services intended for individual and collective consumption and/or in the redistribution of national income and wealth. Included are central, regional and local government authorities, as well as social security funds. Excluded are government-owned entities that conduct commercial operations, such as public enterprises.

Governing Council: the supreme decision-making body of the European Central Bank (ECB). It comprises all the members of the Executive Board of the ECB and the governors of the NCBs of the Member States that have adopted the euro.

Gross domestic product (GDP): a measure of economic activity, namely the value of an economy's total output of goods and services, less intermediate consumption, plus net taxes on products and imports, in a specified period. GDP can be broken down by output, expenditure or income components. The main expenditure aggregates that make up GDP are household final consumption, government final consumption, gross fixed capital formation, changes in inventories, and imports and exports of goods and services (including intra-euro area trade).

Harmonised index of the consumer prices (HICP): a measure of the development of consumer prices that is compiled by Eurostat and harmonised for all EU Member states.

Implied volatility: the expected volatility (i.e. standard deviation) in the rates of change of the price of an asset (e.g. a share or a bond). It can be derived from the asset's price, its maturity date and the exercise price of its options, as well as from a riskless rate of return, using an option pricing model such as the Black-Scholes model.

Key ECB interest rates: the interest rates, set by the Governing Council, which reflect the monetary policy stance of the European Central Bank. They are the rates on the main refinancing operations, the marginal lending facility and the deposit facility.

Longer-term refinancing operation: a regular open market operation executed by the Eurosystem in the form of reverse transactions. Such operations are carried out through a monthly standard tender and normally have a maturity of three months. During the financial market turmoil that started in August 2007, supplementary operations with maturities ranging from one maintenance period to one year were conducted, the frequency of which varied.

Main refinancing operation: a regular open market operation executed by the Eurosystem in the form of reverse transactions. Such operations are carried out through a weekly standard tender and normally have a maturity of one week.

Maintenance period: the period over which credit institutions' compliance with reserve requirements is calculated. The maintenance period begins on the settlement day of the first main refinancing operation following the meeting of the Governing Council at which the monthly assessment of the monetary policy stance is pre-scheduled. The ECB publishes a calendar of the reserve maintenance periods at least three months before the start of the year.

Marginal lending facility: a standing facility of the Eurosystem which counterparties may use to receive overnight credit from an NCB at a pre-specified interest rate against eligible assets (see also key ECB interest rates).

Market liquidity risk: the risk that transactions on the financial market cannot be concluded or can only be concluded at worse than expected conditions owing to inadequate market depth or market disruption.

Market risk: the risk of losses (in both on and off-balance-sheet positions) arising from movements in market prices.

MFIs (monetary financial institutions): financial institutions which together form the money issuing sector of the euro area. These include the Eurosystem, resident credit institutions (as defined in Community law) and all other resident financial institutions whose business is to receive deposits and/or close substitutes for deposits from entities other than MFIs and, for their own account (at least in economic terms), to grant credit and/or invest in securities. The latter group consists predominantly of money market funds.

Monetary aggregates: Currency in circulation, plus outstanding amounts of certain liabilities of monetary financial institutions and central governments that have a relatively high degree of liquidity and are held by non-MFI euro area residents outside the central government sector. The narrow monetary aggregate M1 has been defined as currency in circulation plus overnight deposits. The "intermediate" monetary aggregate M2 comprises of M1 plus deposits with agreed maturity of up to two years and deposits redeemable at notice of up to three months. The broad monetary aggregate M3 includes M2 plus repurchase agreements, money market funds shares and units, money market paper and debt securities with a maturity of up to two years. In October 1998, the Governing Council announced a reference value for the growth of M3, which it has since reconfirmed (see also reference value for monetary growth).

Monetary analysis: one pillar of the European Central Bank's framework for conducting a comprehensive analysis of the risks to price stability, which forms the basis for the Governing Council's monetary policy decisions. The monetary analysis helps to assess medium to long-term trends in inflation, in view of the close relationship between money and prices over extended horizons. The monetary analysis takes into account developments in a wide range of monetary indicators including M3, its components and counterparts, notably credit, and various measures of excess liquidity (see also economic analysis).

Monetary income: income accruing to the NCBs in the performance of the Eurosystem's monetary policy function, derived from assets earmarked in accordance with guidelines established by the Governing Council and held against banknotes in circulation and deposit liabilities to credit institutions.

Money market: the market in which short-term funds are raised, invested and traded, using instruments which generally have an original maturity of up to and including one year.

Non-standard measures: temporary measures taken by the ECB to support the effectiveness of interest rate decisions and their transmission to the wider euro area economy in the context of a dysfunctional situation in some financial market segments and the financial system more broadly.

OFIs (other financial intermediaries): corporations or quasi-corporations (other than insurance corporations or pension funds) that are engaged mainly in financial intermediation by incurring liabilities in forms other than currency, deposits and/or close substitutes for deposits from institutional entities other than MFIs. OFIs include in particular corporations engaged primarily in long-term financing (such as financial leasing), securitised asset holdings, other financial holdings, securities and derivatives dealing (on their own account), venture capital and development capital.

Open market operation: an operation executed on the initiative of the central bank in the financial market. With regard to their aims, regularity and procedures, Eurosystem open market operations can be divided into four categories: main refinancing operations; longer-term refinancing operations; fine-tuning operations; and structural operations. As for the instruments used, reverse transactions are the main open market instrument of the Eurosystem and can be employed in all four categories of operations. In addition, the issuance of debt certificates and outright transactions are available for structural operations, while outright transactions, foreign exchange swaps and the collection of fixed-term deposits are available for the conduct of fine-tuning operations.

Outright transaction: A transaction whereby assets are bought or sold up to their maturity (spot or forward).

Over-the-counter (OTC) trading: a method of trading that does not involve a regulated market. In over-the-counter markets, such as those for OTC derivatives, participants trade directly with each other, typically through telephone or computer links.

Price stability: the maintenance of price stability is the primary objective of the Eurosystem. The Governing Council defines price stability as a year-on-year increase in the Harmonised Index of Consumer Prices for the euro area of below 2%. The Governing Council has also made it clear that, in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term.

Projections: the results of exercises conducted four times a year to project possible future macroeconomic developments in the euro area. Eurosystem staff projections are published in June and December, whereas ECB staff projections are published in March and September. They form part of the economic analysis pillar of the monetary policy strategy of the ECB and are thus one of several inputs into the Governing Council's assessment of the risks to price stability.

Real-time gross settlement (RTGS) system: a settlement system in which processing and settlement take place on an order-by-order basis (without netting) in real time (continuously) (see also TARGET).

Reference value for M3 growth: the annual growth rate of M3 over the medium term that is consistent with the maintenanc of price stability. At present, the reference value for annual M3 growth is 4.5%.

Repurchase agreement: the process of borrowing money by combining the sale of an asset (usually a fixed income security) with the subsequent repurchase of that same asset on a specified date for a slightly higher specified price (which reflects the borrowing rate).

Reserve base: the sum of the eligible balance sheet items (in particular liabilities) that constitute the basis for calculating the reserve requirement of a credit institution.

Reserve ratio: the ratio defined by the central bank for each category of eligible balance sheet items included in the reserve base. The ratio is used to calculate reserve requirements.

Reserve requirement: the minimum amount of reserves a credit institution is required to hold with the Eurosystem over a predefined maintenance period. Compliance with the requirement is determined on the basis of the average of the daily balances in the reserve accounts over the maintenance period.

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Reverse transaction: an operation whereby the central bank buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

Securitisation: the pooling of financial assets, such as residential mortgage loans, and their subsequent sale to a special-purpose vehicle, which then issues fixed income securities for sale to investors. The principal interest of these securities depend on the cash flows produced by the pool of underlying financial assets.

Securities Markets Programme (SMP): a programme for conducting interventions in the euro area public and private debt securities markets to ensure depth and liquidity in dysfunctional market segments with a view to restoring an appropriate monetary policy transmission mechanism.

Securities settlement system (SSS): a system which permits the holding and transfer of securities or other financial assets, either free of payment or against payment (delivery versus payment).

Settlement risk: the risk that settlement in a transfer system will not take place as expected, usually owing to a party defaulting on one or more settlement obligations. This risk comprises, in particular, operational risk, credit risk and liquidity risk.

Stability and Growth Pact: the Stability and Growth Pact is intended to serve as a means of safeguarding sound government finances in Stage Three of Economic and Monetary Union in order to strengthen the conditions for price stability and for strong, sustainable growth conducive to employment creation. To this end, the Pact prescribes that Member States specify medium-term budgetary objectives. It also contains concrete specifications on the excessive deficit procedure. The Pact consists of the Resolution of the Amsterdam European Council of 17 June 1997 on the Stability and Growth Pact and two Council Regulations, namely i) Regulation (EC) n°1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies as amended by Regulation (EC) n°1055/2005 of 27 June 2005, and ii) Regulation (EC) n°1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation (EC) n°1056/2005 of 27 June 2005. The Stability and Growth Pact is complemented by the ECOFIN Council's report entitled "Improving the implementation of the Stability and Growth Pact", which was endorsed by the Brussels European Council of 22 and 23 March 2005. It is also complemented by the new Code of Conduct entitled "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of stability and convergence programs", which was endorsed by the ECOFIN Council on 11 October 2005.

Standing facility: a central bank facility available to counterparties on their own initiative. The Eurosystem offers two overnight standing facilities: the marginal lending facility and the deposit facility.

Straight-through processing (STP): the automated end-to-end processing of trades/payment transfers – including, where relevant, the automated completion of confirmation, matching and generation of orders, clearing and settlement.

Systemic risk: the risk that the inability of one participant to meet its obligations in a system will cause other participants to be unable to meet their obligations when due, with possible spillover effects such as significant liquidity or credit problems that may threaten the stability of the financial system. Such inability may be caused by operational or financial problems.

TARGET (Trans-European Automated Real-time Gross settlement Express Transfer system): the real-time gross settlement (RTGS) system for the euro. The first-generation TARGET system was replaced by TARGET2 in May 2008.

TARGET2: a new generation of the TARGET system which replaces the former decentralised technical structure with a single shared platform offering a harmonised service with a uniform pricing scheme.

TARGET2-Securities (T2S): the Eurosystem's single technical platform enabling central securities depositories and NCBs to provide core, borderless and neutral securities settlement services in central bank money in Europe.

Treaties: unless stated otherwise, all references in this report to the "Treaties" refer to both the Treaty on the Functioning of the European Union and the Treaty on European Union.

Treaty: unless stated otherwise, all references in this report to the "Treaty" refer to the Treaty on the Functioning of the European Union, and the references to article numbers reflect the numbering in effect since 1 December 2009.

Treaty of Lisbon (Lisbon Treaty): amends the EU's two core treaties: the Treaty on European Union and the Treaty establishing the European Community. The latter has been renamed the Treaty on the functioning of the European Union. The Treaty of Lisbon was signed in Lisbon on 13 December 2007 and entered into force on 1 December 2009.

The BCL Annual Report is an abridged translation of the *Rapport Annuel de la BCL 2011*,
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