01 THE BCL'S ACTIVITIES

1
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1.1 MONETARY POLICY OPERATIONS

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

The primary objective of monetary policy is price stability through interest rates and liquidity situation management. In order to achieve its objectives, the Eurosystem has at its disposal a set of monetary policy instruments:

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 in 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 (LTRO), 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 liquidities 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.

Besides the regular monetary policy operations, the Eurosystem has implemented a number of non conventional operations:

Temporary currency auction facilities (swaps)

The Eurosystem established end-2007 a swap facility agreement with the US Federal Reserve. This agreement allows the Eurosystem to provide US dollars and the US Federal Reserve to provide euro to their counterparties, guaranteed by eligible collateral.

In September 2012, the Eurosystem renewed the swap agreement established with the Bank of England in December 2010.

In addition, in December 2012, the Eurosystem, the Bank of Canada, the Bank of England, the Federal Reserve and the Swiss National Bank announced the extension of the temporary liquidity swap arrangements until 1 February 2014.

Extension of operation maturities

The maturities of open market operations have been extended to an exceptional maturity of 36 months for some operations.

Covered Bond Purchase Programmes

In order to revitalize the covered bond market, the Eurosystem established two purchase programmes.

Securities Markets programme

This programme was implemented by the Eurosystem in order to address the malfunctioning of securities markets in the euro area.

Outright Monetary Transactions

Outright monetary transactions can only be activated for the purchase of securities of countries that strictly adhered to the requirements of a programme of the European Stability Mechanism or being under a macroeconomic adjustment programme and about to regain access to the market.

1.1.1 Conventional Operations

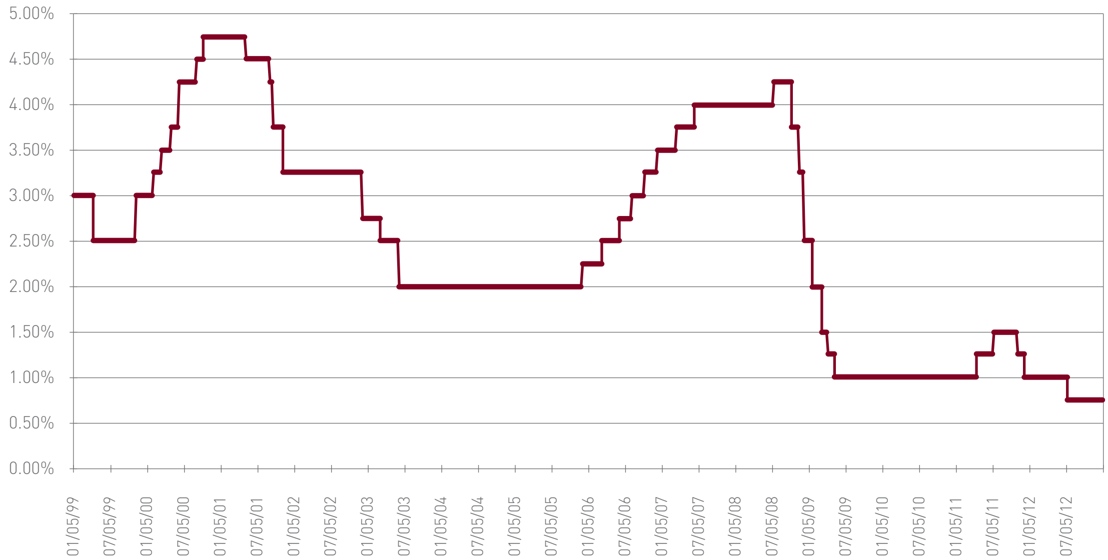
1.1.1.1 Open market operations

1.1.1.1.1 Main refinancing operations (MRO)

Since October 2008, the MRO were conducted by the Eurosystem on a full allotment and fixed rate basis. This measure was effective all through the year 2012. It is foreseen that this allotment method be maintained as long as necessary and at least until July 2013.

The Governing Council decreased the interest rate on the main refinancing operations to 0.75% in July 2012.

Graph 1:
MRO - Interest rate evolution since 1999

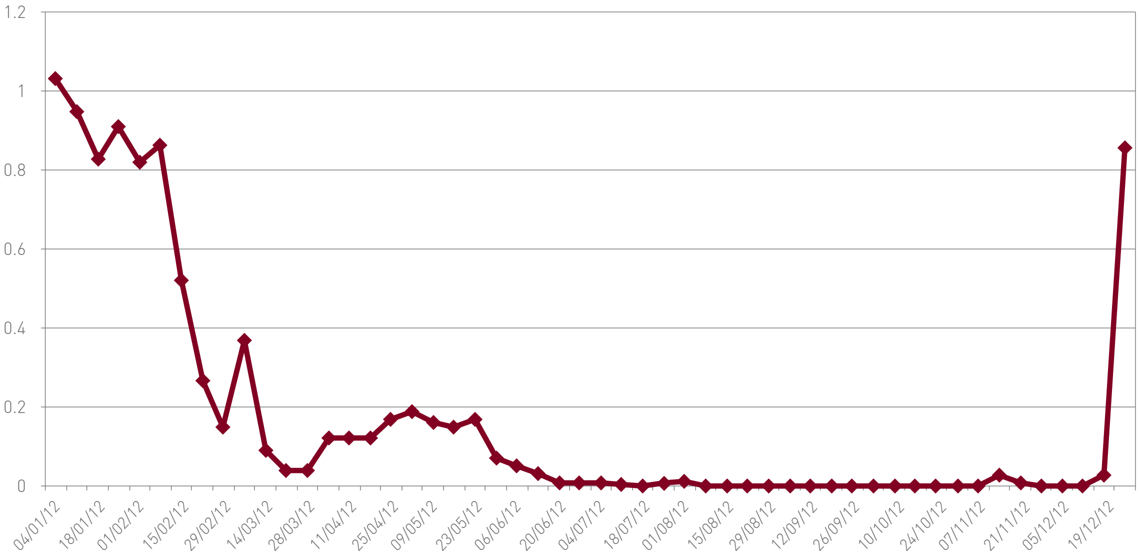


Source: BCL

The percentage of participation of Luxembourg to the MRO decreased strongly in the first part of 2012 down to an almost zero % in the second part of 2012.

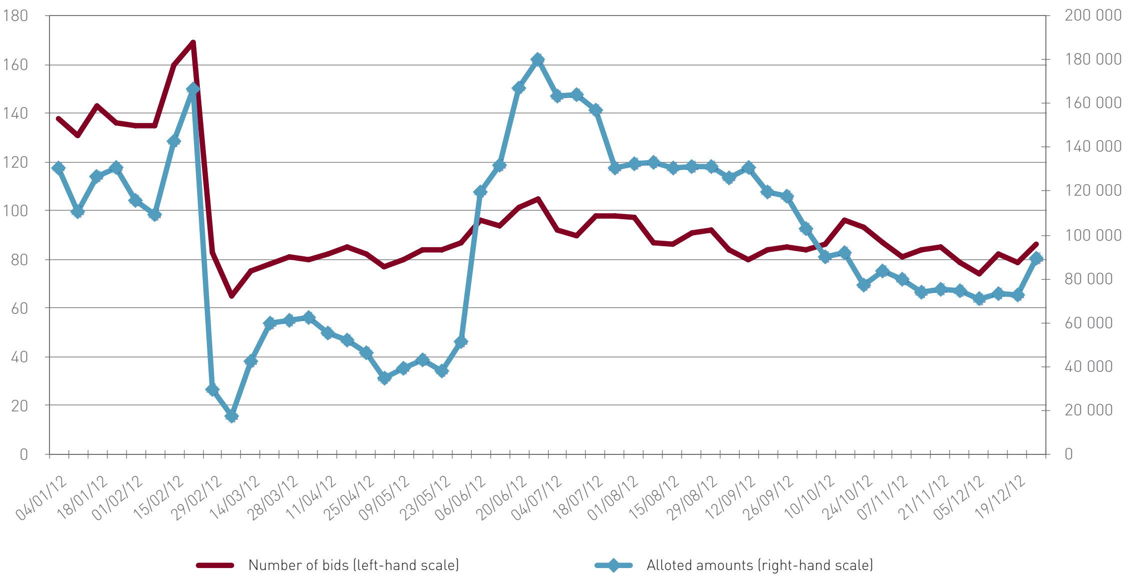
Luxembourg now ranks twelfth in the euro area in terms of percentage of participation. Since August 2012, Luxembourg counterparties have not shown interest for MRO. Some counterparties have nevertheless chosen to participate in the last MRO (28/12/12 to 03/01/13), which is reflected in their balance sheet (see Graph 2).

Graph 2:
MRO - Participation of LU compared to the euro area in 2012 (in %)



Source: BCL

Graph 3:
MRO - Number of bids and alloted amounts in 2012 in the euro area (in € million)



Source: BCL

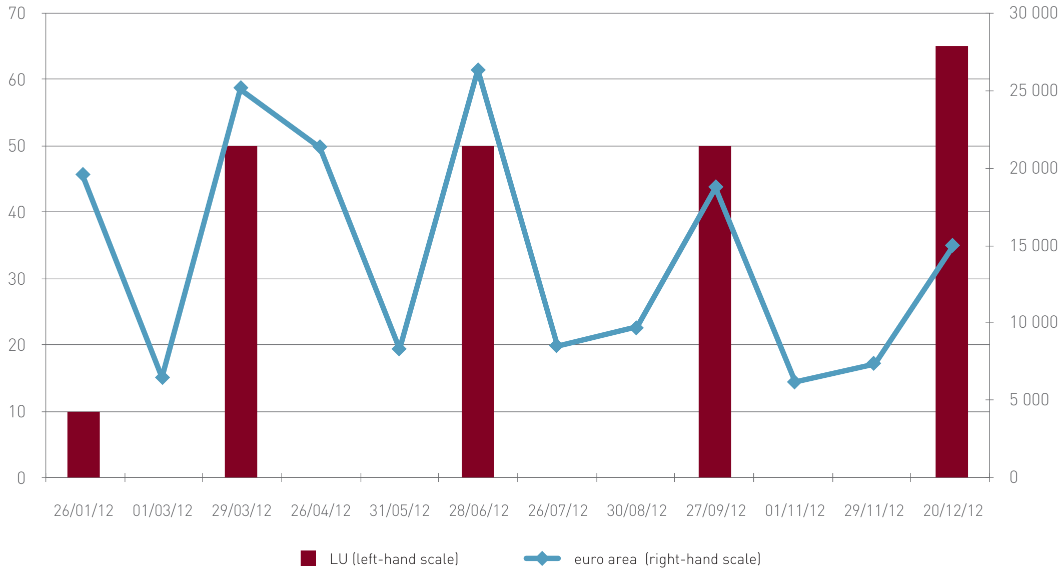
1.1.1.1.2 Longer-term refinancing operations (LTRO)

Additional one-maintenance period operations were conducted all through the year 2012. The Eurosystem announced that these operations would be maintained at least until mid-2013.

Luxemburgish counterparties did not participate in the one-maintenance period operations in 2012.

As shown in graph 4, Luxemburgish counterparties did not participate in all LTRO three-month operations in 2012.

Graph 4:
LTRO 3 months - LU and euro area - alloted amounts in 2012 (in € million)



Source: BCL

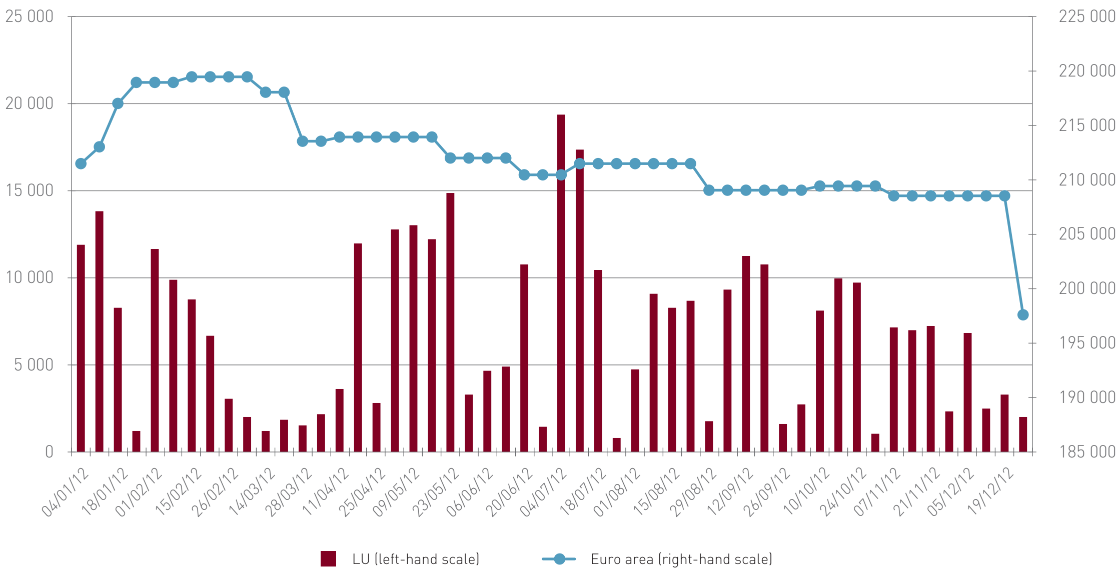
1.1.1.1.3 Fine-tuning operations

Liquidity-absorbing operations

From May 2010, the Eurosystem implemented one-week operations aiming at absorbing the liquidities injected through the Securities Markets Programme (see 1.1.2.4.).

Overall, 52 operations of this type were conducted in 2012, absorbing on average € 6.9 billion in Luxembourg and € 212 billion in the euro area.

Graph 5:
One-week deposits in 2012 - LU and euro area (in € million)



Source: BCL

Liquidity-providing operations

In 2012, there was no fine-tuning liquidity-providing operation.

1.1.1.2 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 in connection with the reference rate of the Eurosystem.

The Governing Council reduced the interest rate on the marginal lending rate to 1.5% and on the deposit facility to 0% in July 2012.

Marginal lending facility

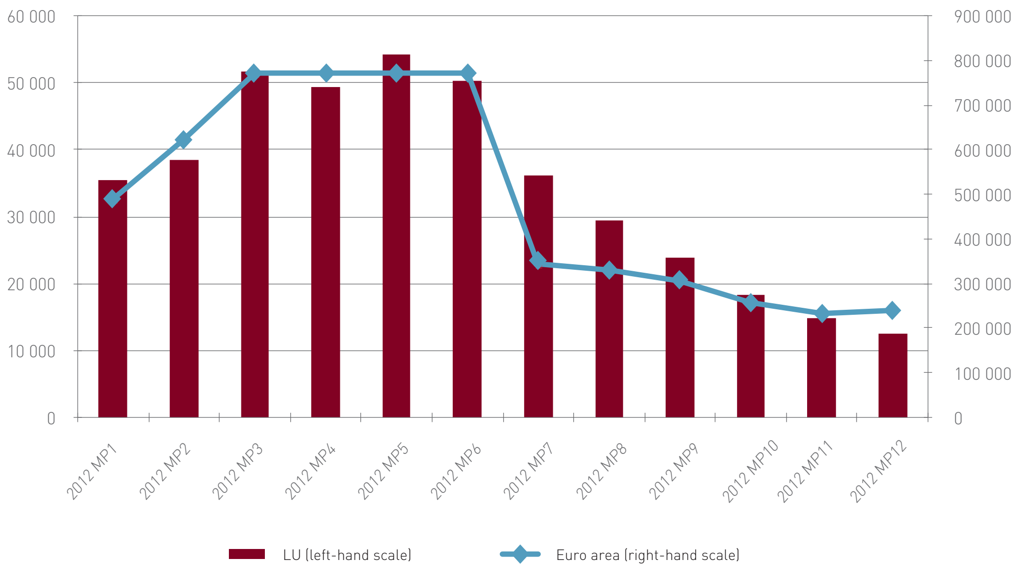
The marginal lending facility was scarcely used in 2012 by the Luxemburgish counterparties. It was only used punctually for limited amounts.

Deposit facility

After the continuous growth that had begun in mid-2011, the deposit facility's amounts in Luxembourg began to decline steadily in the second half of 2012, following the change in the rate of deposit facility (0%).

At the same time, the amounts left on current accounts increased due to the reduction of opportunity cost.

Graph 6:
Evolution of the deposit facility in 2012 - LU and euro area (average daily amount) (in € million)



Source: BCL

1.1.1.3 Minimum reserves

Since January 2012, the reserve ratio has been 1%, compared to 2% previously.

The change of the rate of the deposit facility - reduced to 0% in July 2012 - has modified the behaviour of Luxemburgish counterparties concerning their excess reserves. Amounts that can be considered as excess reserves (unremunerated) have increased dramatically.

1.1.2 Non-conventional operations

1.1.2.1 Temporary currency auction facilities

In 2012, the Eurosystem, in cooperation with the US Federal Reserve System, carried on supplying US dollar liquidities to the banks of the euro area. These operations were conducted as reverse transactions against collateral securities with a maturity of 7 or 84 days. All bids were satisfied at a fixed rate, announced beforehand.

In 2012, these operations met with a low level of interest in Luxembourg and in the euro area. Luxemburgish counterparties have no longer participated since May 2012.

In September 2012, the Eurosystem extended the agreement made in December 2010 with the Bank of England. It is now applicable until 30 September 2013.

In addition, in December 2012, the Eurosystem, the Bank of Canada, the Bank of England, the US Federal Reserve System and the Swiss National Bank announced the extension of the temporary currency agreements, set up in November 2011, which were originally due to expire on 1 February 2013. These agreements have been extended until February 1, 2014.

1.1.2.2 Extension of operation maturities

Alongside the traditional 3-month operations (12 for the year), and after additional operation to 36 months launched in December 2011, an additional second 36 months operation was implemented in February 2012 to support bank lending and liquidity in the money market in the euro area.
This was allocated at 100% at a floating rate, calculated at maturity and fixed to the average minimum bid rate on the main refinancing operations over the life of the operation. After one year, counterparties have the opportunity to repay part or all of the amounts allocated at any date coinciding with the settlement day of MRO.

The 36-months-operation, proposed for the second time, met a considerable success. € 529 billion were allocated to 800 counterparties in the euro area. 7 Luxembourg participants submitted bids for this operation.

1.1.2.3 Covered bond purchase programmes

The covered bonds that are guaranteed by mortgage bonds or by local authorities are a key instrument for the credit institutions funding. This market segment was particularly affected by the financial crisis.

In November 2011, the Eurosystem decided to launch a second covered bonds purchase programme on the primary and secondary markets.

This programme matured in November 2012. A nominal amount of € 16.4 billion was purchased on the primary and secondary markets between November 2011 and October 2012.

National central banks of the Eurosystem notified their intention to keep the purchased bonds until maturity.

1.1.2.4 Securities Markets programme

In May 2010, the Eurosystem decided to conduct an exceptional securities market programme.

The objective of this programme is to address the malfunctioning of definite segments of debt securities markets in the euro area and restore an appropriate monetary policy transmission mechanism.

In order to sterilise the impact of those bond purchases, the Eurosystem conducts specific operations aimed at re-absorbing the liquidities injected through the Programme.

The Securities market programme ended in September 2012, following the decision of the Eurosystem concerning monetary transactions (see below).

As of 31 December 2012, the cumulated value of the purchases realised on the ground of the securities market programme reached € 218.1 billion.

1.1.2.5 Outright Monetary Transactions

In September 2012 the Eurosystem published the technical specifications of outright monetary transactions in secondary sovereign bond markets.

Outright Monetary Transactions can only be activated for the purchase of securities of countries that strictly adhered to the requirements of a programme of the European Stability Mechanism (ESM) or being under macroeconomic adjustment programme and about to regaining market access.

As for the Securities Markets programme, the liquidity created through Outright Monetary Transactions will be fully neutralised.

1.2 FOREIGN EXCHANGE RESERVE MANAGEMENT BY THE BCL

The ECB's foreign exchange reserves have been managed in a decentralised way by the national central banks since January 1999. 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.

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 2012, the total market value of the ECB's reserves (including accrued interest) managed by the BCL corresponded to € 321 million[3]. 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 passively managed assets in gold is determined by the ECB, taking into account strategic considerations and market conditions.

3 This amount includes the reserves of the Bank of Slovenia (BS) which are pooled with the reserves of the BCL and are managed by the latter pursuant to a pooling agreement.

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 own fund 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. In the course of the year, ALCO has regularly assessed 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 check compliance with the pre-defined limits. This monitoring is carried out daily and independently from the Front Office. This monitoring structure is reinforced by specific missions allocated to different levels of the organisation and by the monitoring carried out by the Middle and Back Offices.

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 international economies and financial markets;
- the asset allocation decisions through the assessment of 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 geographical 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. The strategic orientation enables diversification in other asset categories.

The BCL manages eight kinds of portfolios.

a) 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 2012 the total market value (including accrued interest) amounted to € 2 719 million.

In 2012, the share of this portfolio invested in fixed income securities with a maturity above three years was raised from 29% to 53%, whereas the percentage of bonds with a one to three-year maturity decreased from 33% to 23%. Moreover, by the end of 2012, variable rate and fixed rate bonds with a maturity under one year represented 24% of the investment portfolio.

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

b) 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 (Euro commercial paper (ECP), provided that they comply with strict and predefined rating criteria). As of 31 December 2012, the total market value (including accrued interest) amounted to € 1 683 million. Since 2011 a part of the portfolio has been outsourced to an external portfolio manager.

Table 1: Breakdown of reserves as of 31 December 2012

Maturity	Portfolio 1	Portfolio 2
0-1 year	24%	90%
1-3 years	23%	10%
› 3 years	53%	0%

c) Domestic Foreign 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 2012, the total market value (including accrued interest) of this portfolio in foreign currencies amounted to € 132 million.

d) Pension Fund Portfolio

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

e) Foreign Reserves Portfolio of the European Central Bank

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

f) Covered Bond Purchase Programme

After participating in the first CBPP, the BCL also took part in the second programme. This programme expired in November 2012.

g) Securities Market Programme

The Securities Market Programme, which was initiated in May 2010, ended in September 2012 following a decision of the Eurosystem.

h) 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 Eurosystem's 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.

1.4 BANKNOTES AND COINS

1.4.1 Production of banknotes and coins

Within the Eurosystem, the euro banknote production is assigned on the basis of a decentralised pooling scenario adopted in 2002, in which each NCB of the euro area is responsible for providing a part of the total requirements. Euro banknotes are produced in accordance with the needs expressed by the participating NCBs and aggregated by the ECB. In this context, in 2012, the BCL was responsible for the production of 21.1 million of € 20 banknotes for the Eurosystem's needs (compared to 7.7 million € 20 and 8.0 million € 50 banknotes in 2011). The BCL allocated these banknotes via a tender. In addition, for its own needs, the BCL received 39.8 million banknotes from other NCBs (compared to 36.3 million in 2011).

Under an agreement with the State of Luxembourg, the BCL is also in charge of Luxembourg's euro coin production and puts these coins into circulation. Following a tender, the BCL has commissioned the production of 38.6 million coins of the 2012 series, identical to the 2011 figure, to cover the needs of economic agents and numismatists.

1.4.2 Circulation of banknotes and coins

1.4.2.1 Euro banknotes and coins

1.4.2.1.1 Banknotes

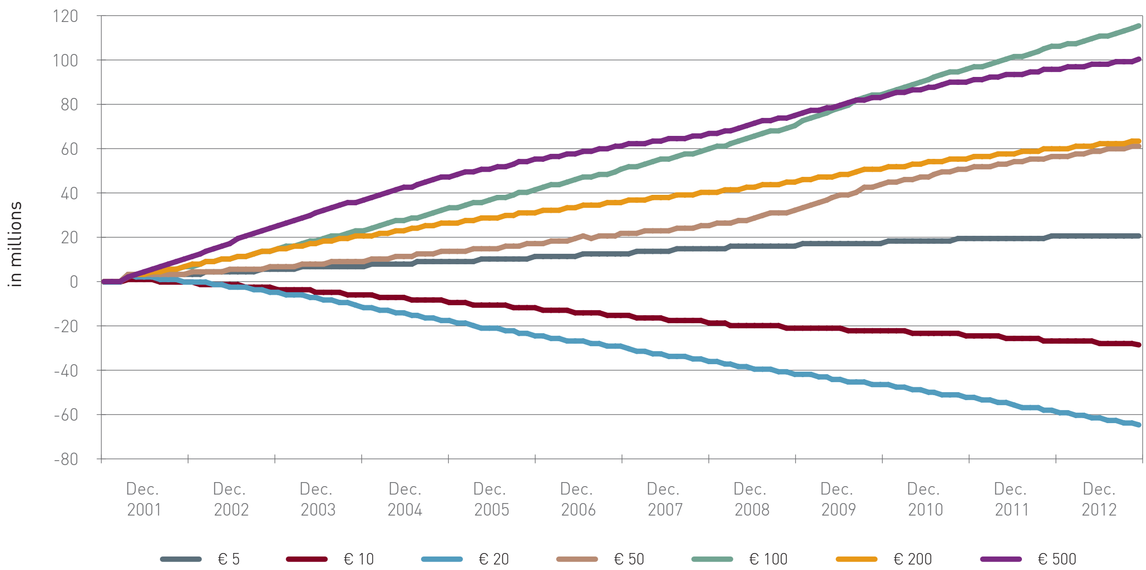
The total net volume of notes issued by the BCL during the year 2012 amounts to 18.0 million banknotes compared to 18.7 million in 2011, a decrease of 3.3%. Notwithstanding these developments, the BCL still contributed 2.4%, the same figure as in 2011, to the overall volume of banknotes put into circulation by the Eurosystem.

A closer look at the distribution of banknotes by denomination reveals that the number of € 10 and € 20 banknotes deposited at the BCL exceeds the number of banknotes issued. This is explained by the fact that 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, e.g. banknotes of € 100 and € 200, in line with what had been observed since 2010, the year 2012 was marked by a sustained demand, both in Luxembourg and in the euro area. Regarding banknotes of € 500, the number of banknotes put into circulation in Luxembourg increased, continuing the trend observed in previous years, whereas at the European level demand for this denomination decreased slightly. It is noted that the € 100 banknote continues to grow in terms of numbers, already exceeding the € 500 banknote since the beginning of 2010. A similar development is taking shape for € 50 and € 200 banknotes. This reflects a shift in preference of the general public away from € 200 and € 500 banknotes towards € 50 and € 100 banknotes.

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

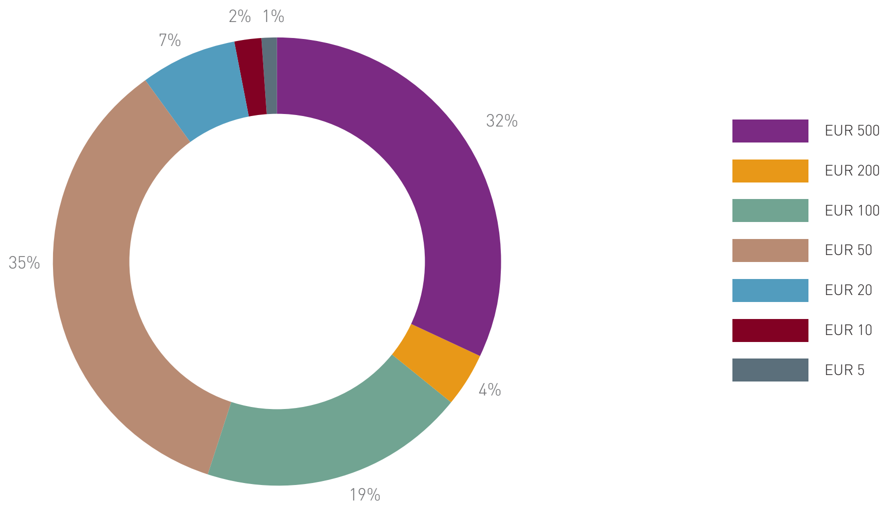
Graph 7:
Denominational breakdown of the number of euro banknotes put into circulation by the BCL



Source: BCL

In value terms, the net issuance of banknotes in Luxembourg grew at a less sustained pace in 2012 (+€ 4.3 billion, or +6.0% in moving annual average) and reached € 76.4 billion by end-December 2012. This increase is less strong than the ones recorded in previous years: 7.7% in 2011, 10.5% in 2010 and 15.1% in 2009. Moreover, in terms of net issuance Luxembourg ranked fourth in the Eurosystem in 2012, behind Germany (€ 427.5 billion), Italy (€ 146.3 billion) and France (€ 95.9 billion). In fact, the annual growth of net issuance in Luxembourg was higher than the one observed for the euro area as a whole (+2.7% after +5.8% in 2011), where it reached € 912.6 billion at the end of 2012 (compared to € 888.6 billion at end-December 2011), with the following breakdown by denomination:

Graph 8:
Distribution of the value of euro banknotes put into circulation by the Eurosystem by denomination at the 31.12.2012



Source: ECB

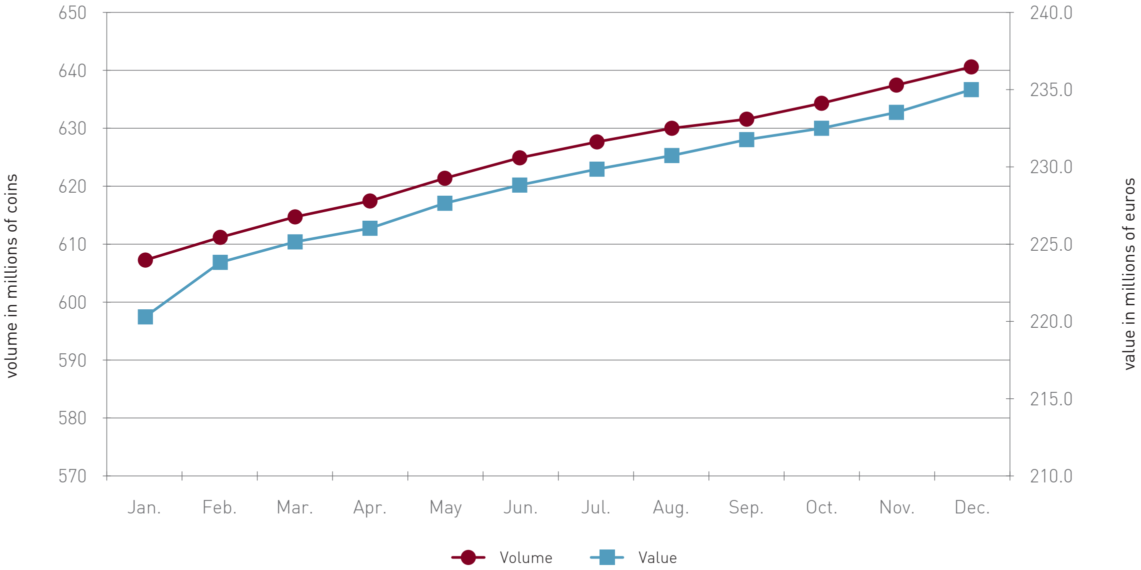
1.4.2.1.2 Coins

Luxembourg coins continue to be the object of strong demand from the public. The total value of coins put into circulation increased by 7.1% in 2012 (compared to 6.7% in 2011). It increased from € 219.5 million to € 235.0 million.

The volume of coins put into circulation in the course of the year 2012 increased by 34.9 million units, equalling a growth of 5.8% to a total of 640.6 million of Luxembourg coins in circulation at the end of the year.

The graph below shows the evolution both in terms of the volume and value of Luxembourg euro coins in circulation in 2012. The demand for Luxembourg coins steadily increased throughout the year.

Graph 9:
Volume and value of Luxembourg euro coins put into circulation in 2012

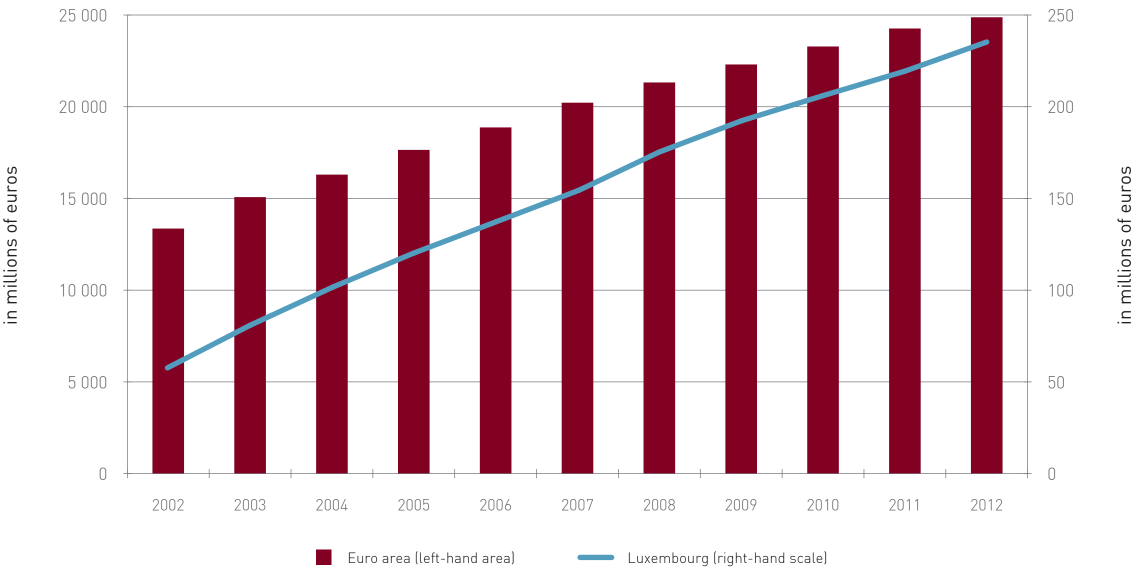


Source: BCL

Within the euro area, Luxembourg contributes nearly one percent (0.9%) to the total value issued by all issuing authorities and 0.6% to the total volume. The average value of Luxembourg coins in circulation amounted to 37 cents compared to 24 cents on average in the euro area. The average value for the euro area has remained unchanged compared to 2010 and 2011.

The graph below shows a visual comparison of the volume of coins put into circulation in Luxembourg with the corresponding volume of the euro area.

Graph 10:
Comparison of the euro coin circulation volume in Luxembourg and in the euro area (in millions of coins)

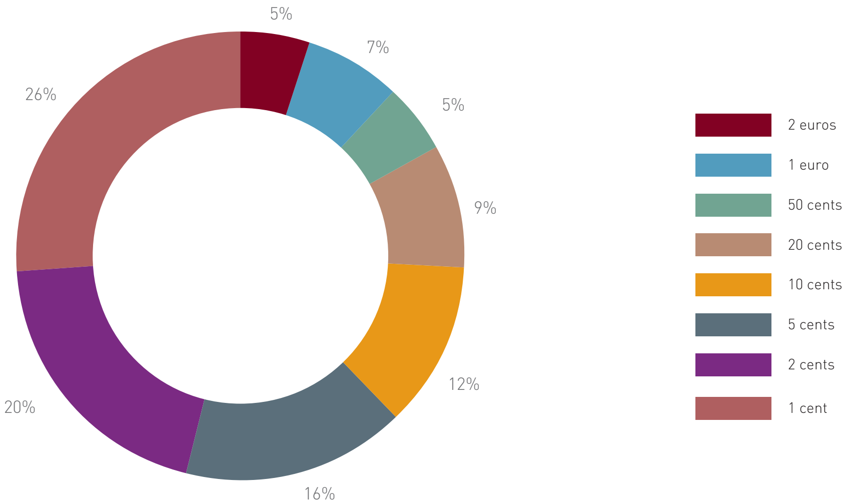


Source: ECB and BCL

The total value of euro coins put into circulation by the issuing authorities rose from € 24.2 billion in 2011 to € 24.8 billion in 2012, while the total number of coins totalled 104.8 billion.

The following chart shows the breakdown by denomination of the volume of coins at the euro area level. It is noted that the 1 and 2 cent coins represent almost half the number of coins put into circulation in the euro area while at the national level these two denominations represent only a third of the coins put into circulation.

Graph 11:
Breakdown of the volume of coins of the euro area in circulation by denomination at the 31.12.2012



Source: ECB

1.4.2.2 Luxembourg franc banknotes

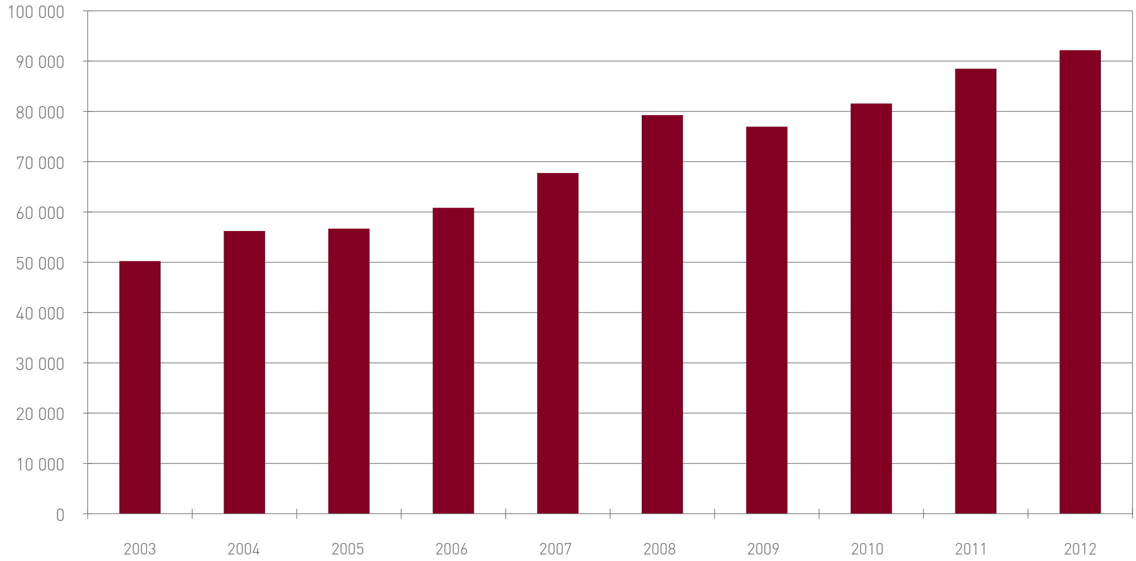
During the year under review, the total value of Luxembourg franc banknotes issued by the *Institut Monétaire Luxembourgeois* and not yet presented for exchange, fell from LUF 206.9 million to LUF 206.3 million, equalling a decrease of 0.3%. In 2012, holdings of the 5 000 LUF banknote continued to decline more sharply by 0.6%, while 1 000 LUF banknotes decreased by 0.3% and 100 LUF by 0.05%.

1.4.3 Handling of banknotes and coins

The volume of euro banknotes returned by financial institutions to the BCL increased by 3.9%, compared to the previous year thus increasing from 88.7 million to 92.1 million banknotes. Over the past ten years, banknote lodgements made at the BCL increased by 83%.

The following graph describes the evolution of these lodgements at the BCL since 2003.

Graph 12:
Lodgements of euro banknotes by financial institutions at the BCL (in thousands of banknotes)



Source: BCL

The number of banknotes processed by sorting machines amounted to 77 million in 2012. These sorting machines perform checks on the banknotes' authenticity and cleanliness. 8.3 million banknotes of all denominations were destroyed because they were unfit for circulation, which amounts to a destruction rate of 10.7%. This rate shows a wide variation between the denominations processed: ranging from 5.6% for the € 500 banknote to 53.9% 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 counterfeited and mutilated euro banknotes and coins, the BCL has collaborated since 2002 with the *Banque de France* and the *Deutsche Bundesbank* in accordance with cooperation agreements.

In meetings organised by the ECB, the BCL's Currency and Numismatics Department participates in the preparation of the new series of euro banknotes. The design of this new series, which is also based on the theme of 'Ages and styles in Europe', is slightly modified.
The dominant colour of each of the denominations is maintained. New or improved security features are incorporated to ensure maximum protection against counterfeiting and in order to enable the public to quickly distinguish a genuine banknote from a counterfeit. The introduction of the new series will begin with the € 5 note on 2 May 2013.
The issuance sequence of the second series will be at a pace of one denomination per year, or two for the highest denominations. The end of the legal tender status of the first series will be announced in due course. Banknotes of the first series will remain redeemable at the NCBs with no time limit.

For five years, the BCL has been pooling its share of banknotes to be produced for the Eurosystem with seven other Eurosystem NCBs (the central banks of Cyprus, Estonia, Finland, Malta, the Netherlands, Slovakia and Slovenia). This pooling, whose goal is to share resources and experience necessary to follow a production of banknotes, foreshadows the future 'Single European Tender Procedure'.

The BCL also collaborates with eight other NCBs (the national central banks of Belgium, Cyprus, Estonia, Finland, Ireland, Latvia, Malta and the Netherlands) in the management and maintenance of the CashSSP application. This system allows the BCL's Currency and Numismatics Department not only to manage its banknote and coin stocks and to monitor its sorting activity of fiduciary money, but also to obtain in a secured manner the deposit and withdrawal announcements of commercial banks.

1.4.5 Numismatic issues

The BCL issues numismatic products on the theme of the history and culture of the Grand Duchy. Via its numismatic premises, more than 2 500 sales operations were performed in 2012. More than 6 000 packages were sent out, corresponding to sales made through traditional mail or through the Internet shop with the use of an online sale of numismatic products (https://eshop.bcl.lu).

During the year 2012, the BCL issued the following numismatic products:

- a € 2 commemorative coin, minted in 700 000 units, was put into circulation in February 2012. This coin, representing the effigies of Their Royal Highnesses Grand Duke Henri and Grand Duke William IV, was also issued in BU quality as a coin card limited to 10 000 units;
- a second € 2 commemorative coin, minted in 500 000 units, was put into circulation in February 2012. This coin, dedicated to the tenth anniversary of the euro banknotes and coins was also issued in BU quality as a coin card limited to 10 000 units;
- the 2012 BU set, issued in 7 500 units, comprises Luxembourg's euro coins of the 2012 series (including both € 2 commemorative coins);
- the 2012 BENELUX set, issued in an edition of 10 000 units, contains eight pieces of the 2012 series of each of the three member countries;
- the 2012 PROOF set, limited to 2 000 units, is composed of ten coins;
- the 2009-2012 PROOF set, limited to 3 000 units, is composed of six € 2 commemorative coins, issued between 2009 and 2012;
- a silver-niobium coin, issued in June 2012 in an edition of 3 000 units, was dedicated to the Castle of Bourscheid and is the fourth part of the series devoted to the castles of Luxembourg;
- a silver and Nordic gold coin, issued in September 2012 in an edition of 3 000 units was dedicated to 'Ophrys bourdon' and is the fourth part of the series devoted to the fauna and flora of Luxembourg.

1.5 STATISTICS

The BCL develops, collects, compiles and disseminates a wide range of statistics that allow it to fulfil its legal missions within the European System of Central Banks, the European Systemic Risk Board as well as at the national level. This information is also used by other national institutions such as the *Institut National de la Statistique et des Etudes Economiques* (STATEC) and the *Commission de Surveillance du Secteur Financier* (CSSF) for the fulfillment of their respective missions.

In 2012, statistics were generally provided within the deadlines and significant efforts were undertaken in order to improve the statistical set disseminated by the BCL. An important challenge in 2012 was the collection and the compilation of data required for the fulfilment of the financial stability missions.

1.5.1 New data collection and improvements

In the course of 2012, the BCL was involved in the development of a risk scoreboard for the ESRB that was published for the first time after the ESRB meeting of 20 September 2012. These initial developments will be regularly completed and improved.

The BCL also contributed to the development of an improved measure of the monetary aggregate M3 that was corrected for repurchase agreements operations through central counterparties.

In January 2012, the BCL implemented a new definition of monetary investment funds, in accordance with the ECB Regulation (UE) N° 883/2011 of 25 August 2011 modifying the Regulation (CE) N° 25/2009 on the balance sheet of monetary financial institutions. This new definition is in line with the guidelines for a common definition of the European monetary undertakings for collective investment (UCIT) published on 19 May 2010 by the Committee of the European regulators of securities markets (CESR 10-049)[4]. This definition is more restrictive than the previous one, which has impacted the measure of the number and the activity volume of the monetary UCITs in Luxembourg.

1.5.2 Other developments in statistics

In 2012, the BCL pursued its efforts to improve the quality and the quantity of statistical data published on its website, in order to meet the needs and requests of the users.

The Governing Council adopted the regulation BCE/2012/24 on the statistics of security holders. This regulation focuses on the collection of data on the holdings of securities by euro area residents as well as the holding of securities issued by euro area residents that are held by non-euro area residents and held in custody in the euro area, on a security by security basis. This new data collection will start in March 2014 and will cover data from December 2013.

The BCL continued its cooperation with national institutions in charge of collecting and compiling data, in order to minimize the burden on respondents. It is also involved in the redesigning of certain international standards such as the European system of accounts (ESA95), which will affect the concepts used in the area of data collection.

Finally, the BCL participates in the G20 initiative to introduce a *Legal Entity Identifier* in March 2013. This unique identifier will allow a better identification of participants in financial markets, and consequently a better analysis of the risks incurred by the different economic stakeholders. In the same context, the BCL took part in the development of the ECB register of financial institutions, now including insurance companies and pension funds.

1.6 PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

1.6.1 TARGET2-LU

The real time gross settlement system (RTGS) TARGET2 runs on the Single Shared platform operated in common by the 18 central banks of the Eurosystem and six central banks of the ESCB.

The Luxembourgish component TARGET2-LU has 32 direct participants (7 more than in 2007 and 2 more than in 2011), 42 indirect participants and 3 ancillary systems.

Domestic payments

In 2012, participants in TARGET2-LU exchanged a monthly average of 21 503 payments (compared to 20 773 in 2011) for a value of € 111.4 billion (compared to € 103.2 billion in 2011). 15 005 or 69.8% of these payments were retail payments. Their value represented a monthly average of € 9.3 billion or 8.3% of the domestic value exchanged.

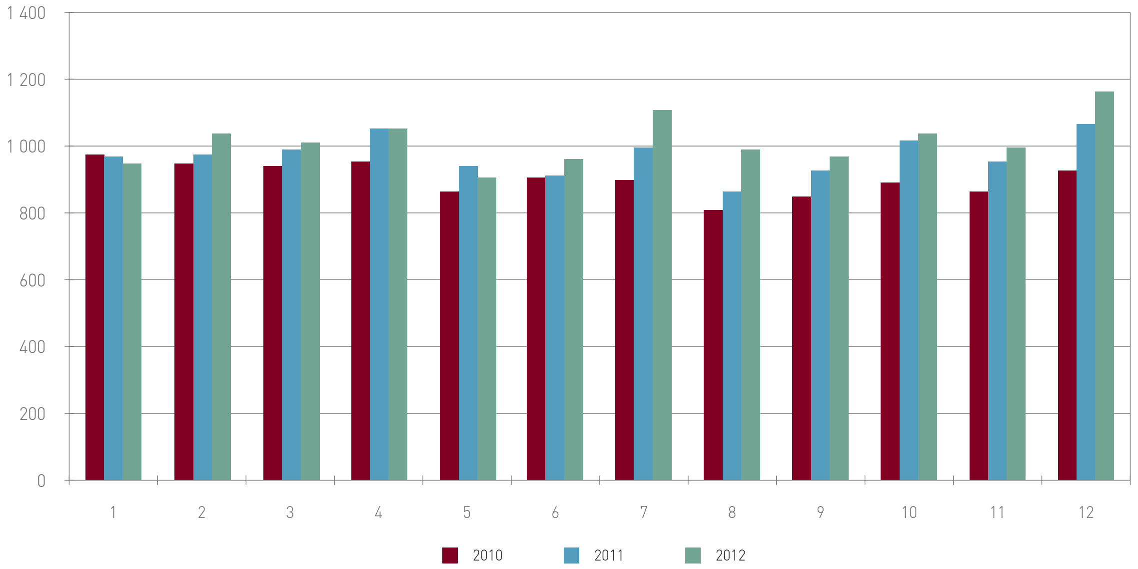
In TARGET2-LU, the decrease of domestic volumes triggered by the financial crisis of 2008 continued until 2010. The renewed increase of volumes by 3.5% was less pronounced than in 2011. It allowed domestic volumes to reach 21 015 payments, slightly above pre-crisis levels.

In parallel, with 7.9%, the increase in the value exchanged between domestic participants was less important than in 2011.

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

4 On 1 January 2011, the CESR became the ESMA (European securities and markets authorities).

Graph 13:
Domestic payments: development of average daily volumes (number of payments)



Cross-border payments

In 2012, participants in TARGET2-LU sent a monthly average of 51 937 payments towards other countries of the EU (47 820 payments in 2011) for an average value of € 780.2 billion (€ 808.4 billion in 2011). The volume of retail payments increased by 6.6% thus reaching 27 326 payments representing 52.6% of the total cross-border volume. Their relative part decreased by 1%. After a decrease of 5% in 2011, the volume of interbank payments increased again by 11% to reach a monthly average of 24 605 transactions in 2012.

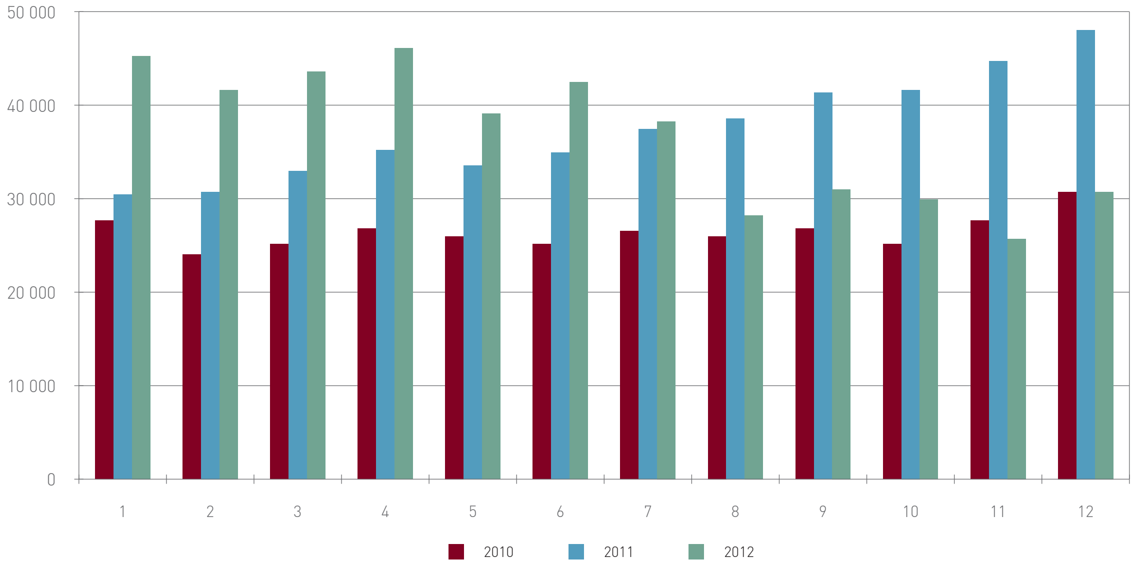
Customer payments amounted to a monthly average value of € 24.5 billion representing an increase of 38%. In contrast, the monthly value of interbank cross-border payments decreased by 4.4% reaching € 755.7 billion. The decrease was largely triggered by reduced transfers related to lower overnight deposits with BCL.

Cross-border payments increased in volume by globally 8.6%. This was partially due to the transactions issued by the new participants. In value, they decreased by 3.5% within one year. The average value per transaction sent was € 15.0 million (compared to € 16.9 million in 2011). The average value of an interbank payment decreased from € 35.6 million to € 30.78 million between 2011 and 2012.

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

Graph 14:
Cross-border payments sent: development of average daily volumes (number of payments)

Graph 15:
Cross-border payments sent: development of average daily values (in million €)



Aggregated figures of domestic and cross-border payments

The total number of payments sent by participants in TARGET2-LU in 2012 amounted to 881 282 transactions (823 113 in 2011, increase of 7.1% in one year). 507 978 or 57.6% of all payments were retail payments.

Table 2 provides a global overview of the average daily volumes of payments per year since 2010. In 2012, all categories displayed increased figures.

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)
2010	893	(29.8%)	2 107	(70.2%)	3 000	1 704	36.2%
2011	970	(30.3%)	2 233	(69.7%)	3 203	1 722	35.0%
2012	1014	(29.3%)	2 447	(70.7%)	3 461	1 965	36.2%
Variation 2011-2012	+4.5%		+9.6%		+8.1%	+14.1%	

The average monthly value of all payments sent was € 891.6 billion of which € 33.7 billion (3.8%) represented retail payments.

TARGET2-LU compared to other systems participating in TARGET2

All national RTGS systems participating in TARGET2 transferred a monthly average of 7.55 million payments in 2012 representing an increase of 1.6% compared to 2011. Luxembourg's part represented 1% of this volume. The average monthly value exchanged totalled € 52 636 billion. The part of Luxembourg in the value exchanged was 2.3%.

64% of all payments in 2012 were domestic transactions and 60% were retail payments. In TARGET2-LU, domestic payments represented 29.3% and customer payments 57.6% of the volume.

The average value of a TARGET2 payment was € 7.1 million in 2012. In TARGET2-LU, this value was € 12.1 million.

The daily maximum of payments sent in TARGET2 was 542 773 transactions (29 June 2012). In 2011, the maximum had been reached in January with 515 253 payments. For Luxembourg, the daily maximum was reached on 21 December 2012 with 5 663 payments. In 2011, the maximum had been reached in April with 4 722 payments sent.

Availability and performance of TARGET2

After 99.89% in 2011, the availability of the TARGET2 platform, and hence of TARGET2-LU, was 100% in 2012.

The SSP received a daily average of 360 146 payment instructions. 99.98% were settled within five minutes (99.85% in 2011) and 100% within 15 minutes.

1.6.2 Retail payments in Luxembourg

Except for 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. Network-based electronic money schemes, which are issued and operated by credit institutions or electronic money institutions, are mainly used for remote payments. Several mobile payment solutions emerged in 2012; they are based on different payment instruments (e-money or credit transfers). These new payment solutions are not widely used.

Credit transfers and standing orders

Credit transfers can be processed internally in banks, on a bilateral basis between the involved banks or through a payment system (for instance TARGET2 or STEP2[5]). The bulk of Luxembourg customer credit transfers and standing orders are processed on the pan-European platform STEP2.

5 STEP2 is managed by the Euro Banking Association (EBA).

In 2012, Luxembourgish participants sent 21.28 million transactions to STEP2 for a total value of € 69.45 billion. The share of domestic[6] transactions was 66% for the volume (approximately 14 million transactions) and 59% for the value (€ 41 billion). Compared to 2011, the Luxembourgish participants' activity increased by 5.20% in volume and by 18.09% in value. The growth of the domestic activity reached 5.47% in volume and 17.45% in value.

Direct debits

Until the European direct debit (see below, 'The Single European Payments Area (SEPA)') takes off, direct debits are domestic payments that banks clear either via the DOM-Electronic system, bilaterally or internally.

In 2012, there were 15.46 million direct debits for a value of € 8 591 million (16.71 million transactions worth € 7 565 million in 2011).

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.

As from 2012, the BCL has been using a new methodology for the collection of the payment card activity data in Luxembourg. The new methodology had a strong impact on the credit card data collected. Previously, data was only collected from the main card processor whereas the new methodology includes all the stakeholders in Luxembourg.

At the end of 2012, banks in Luxembourg issued 627 000 debit cards (compared to 782 000 at the end of 2011, the higher number is due to the new debit card changeover period) and 1.3 million credit cards (compared to 533 000 at the end of 2011 for the main card processor).

In 2012, the number of transactions[7] with Luxembourg-issued[8] debit cards totaled 58.35 million (44.92 million in 2011) for a value of € 4.93 billion (€ 3.48 billion in 2011). The number of credit card transactions amounted to 43.68 million (24.77 million in 2011 for the main card processor) worth € 4.51 billion (€ 2.66 billion in 2011).

As for the transactions in Luxembourg on cards issued in Luxembourg or abroad, the volume on debit cards was 50.60 million (40.91 million in 2011) for a value of € 4.26 billion (€ 2.91 billion in 2011) and the volume on credit cards was 22.72 million (22.50 million in 2011) worth € 2.12 billion (€ 2.01 billion in 2011).

The Single European Payments Area (SEPA)

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 as domestic transactions.

The SEPA project is being implemented by the European banking industry through the European Payments Council (EPC)[9].The Eurosystem and the European Commission are the catalysts of this project.

6 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.

7 Payment transactions and cash withdrawals at ATMs.

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

9 www.europeanpaymentscouncil.eu

The following set of SEPA payment instruments are already available to the users:
- 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.

The migration of credit transfers and direct debits should be achieved on 01 February 2014 in the euro area countries, according to the migration end-dates set in the EU Regulation 260/2012[10].

Banks in Luxembourg have already widely adopted the European credit transfer for retail operations. So far, the European direct debits are hardly used. Their adoption should then soar, following the migration plan that the domestic banking community started up in October 2012. In its capacity as a catalyst of the harmonisation in the payments area, the BCL monitors the creditors' preparedness on a voluntary basis.

1.6.3 Collateralisation of Eurosystem credit operations

1.6.3.1 List of eligible assets

All credit operations of the ECB and national central banks are based on 'adequate collateral'[11]. 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 the country in which they are settled, 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.

In the context of the buy-back scheme of the public debt of the Greek state, the Eurosystem suspended the eligibility of marketable debt instruments issued or guaranteed by the Hellenic Republic for use as collateral in Eurosystem monetary policy operations:
- From 28 February 2012 to 8 March 2012:
  Greek marketable debt instruments became eligible again after this period thanks to the activation of the buy-back programme. This lasted until 24 July 2012. Moreover, the Eurosystem decided to no longer apply the minimum credit rating threshold for these securities until further notice.
- From 25 July 2012 to 21 December 2012:
  Following the positive analysis of the European Commission, the IMF, and the ECB, these securities became eligible again after this period, but with higher applicable haircuts.

The Governing Council took the following measures in order to increase the availability of collateral:
- In December 2011, the Eurosystem authorised the acceptance of certain private credit claims as of 9 February 2012.
- On 22 June 2012, the Eurosystem decided to reduce the rating threshold for certain asset-backed securities (ABSs) and certain other private credit claims. More detailed information on this haircut schedule is published on the website of the ECB.

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10 Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009.

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

- On 6 September 2012, until further notice, the Eurosystem decided to suspend for certain assets the application of the minimum credit rating threshold in the collateral eligibility requirements for Eurosystem credit operations. This measure concerns marketable debt instruments issued or guaranteed by the central government, and credit claims granted to or guaranteed by the central government of countries that are eligible for Outright Monetary Transactions or are under an EU-IMF programme and comply with the conditions foreseen by the Governing Council.
- On 6 September 2012, with effect as of 9 November 2012, the Eurosystem decided to temporarily extend the list of eligible assets to marketable debt instruments denominated in USD, GBP, and JPY, under the condition that these securities are issued and held in the euro area, that the issuer is established in the European Economic Area, and that the securities fulfil all other eligibility criteria.

On 3 July 2012, the Governing Council decided that counterparties that participate in the Eurosystem's refinancing operations may no longer increase the levels of own-used government guaranteed bank bonds above the prevailing level decided upon on 3 July 2012. Any derogation to this rule requires explicit ex-ante approval by the Governing Council of the counterparty's request along with a funding plan.

On 30 October 2012, the Governing Council announced the end of the covered bond purchase programme that had been launched in November 2011. More detailed information on this measure is published on the website of the ECB.

On 28 November 2012, effective as of 1 January 2013, the Eurosystem published amendments to its General Documentation applicable to monetary policy operations. Details about the main changes are available on the website of the ECB.

On 4 December 2012, the Governing Council decided to extend until 1 February 2014 the reciprocal swap lines between the ECB and the Federal Reserve, the Bank of Japan, the Bank of England, the Swiss National Bank, and the Bank of Canada. Moreover, the Governing Council decided to continue the 7-day and 84-day liquidity-providing operations in US dollars until further notice.

1.6.3.2 Securities settlement systems

Selection of eligible depositories

For the mobilisation of securities by its counterparties, the Eurosystem has selected securities settlement systems operated by central securities depositories. A securities settlement system 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), VP Lux S.à r.l., and by LuxCSD S.A. are eligible for the mobilisation of securities by the Eurosystem's counterparties.

Cross-border use of securities

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 has set two procedures for such cross-border use of collateral. Counterparties may use:
- the CCBM[12]; 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;

12 Correspondent Central Banking Model, see section 1.6.4.

– Relayed links enable the transfer of securities between two systems without bilateral accounts by using a third intermediary system.

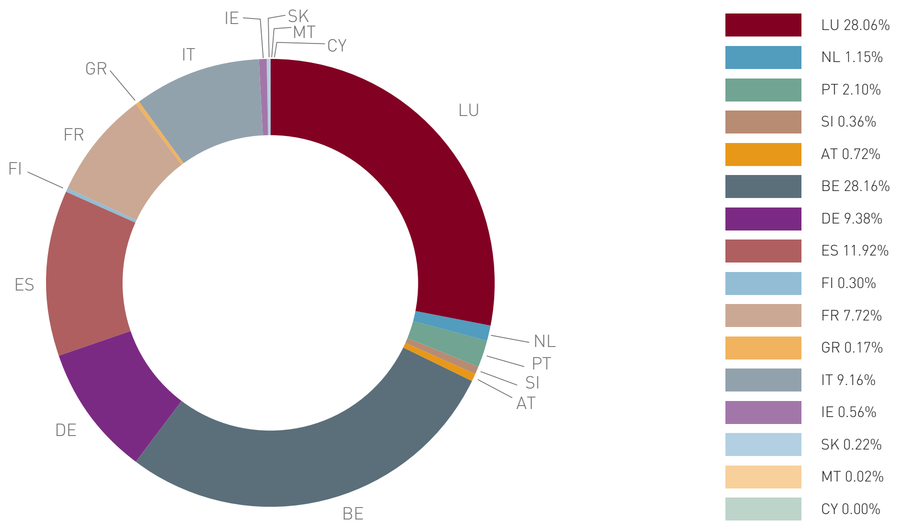
Links have to be approved by the Governing Council before being used for collateralisation of central bank credit operations. In 2012, Luxembourg counterparties had the possibility to use the direct links between CBL and Clearstream Banking A.G. Frankfurt, Euroclear Bank, the SSS operated by the National 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. 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. Moreover, the home central bank (HCB) grants the credit to its counterparty based on the confirmations it receives from the CCB.

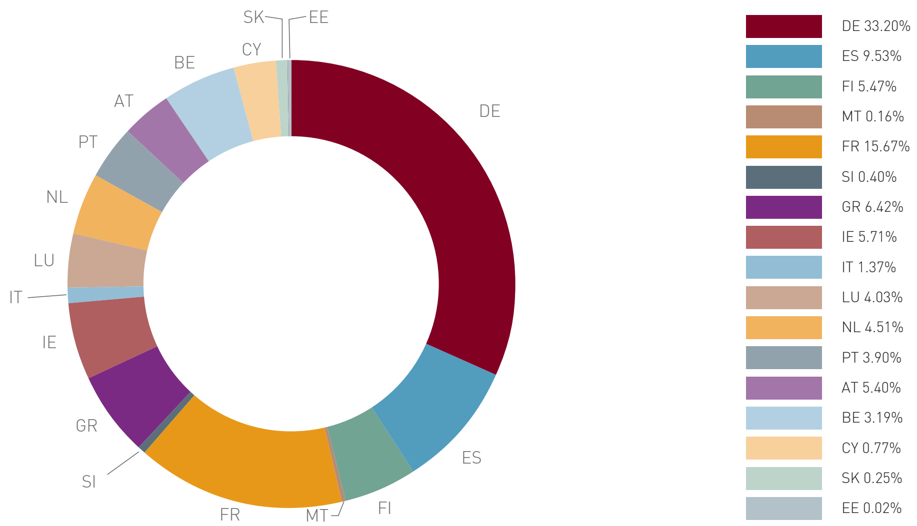
The CCBM remains the main channel for the cross-border mobilisation of collateral used in the Eurosystem's credit operations. In terms of value, the most active correspondent central banks in 2012 were those of Belgium (28.2%), Luxembourg (28.1%), Spain (11.9%), and Germany (9.4%). The most active home central banks were those of Germany (33.2%), France (15.7%), Spain (9.5%), and Greece (6.4%).

Graph 16:
Correspondent Central Bank – 2012



Source: Eurosystem

Graph 17:
Home Central Bank – 2012



Source: Eurosystem

1.6.5 Future collateral management of the Eurosystem

In 2012, the Eurosystem continued its work aimed at enhancing collateral management, both for the Eurosystem and for counterparties. In particular, certain counterparties suggested to abandon the need to repatriate 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 has required the defininition of 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 accommodate both the securities and the cash component of transactions and provide delivery-versus-payment settlement in central bank money (CeBM) accordingly. This initiative is part of a more general process of financial market integration in Europe, leading to a streamlining of procedures and to a substantial reduction of costs and risks.

In July 2012, the Governing Council appointed the members of the T2S Board, a new executive body in charge of formulating proposals to the Governing Council on strategic matters related to T2S. One of the BCL Directors was appointed Vice-Chairman of the T2S Board.

In parallel to the ongoing technical development of the platform by the four central banks (4CB) involved, the most important event in the T2S project in 2012 was the signature, between all CSDs involved and the Eurosystem, of the Framework Agreement, confirming their commitment to the project. The signature took place in two steps. Early May 2012, 9 CSDs committed to the Framework Agreement, including the two CSDs based in Luxembourg, VP Lux and LuxCSD. A second group of CSDs signed the Agreement in June 2012, thus reaching a total of 23 CSDs supporting the initiative which will de facto allow T2S to reach, from launch, a critical mass close to 100% of all domestic transactions settled in Europe.

Beyond the Eurosystem, the National Bank of Denmark also decided to make its currency available for settlement in T2S from 2018 onwards.

1.6.7 LuxCSD

LuxCSD, Luxembourg's central securities depository was jointly created 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 became operational in 2011. In 2012, it enhanced its range of services and started its commercial deployment. In that respect, LuxCSD provides 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 fund shares;
- direct settlement against Clearstream Banking counterparties or against counterparties in domestic markets;
- upon its availability, a national access point to T2S.

Securities eligible in LuxCSD are debt securities, equities or investment fund shares, whether they are domiciled in Luxembourg or not. The first securities issuances, within LuxCSD, are foreseen for 2013.

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

In 2012, LuxCSD confirmed its commitment to the T2S initiative by signing the Framework Agreement with the Eurosystem.

1.7 FINANCIAL STABILITY AND PRUDENTIAL SUPERVISION

1.7.1 Macro-prudential supervision

The financial stability mandate attributed to the BCL is based on the Treaty on the functioning of the European Union (TFEU), through its participation in the Eurosystem, and on national legislation.

At the European level, in addition to its central tasks, article 127 (5) of the TFEU entrusts the Eurosystem with the responsibility of contributing to 'the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system'. At the national level, article 2(6) of the organic law of the BCL stipulates that 'the Central Bank shall cooperate with the Government and with prudential supervision authorities at national level, as well as with the other central banks at Community and international level, in order to ensure financial stability, notably within committees set up for this purpose'.

In addition to the financial stability mandate, the legislator has entrusted the BCL with the supervision of the payment systems and securities settlement systems.

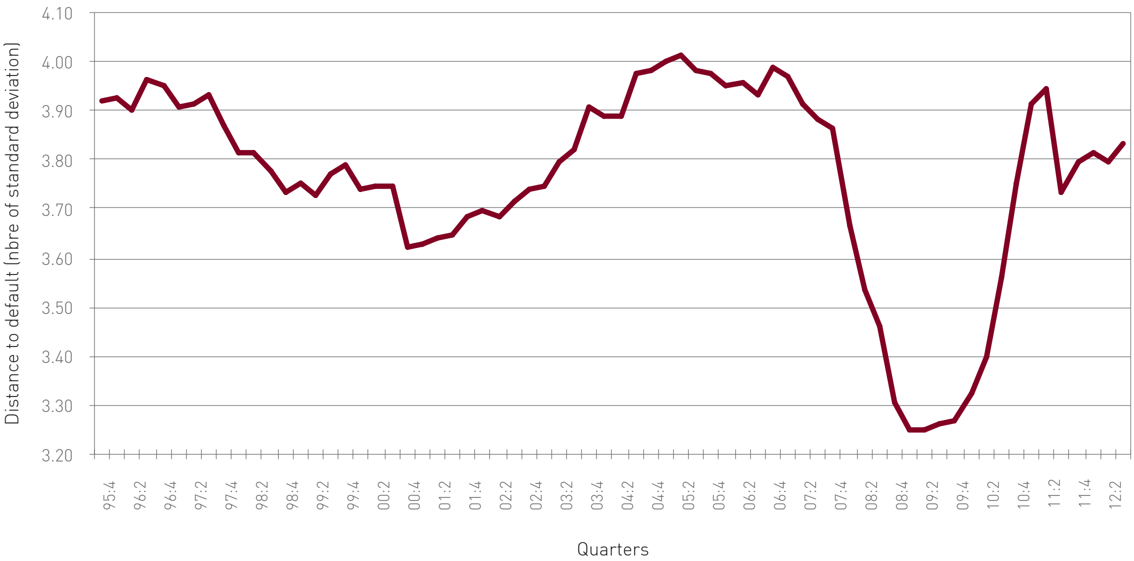
1.7.1.1 Macro-prudential supervision in Luxembourg

Despite the absence of any legislative framework establishing an authority in charge of macro-prudential supervision, the BCL is actively involved in the surveillance of risks that could compromise the stability of the national financial system as a whole. However, given the considerable size of the banking industry in the Luxembourgish financial system, the analyses undertaken by the BCL give prominence to the assessment of the accumulation of risks within the banking sector over time.

Therefore, the analysis of the temporal dimension of risk focuses on the issue of pro-cyclicality in the banking sector. Pro-cyclicality leads to an accumulation of risk over time due to the interaction of the financial and real sectors of the economy and can be analysed using indicators for the credit cycle, asset prices, leverage and maturity mismatches. Furthermore, the BCL has developed several complementary indicators. The list of additional BCL indicators includes marginal probabilities of default of individual banks and their counterparties, conditional probability of default and risk of contagion, aggregate z-scores and specific indicators to monitor liquidity.

The preliminary results of estimations made by the BCL concerning the probability of default of banks operating in Luxembourg in 2012 show a slight rise in their dispersion compared to the levels assessed in 2011. This result applies only to the maximum values assessed and not to the median of the probabilities of default, which remains quite low (0.01%). Hence, the examination of individual results, which reveal the existence of vulnerabilities for some banks. However, these banks do not pose any risk of systemic nature to the Luxembourgish financial system due to their lack of significant interbank linkages at the national level. This last observation is confirmed at the aggregate level by the results obtained from the z-score (see graph below) as well as those of the vulnerability index computed by the BCL. Variation of the aggregate z-score index reflects the cyclical evolution of the financial sector. This index increased between 2009Q4 and 2010Q4 after the sharp decline which lasted from 2007Q4 to 2009Q1. Nevertheless, after such a substantial improvement, the trajectory of the index in 2011-2012 stabilised around its historical mean. A slight decrease in the level of the index at the beginning of 2012 reflects the marginal impact of a severe turmoil prevailing in the European sovereign debt market, which seems to indicate that Luxembourg's credit institutions had very little exposure to the risks arising from Euro area periphery countries. Finally, it is important to stress that the aggregate level of the index remains below the threshold of two standard deviations. Thus, the overall financial situation of the banking sector in Luxembourg seems to be in line with the conditions of financial stability.[13]

Graph 18:
Z-score index of banks located in Luxembourg: 1995Q4 – 2012Q3

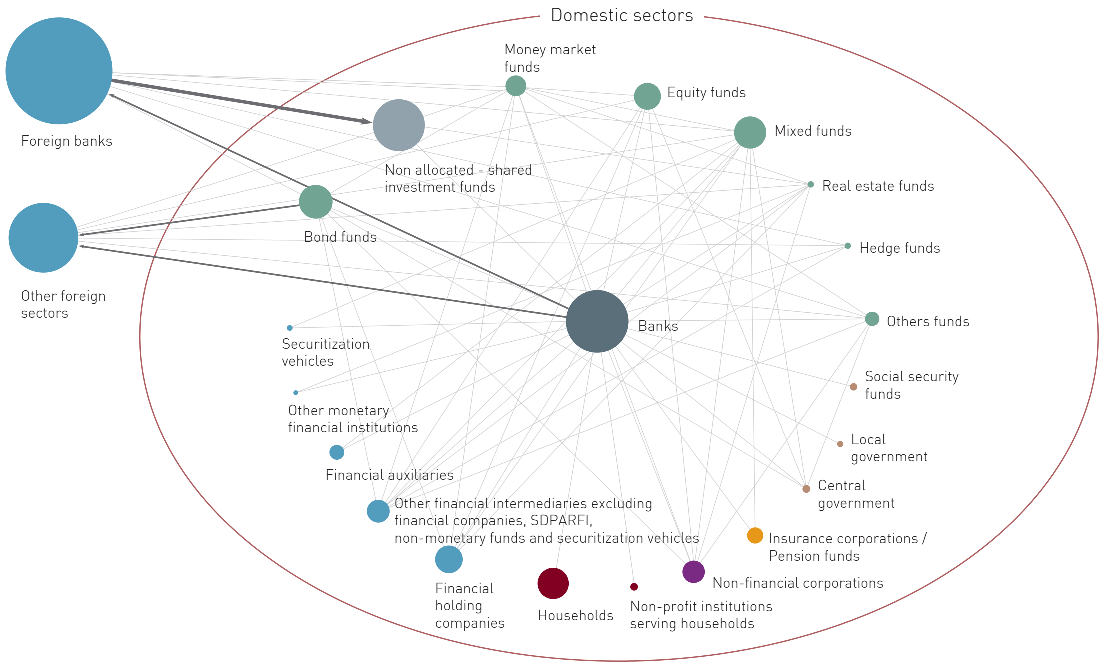


Recently, the analysis was extended to other segments of the financial sector in order to take the systemic importance of certain market participants into account, including their connectedness with the banking sector. In this context, specific emphasis was paid to the linkages between the banking sector and investment funds. The application of network analysis techniques enables linkages between different sectoral components to become visible; thus highlighting potential channels of contagion. The graph below illustrates the degree and significance of interconnectedness among the market participants, where the significance of

13 A more detailed analysis of the results of the indicators will be provided in May of the current year with the publication of the 2013 Financial Stability Review.

interconnectedness is represented by the thickness of an arrow. From this analysis it therefore appears that the factors of vulnerability that could have an impact on the stability of the financial system in Luxembourg arise from external financial conditions rather than domestic.

Graph 19:
Network of credits and debts between Luxembourg sectors and foreign counterparts – June 2012



The BCL also engages in determining the link between finance and the real economy and in liquidity stress-testing. In this context it may be noted that a number of indicators which were developed at the BCL take a forward-looking approach. In order to anticipate rising vulnerabilities in the banking sector, the BCL has put special emphasis on its synthetic financial vulnerability indicator as well as macro-prudential stress tests.

The vulnerability indicator is constructed using a host of variables from bank balance sheets and profit and loss accounts (overnight and inter-bank deposits, profitability, variability in own funds and provisions), macro-financial variables (stock market returns) and variables that reflect the structure of the Luxembourgish banking sector (variation in the number of banks). In order to keep track of medium term vulnerabilities in the Luxembourgish banking sector, and while taking Eurosystem macro conditions into account, the indicator is set for up to two years. Despite the current adverse European economic environment, predictions for 2013 and 2014 display a convergence of vulnerability in historical averages. In addition, over this time period, the index remains below the vulnerability threshold. With regard to the estimates, it is worth noting that confidence intervals still remain relatively large, thus revealing a high degree of uncertainty.

The BCL also carries out regular top-down stress tests in the context of a macro-prudential approach. The aim of macro-prudential, or top-down stress tests is to quantify the impact of severe, but plausible, hypothetical shocks on the stability of individual components of the financial system. Such studies can be followed up with the use of additional risk indicators to support the results of the stress test. Both of these indicators and the outcome of the stress tests can subsequently help to calibrate the prudential response.

In conjunction with the conduct of macro-prudential stress testing, during the second half of 2012, the BCL analysed the impact of certain sovereign risks on the solvency ratios of banks located in Luxembourg.[14] In

14 The results of this exercise were published in the last BCL bulletin of 2012.

fact, simulations of downgrades of certain sovereign bonds in bank portfolios contributed to the determination of additional capital that Luxembourg banks could request if confronted with further deterioration in European sovereign debt markets. Moreover, a detailed analysis of the importance of the outstanding amounts of certain sovereign bonds held by the Luxembourg fund industry is also provided.

It is worth noting that the BCL has carried out a number of specific studies aimed at identifying the emergence of new risks within the Luxembourg financial system. In the context of recent developments in banking and financial regulation, several quantitative studies were undertaken to assess the impact of the new Basel III liquidity requirements on Luxembourg's credit institutions. Moreover, particular consideration has been given to the analysis of the debt ratio of Luxembourg's banks as an indicator of bank reliance on external funding. Furthermore, a common project between the BCL and the Luxembourg School of Finance (LSF) with financing from the *Fonds National de la Recherche* (FNR) focuses on stability in the Luxembourg financial sector and on the construction of macro-prudential instruments, and has been running since early 2011.

In addition, the BCL used the Basel Committee on Banking Supervision's (BCBS) framework to determine 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. Furthermore, the BCL takes part in the work of the BCBS Macro-prudential Supervision Group which was set up to establish macro-prudential supervision standards.

In performing its macro-prudential supervision functions, 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 and Supervision 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.

1.7.1.2 The European Systemic Risk Board (ESRB)

The BCL has considerably increased its involvement in macro-prudential supervision following the creation of the European Systemic Risk Board (ESRB) under European regulation n°1092/2010, issued by the European Parliament and the Council on November 24, 2010, as well as its components, in particular the Advisory Technical Committee and its two substructures related to macro-prudential instruments and macro-prudential analysis. The BCL takes part in various subgroups operating under the ESRB such as the task force on stress testing, the expert group on guidance on setting countercyclical capital buffer and the expert group on securities financing transactions.

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) involving experts from the member institutions, and by an Advisory Scientific Committee involving academic experts.

This new structure calls for new responsibilities, in particular for central banks, which now play a major role in European macro-prudential surveillance in regard to their expertise and responsibility in sustaining financial stability. More specifically, the Governor of the BCL is a voting member of the ESRB General Board, which is the unique decision-making body of the institution. Furthermore, the national micro-prudential supervisory authorities are also part of the General Board, although as non-voting members, so as to share their expertise and exchange specific information. In this regard, the BCL finds itself also represented in the General Board as a liquidity supervisor, according to a rotation principle among the other national supervisory authorities. Finally, 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 under 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). National authorities are requested to establish a national authority entrusted with the conduct of macro-prudential policy and the evaluation of systemic risk accumulation by June 30, 2013;
- 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 surveillance

The mission of liquidity surveillance of market operators was assigned to the BCL through a modification of its organic law on 24 October 2008. The liquidity surveillance of market operators principally aims to apprehend 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 financial turbulences in 2008, liquidity management and the related risks were in the focus of attention of supervisory authorities at the international level during the last years.

The regulation of liquidity is important for a central bank because, on the one hand, it acts as supplier of liquidity to the financial system in normal times as well 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.

The mission of liquidity surveillance also constitutes an essential support function for analyses conducted in the field of financial stability and the analysis of systemic risks, by providing micro prudential data as input. In this context, the framework of supervision of the BCL is based essentially 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 the on-site inspections of market operators.

Particular importance is given to the monitoring of works carried out at the international level, in relation to the definition and set-up of new liquidity standards in the framework of Basel III as well as in the context of their transposition at the European level.

1.7.2.1.1 Tools for liquidity surveillance

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

From a database containing historical data listed in this daily liquidity reporting, the BCL has moreover developed an analysis tool, the 'Daily Liquidity Assessment Tool (DAT)', which allows the apprehension of the structural liquidity position of these credit institutions and the evolution of their liquidity position over time on an individual basis.

The Liquidity Monitoring Framework (LMF) is another analysis tool that allows the assessment of the vulnerability of individual credit institutions in terms of liquidity as well as in identifying liquidity risks at an aggregate level. The LMF was supplemented by the development of a quarterly Watch List identifying all credit institutions having suffered a deterioration in their situation beyond a certain threshold, while highlighting the parameters of the model that are at the origin of this development. All information available from the prudential and statistical reporting are introduced in dashboards and allow real-time access to significant information and ratios on each supervised entity. Finally, a daily report with several financial market indicators is made available to the analysts. Altogether, these tools add an extra dimension to the surveillance mission carried out by the BCL.

In 2012, the BCL carried out seven on-site visits with regard to liquidity surveillance. These assessments serve to understand in detail the framework and the procedures the individual operators have in place, in the context of assessing the appropriateness of the framework for the liquidity risk management of the operators in question. The BCL mainly targets the credit institutions that are the most exposed to liquidity risk or those which participate as a counterparty in monetary policy operations. As a general rule, the on-site visits are coordinated and carried out in consultation with the CSSF. The BCL is in regular contact with other institutions in the context of its surveillance mission, especially with institutions that are engaged or wish to participate in the monetary policy operations of the BCL.

1.7.2.1.2 Impact studies for the implementation of the Basel III standards

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

These weaknesses also persist in the impact studies carried out in the context of the implementation of the new Basel III standards for liquidity. In the course of 2012, the BCL conducted in cooperation with the CSSF, two impact studies on a representative sample of credit institutions of the financial centre, in order to determine the current positions of these banks facing these new liquidity standards. The last study showed that, on the basis of the 30 June 2012 figures, twenty-four credit institutions on a total of 66 succeeded in respecting the LCR (Liquidity Coverage Ratio) whereas 32 entities respected the NSFR (Net Stable Funding Ratio). Finally, 18 credit institutions of the sample succeeded in respecting both standards for funding liquidity.

In early January 2013 the Basel Committee on Banking Supervision issued a revised LCR. The amendments compared to the version presented in 2010 are fourfold: revisions of the definition of high-quality liquid assets and net cash outflows; a revised timetable establishing a gradual implementation of the standard; a reaffirmation of the possibility of using the stock of liquid assets in times of stress, including the transition period; the approval to pursue the work undertaken by the Basel Committee on the interaction between the LCR and the provision of central bank facilities. The LCR will be introduced as planned on 1 January 2015; but the minimum requirement will be set initially at 60%, rising in equal annual steps of 10 percentage points to reach 100% on 1 January 2019.[15]

In order to ensure an effective implementation of the liquidity ratios, it is planned to introduce, from the first quarter of 2014 onwards, a formalised and harmonised reporting at the European level to which all credit institutions will be subjected. In the meantime, the BCL will continue in 2013 to closely follow-up the two liquidity ratios of the banks belonging to the representative sample.

1.7.2.1.3 National and international cooperation

As a supervisor in charge of liquidity, the BCL is also involved in the work of 11 supervisory colleges. The majority of the credit institutions being affiliates of groups having their head office abroad, the participation in these colleges allows for the understanding of the activity and risk profile of the Luxembourg entities in the context of their group.

15 According to a press release by the Council of the European Union in March 2013, confirming the agreement with the European Parliament on amended bank capital and liquidity rules, the so called 'CRD 4' package, it is foreseen that in the EU, the LCR will reach 100% in 2018.

As regards the follow-up of regulatory developments at the international level, the BCL participates 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 BCL participates in these committees and working groups jointly with the CSSF.

Following the recommendations of the European Systemic Risk Board on foreign currency loans and USD financing of the credit institutions, the BCL and the CSSF formulated in June 2012, for the financial center, the respective detailed rules of application for concerned market operators in common circulars. The respective positions are monitored quarterly, at both the individual level and the aggregated level of the entities under surveillance.

1.7.2.1.4 Single supervisory mechanism project

Finally, the year 2012 was marked by the launch of the single supervisory mechanism (SSM) project following the decision of the European Council on 28 and 29 June 2012. The introduction of the SSM will represent a first cornerstone of the banking union, which will also include a single rule book for the banking sector, a common deposit guarantee scheme and a single recovery and resolution framework for banks under the control of a European resolution authority.

Based on the proposal for a regulation of the European Commission on the introduction of a SSM for banks in the euro area dated 12 September 2012, which confers a central role to the ECB, the preparatory work for the setting up of the SSM was immediately initiated. The BCL has been involved right from the start in this work which is led by a group of High Level Supervisory Representatives at the ECB. The group is assisted by a task force and several other working groups that have to address, notably legal, operational and reporting issues related to the implementation of the SSM.

According to the proposal for a regulation of the European Commission, the ECB will be responsible for the overall functioning of the SSM and will be in charge of the direct supervision of banks in the euro area, although in a differentiated manner and in close cooperation with the authorities responsible for the supervision at national level.

During a phasing-in period, initially scheduled from 1 March 2013 to 1 March 2014, supervision of the ECB will focus on credit institutions having received or requested European public funding. After this phase of gradual implementation on 1 March 2014, or twelve months after the entry into force of the legislation, the ECB will assume full supervisory responsibility over any credit institution within the SSM. The transitional phase will also serve to make all necessary preparations for the establishment and functioning of the SSM.

Upon adoption of the Regulation, a Supervisory Board established within the ECB will take office, and will have as its main task the direct supervision of the largest European credit institutions.

The 'less significant' credit institutions, defined as those that do not exceed certain quantitative and qualitative thresholds (30 billion euros of assets or representing more than 20% of GDP and at least € 5 billion euros as well as a cross-border activity) will remain under the direct supervision of national authorities; however the ECB may take over the supervision on a case by case basis, if deemed necessary.

The BCL will be involved in the work of the Supervisory Board and will actively contribute to the development of the new supervisory framework at the level of the ECB. Adequate representation of Luxembourg in these new supervisory structures will require enhanced cooperation between the BCL and the CSSF.

1.7.2.2 Oversight

The smooth functioning of financial market infrastructures such as payment, clearing and securities settlement systems is essential for preserving the confidence of financial market participants in the infrastructures and financial markets as well as for the preservation of public confidence in the currency in general. Furthermore, the resilience of the abovementioned financial market infrastructures contributes to the preservation of financial stability, the adequate implementation of monetary policy as well as the sound functioning of the economy as a whole.

Hence, oversight of payment, clearing and securities settlement systems is to be considered as a key function of the ESCB, through which the reliability and the efficiency of the systems are promoted. In addition, the ESCB, in its oversight function and in order to contribute to the preservation of public confidence in the currency, is concerned with the safety of payment instruments. In this respect, the ESCB in general and the BCL in particular, foster the development, by the respective system operators and the respective issuers of payment instruments, of a risk management framework commensurate with the volume and the complexity of the activities performed as well as with the services offered.

The BCL's oversight mission is detailed in articles 2(5) and 27-3 of the law of 23 December 1998 concerning the monetary status and the Banque centrale du Luxembourg. Furthermore, in line with article 34(1) of that law, the BCL has, within the limits of its competencies and responsibilities, the power to issue regulations. In this context, the BCL amended, on 10 July 2012, the BCL regulation 2010/n°6 of 8 September 2010 concerning the oversight of payment systems, securities settlement systems and payment instruments in Luxembourg, in order to include a reference to central counterparties and trade repositories. In the context of the abovementioned amendment, the BCL has also adopted the new principles for financial market infrastructures, published by the CPSS-IOSCO committee during April 2012, by integrating the latter within its general oversight framework.

The BCL's oversight activities are based, among others, on the regular or ad-hoc collection of quantitative and qualitative information, as well as on the performance, by the respective system operators or payment instrument issuers, of a self-assessment of their level of observance with respect to the applicable recommendations, principles and standards. The BCL is, among others, in regular contact with system operators and payment instrument issuers included within the scope of its oversight. The aforementioned information and contacts are completed with onsite inspections aimed at ensuring an adequate implementation of the risk management framework set up by the respective system operators or payment instrument issuers.

Apart from oversight activities relating to systems designated in and operating out of Luxembourg and to payment instruments available to the public in Luxembourg, the BCL also contributes to oversight activities cooperatively performed at the Eurosystem, or ESCB level, and more specifically aimed at infrastructures having no domestic anchor and for which the Governing Council decided to entrust primary oversight responsibility to the ECB.

1.7.2.2.1 Oversight of securities settlement systems

The BCL's oversight covered the activities and functioning of the systems operated by Clearstream Banking S.A., LuxCSD S.A. and VP LUX S.àr.l.. In general, the functioning of the aforementioned securities settlement systems in 2012 was stable and resilient. Regular oversight activities with respect to these systems included, in particular, the processing and assessment of:

- general information on the systems;
- data on the activity and incidents;
- financial data;
- information relating to the risks the systems are exposed to, as well as on the internal risk mitigation tools;
- information relating to changes affecting the systems;
- information relating to the governance and internal rules and procedures.

Concerning the system operated by Clearstream Banking S.A., the BCL also monitored and assessed the implementation of some of the recommendations issued in the context of the evaluation of the system against the ESCB-CESR recommendations, finalised in late 2010, and against the former CPSS-IOSCO standards conducted and finalised by the International monetary fund (IMF) in collaboration with the national authorities in 2011 in the context of the Financial Sector Assessment Program (FSAP). In addition, the BCL maintained its cooperation with the National Bank of Belgium in the context of the link established between the two International Central Securities Depositories, Clearstream and Euroclear.

Apart from the processing and analysis of data obtained in the context of VP LUX S.àr.l.'s monthly reporting and the set-up of such reporting for LuxCSD S.A., both securities settlement system operators performed, in conjunction with the BCL, a self-assessment of their respective systems against the ESCB-CESR recommendations. These self-assessments are currently being analysed by the BCL in order to assess the respective systems' level of compliance with the ESCB-CESR recommendations and to issue, if need may be, recommendations to the respective system operators.

1.7.2.2.2 Oversight of payment systems

As regards the oversight of payment systems, the BCL contributed to the cooperative oversight of the TARGET2 payment system, the centralised platform set-up and operated by the Eurosystem, through its participation in various European working groups and committees. In the context of the coordinated follow-up to the TARGET2 assessment report against the Core principles for the oversight of payment systems issued by the Eurosystem in 2009, the BCL evaluated in particular the BCL's procedures around the mobilisation of collateral aimed at covering payments performed in the TARGET2 contingency module.

Apart from these cooperative oversight activities with respect to TARGET2, the BCL also oversees certain decentralised features of TARGET2 located in Luxembourg, such as the local technical components ensuring the BCL's connectivity to the single platform (TARGET2-LU). In this respect, the BCL has set-up a specific oversight guide.

Through its participation in various European working groups and committees, the BCL showed a particular interest in the activities and in the oversight of the payment systems operated by EBA Clearing, EURO 1, STEP1 and STEP2, and in the developments related to CLS (Continuous linked Settlement System). Furthermore, the BCL participated in the discussions in relation to the oversight of the development and implementation process of the TARGET2 Securities (T2S) settlement platform as well as to the set-up of a cooperative oversight framework for T2S.

The development of new principles for different types of financial market infrastructures by the CPSS-IOSCO committee attracted, in light of their potential impact on the infrastructures operating out of Luxembourg, the BCL's particular attention until the principles' publication in April 2012. In addition, special interest had been granted to the drawing up of the regulation of the European Parliament and the Council on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – EMIR), published on 4 July 2012. In this context, the BCL attended discussions on the definition of certain EMIR related technical standards.

Finally, the BCL granted particular interest to the evolution of the draft regulation of the European Parliament and the Council on improving securities settlement in the European Union and on central securities depositories (CSD Regulation). In this context, the BCL participated in European Council working group meetings.

1.7.2.2.3 Oversight of payment instruments

As regards payment instruments, the BCL continued to perform its oversight with respect to payment instruments available to the public, with particular attention to card payment, credit transfer, direct debit as well as e-money schemes thus contributing to the Eurosystem's oversight activities. In particular, the BCL closely monitored the migration of the debit card payment scheme operated by Bancomat to the VPAY card payment scheme. Furthermore, the BCL followed with interest the initiatives by Luxembourg card issuers promoting the security of online payments. In particular, various e-money schemes and payment solutions, which had only recently been made available to the public, attracted the BCL's particular attention.

Furthermore, the BCL continued to actively contribute to the initiatives of the European Forum on the Security of Retail Payments (SecuRe Pay). The aim of this forum, established in 2011, is to facilitate a common and homogenous understanding between central banks responsible for the oversight of payment instruments and prudential supervisors of payment service providers, on issues related to the security of retail payments within the European Union. During April 2012, the Governing Council of the ECB launched a public consultation regarding recommendations for the security of internet payments issued by the forum. The final recommendations were published end of January 2013 by the ECB. In parallel, the forum has worked on the elaboration of recommendations relating to payment account access services as well as recommendations relating to payments by mobile phone.

1.8 REGULATORY AND LEGISLATIVE DEVELOPMENTS

1.8.1 European legislation

The Eurosystem, which the BCL is a part of, follows with particular interest the developments related to economic governance and financial stability, both at the European and national level.

1.8.1.1 Banking Union

During 2012, it was decided to strengthen the Economic and Monetary Union (EMU) on the basis of an integrated financial framework. Such integrated financial framework can also be referred to as the setting up of a banking union.

During the European summit held on 28 and 29 June 2012, Heads of State or Government decided that this banking union would be primarily made up of three major components among which a first pillar relating to the banking prudential supervision should be established at the beginning of 2013.

This banking union was motivated by the desire to break the vicious circle between bank failures and the aggravation of Member States' sovereign debts.

On 12 September 2012, the European Commission made legislative proposals aimed at creating a Single Supervisory Mechanism (SSM) under the auspices of the ECB, for all banks established in the euro area and open to all Member States. According to this proposal, the Council of the European Union should adopt a Regulation by unanimity on the basis of Article 127(6) TFEU, conferring to the ECB, exclusively, the main tasks relating to the prudential supervision of banks established in the Member States participating in the SSM. This proposal was presented together with another proposal for a Regulation to be adopted by way of co-decision procedure so as to take into account the new tasks conferred to the ECB and adapt provisions applicable to the European Banking Authority (EBA)[16].

During the European Council held on 18 and 19 October 2012, Heads of State or Government restated that the establishment of the SSM was a matter of priority. In this respect, the European Council highlighted three main requirements of the SSM: first, a separation between monetary policy of the ECB and its supervisory tasks, second, a balance between rights and obligations of all Member States participating in the new supervision mechanism, and, third, the obligation for the new single supervision authority to be adequately accountable, including before the European Parliament.

The specific legislative procedure provided for by Article 127(6) TFEU requires a prior consultation of the ECB and of the European Parliament. The ECB already fulfilled this requirement with an opinion issued on 27 November 2012[17].

At the end of its meeting on 12 December 2012, the Council of the European Union, in its ECOFIN configuration (Economic and Financial Affairs) reached an agreement on a compromise text that confers banking supervision tasks to the ECB.

16 Proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM(2012) 511) and proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) No…/… conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (COM(2012) 512) of 12 September 2012.

17 Opinion of the European Central Bank of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (CON/2012/96), OJ C 30, 01.02.2013, p. 6.

The European Parliament, which is consulted for an opinion on the proposal of a Regulation that confers banking supervision tasks to the ECB, is also co-legislator in the adoption procedure of the second proposal for a Regulation concerning the EBA. Due to this reason, it joined the two legislative proposals. On 31 December 2012, the trilogue phase of consultation between the Council, the Parliament and the Commission was still on going.

During the legislative procedure, the BCL was involved in the technical discussions at the level of the Council of the European Union, within the framework of a working group: the 'ad hoc working party – Banking Supervision Mechanism' established by the COREPER under the Cyprus presidency. Due to the priority given to this legislative proposal, the ad hoc group met often throughout the year 2012.

There are two other pillars necessary for a banking union, namely a resolution system for ailing banks and a uniform system for protecting depositors' savings. These three pillars are bound together by a single rule book for all banks.

With regard to the banking resolution component, on which the BCL already presented its views to national institutions during the summer of 2010, it is worth noting that on 6 June 2012 the European Commission presented a legislative proposal for a bank crisis management framework that foresees common steps and powers, but remains a harmonisation of tools at the national level. The aim of such a framework is to ensure that bank failures across the EU are managed in a way that avoids financial instability and minimises costs for taxpayers. In addition to this national framework, it is foreseen that the European Commission will make a new legislative proposal so as to cover the European dimension and achieve the second pillar of the banking union. Such a proposal is expected by the summer of 2013.

Finally, with regard to the third element of the banking union, on 12 July 2012, the European Commission adopted a legislative proposal for a thorough revision of the Directive on Deposit Guarantee Schemes. It mainly deals with a harmonisation and simplification of protected deposits, a faster payout and an improved financing of schemes at national level. At the moment, the establishment of a deposit guarantee scheme at European level is only envisaged over the medium term because it raises fiscal issues that need to be further dealt with.

1.8.1.2 Economic governance

1.8.1.2.1 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 European Union, the European Council adopted on 25 March 2011 the Decision 2011/199/EU amending Article 136 TFEU with regard to 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 entered into force on 1 January 2013.

In Luxembourg, the decision of the European Council, as mentioned above, was approved by the law of 3 July 2012 approving the decision of the European Council of 25 March 2011 modifying article 136 of the TFEU with regard to a stability mechanism for Member States whose currency is the euro.

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, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) 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 and 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 of all the EU Member States (except the United Kingdom and the Czech Republic) on 2 March 2012 and entered into force on 1 January 2013.

Roadmap towards a Genuine Economic and Monetary Union

The European Council of the EU asked its President, Herman Van Rompuy, in close cooperation with the Presidents of the European Commission, the Eurogroup and the ECB, to develop detailed proposals towards a genuine economic and monetary union. To this end, reports were submitted to the European Council in the month of June, October and December 2012.

These reports defined detailed proposals with different stages that would lead to a genuine economic and monetary union in a manner to contribute best to growth, employment and stability. It is suggested to reinforce the architecture of the EMU in the following decade based on an integrated financial framework, an integrated budgetary framework and an integrated economic policy framework. All these changes should also imply strengthened democratic legitimacy and accountability. Such a 'deepening'would eventually imply an amendment of the TFUE.

More specifically, the above-mentioned reports focus on the following aspects:

(i) The integrated financial framework

The integration of the financial sector in the EU saw a sharp acceleration following the introduction of the single currency. Nonetheless, the lack of common instruments of resolution of bank failures has prevented an effective crisis management given the fact that the crisis management and resolution mechanisms in the banking sector are still organised at the national level.

This is the reason why the creation of an integrated financial framework is a necessary condition in order to achieve a genuine economic and monetary union.

This framework should contain the following elements:

- An SSM, as described above;
- A single mechanism for the recapitalization of banks which would allow after the establishment of the SSM a direct recapitalization of banks by the ESM, without having recourse to the fiscal resources of the Member States;
- A harmonisation of national deposit guarantee frameworks as of 2013, to be entrusted to a European authority in order to limit the risks of contagion.

(ii) The integrated budgetary framework

Taking into account the high degree of interdependence between the Member States of the euro area, it has been proved necessary to complete the current framework concerning the surveillance and coordination of fiscal policies by strengthened rules, notably concerning economic governance.

It should contain the following elements:

- Solid national fiscal policies based on an ex ante coordination of the national budgets and an strengthened surveillance of the Member States that face financial difficulties;
- The creation of an own fiscal capacity of the EMU, similar to what already exists for other monetary unions. The financial resources of the fiscal capacity have not yet been determined, but different options exist, such as national budgets and/or own resources and the establishment of a euro area Treasury function with clearly defined budgetary responsibilities.

(iii) The integrated economic framework

The crisis has shown the importance of competitiveness in the monetary union and the deficiencies in the preceding economic policy framework, leading in this regard to several reforms of its European legal basis. Other reforms have been identified in order to strengthen the ex ante coordination of economic policies of the EU Member States.

This framework should contain the following elements:

1. the reforms of the EU surveillance framework;
2. the promotion of structural reforms by arrangements of a contractual nature;
3. the reinforcement of macroprudential policies.

(iv) The democratic legitimacy and accountability

The authors of the report consider that the three integrated financial, budgetary and economic frameworks will only be effective if they benefit from a strong democratic legitimacy and accountability of the parties. The European decisions will involve the European parliament, whereas the national Parliaments will contribute to their role in the Member States.

The European proposals in the final report of 5 December 2012 are inspired by the Communication of the Commission of 28 November 2012, by specifically incorporating the roadmap which can be broken down into three stages.

The first stage: end 2012 to 2013

This stage implies an increased commitment of the Member States to ensure sound management of public finances.

In addition to the implementation of the revised Stability and Growth Pact ('Six-Pack'), including the 'Two-Pack' which is currently being finalised, the report considers it necessary to put a framework into place allowing an enhanced ex ante coordination of the national economic policies, as foreseen by the article 11 of the TSCG.

The report also requests putting into place a SSM for the banking sector under the auspices of the ECB for all the banks of the euro area. Finally, the objective is to reach an agreement on the harmonisation of national resolution and deposit guarantee frameworks, ensuring appropriate funding from the financial industry. A single mechanism for the recapitalization of banks should also be envisaged with its own European authority backed by the ESM, which would provide it with a credit line.

2nd phase: years 2013-2014

It aims at the achievement of an integrated financial framework and of new structural reforms.

3rd phase: after 2014

It will consist in the creation of a fiscal capacity. At this stage an increasing degree of common decision-making on national budgets and on an enhanced coordination of economic polices is proposed.

It follows from the conclusions of the European Council of 14 December 2012 that it did not entirely follow this proposed road map.

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

The year 2012 was marked by the completion of the ESM. The Treaty establishing the ESM, revised and signed again on 2 February 2013 was finally ratified on 27 September 2012. Thus, it entered into force and the official inauguration took place a few days later in the margins of the Eurogroup meeting that took place on 8 October 2012 in Luxembourg.

Since the creation of the ESM, the combined lending capacity of the EFSF and the ESM has increased to € 500 billion. The EFSF will continue to support ongoing programs but will however cease to finance new ones.

From the perspective of Member States that needed European financial assistance, one may notice that during the year 2012 the EFSF continued to provide financial support to Ireland, Portugal and Greece.

In addition, the Spanish and Cypriot governments submitted official requests for assistance to the Eurogroup on 25 June 2012. For Spain, the request for a loan that could reach up to € 100 billion was related to its banking sector. Such assistance was granted on 20 July 2012. Within the framework of this assistance, the first payout by the ESM was made in December 2012 to the *Fondo de Restructuración Ordenada Bancaria (FROB)*, the restructuring fund of the Spanish government.

For Cyprus, there was no payout made during 2012.

During the euro area summit of 29 June 2012, the Heads of State or Government of the euro area made a statement according to which the establishment of the SSM was a prerequisite for envisaging the possibility to have the European Stability Mechanism (ESM) recapitalising banks directly, instead of indirectly as it was the case for Spain.

The Heads of State or Government tasked the Eurogroup with determining the detailed operational criteria that will be used for a direct recapitalisation of banks by the ESM. The direct recapitalisation of banks by the ESM was not foreseen as a financial assistance tool in the Treaty establishing the ESM. It could be adopted as a supplemental instrument.

1.8.1.2.2 Secondary law

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

The objective was to broaden and improve the surveillance of fiscal policies, but also of macroeconomic policies as well as structural reforms following the shortcomings brought to the fore by the economic and financial crisis.

The adopted legislative package comprises six different legislative acts: 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[18]. This implies a reform of the preventive and corrective arms of the Stability and Growth Pact and the introduction of a new procedure on the prevention and correction of macroeconomic imbalances.

This legislative package implies a reform consisting of the preventive and corrective arms of the Stability and Growth Pact as well as a new procedure for preventing and correcting eventual macroeconomic imbalances.

The 'European semester', a new tool adopted by the European Council in 2010 and reflected in the amended Council Regulation (EC) No 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 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 European Commission published two new proposals for Regulations on 23 November 2011, but their adoption is pending.

One of the proposals sets out provisions for the introduction of a progressive surveillance complementing the existing provisions of the Stability and Growth Pact and which will reinforce the surveillance of fiscal discipline in the Member States whose currency is the euro. These provisions foresee the introduction of national fiscal rules in line with the budgetary objectives defined at a European level as well as enhanced surveillance of Member States in excessive deficit. These rules shall be implemented through provisions of binding force and permanent character, preferably constitutional, in order to show the rigorous adhesion of the national authorities to the Stability and Growth Pact. A common budgetary calendar aiming at ensuring the efficiency of the European semester and the setting up of independent budgetary councils at the national level, in charge of monitoring compliance with national fiscal rules, are also proposed.

1.8.2 National legislation

1.8.2.1 BCL regulations

In 2012, the BCL issued three regulations.

With regard to Oversight, the BCL Regulation 2012/N°11 concerning the oversight of central counterparties and trade repositories in Luxembourg was adopted on 10 July 2012; it modified the amended BCL Regulation 2010/N°6 of 8 September 2010 concerning the oversight of payment systems, securities settlement systems and payment instruments in Luxembourg (the 'Oversight Regulation'). The Oversight Regulation now contains provisions regarding the oversight of central counterparties and trade repositories by the

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18 (i) Regulation (EU) No 1173/ 2011 of the European Parliament and of the Council of 16 November 2011 on the effective renforcement of budgetary surveillance in the euro area ; (ii) Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on the enforcement measures to correct excessive macroeconomic imbalances in the euro area ; (iii) Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ; (iv) Regulation (EU) No 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) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 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.

BCL, following the adoption of the EU Regulation on market infrastructures and OTC derivatives (European Market Infrastructure Regulation – EMIR).

A consolidated version of the Oversight Regulation was thereafter published in both French and English.

With regard to the monetary policy, the BCL issued the following regulations:

- BCL Regulation 2012/N°12 of 12 September 2012 implementing the Guideline of the European Central Bank of 2 August 2012 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9 (ECB/2012/18);

- BCL Regulation 2012/N°13 of 9 November 2012 implementing the Guideline of the European Central Bank of 10 October 2012 amending Guideline ECB/2012/18 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2012/23).

1.8.2.2 Interest rates

Legal interest rate

The legal interest rate for the year 2012 has been set at three point five per cent (3.5%) by the Grand-ducal Regulation of 8 December 2011 (Mémorial A N°255 of 16 December 2011, page 4305). For the year 2013, the rate remains unchanged pursuant to the Grand-ducal Regulation of 26 December 2012 (Mémorial A N°299 of 31 December 2012, page 4723). It may be observed that such a rate does not correspond to a particular money market reference rate.

Late payment interest rate on overdue claims in commercial transactions

As regards late payment interest rates on overdue claims in commercial transactions, reference is made, for the first half of 2012, to the publication in the Mémorial B N°9 of 2 February 2012, page 275, and, for the second half of 2012, to the publication in the Mémorial B N°62 of 24 July 2012, page 978. Both publications have been made in accordance with Article 5 (2) of modified law of 18 April 2004 relating to payment deadlines and late payment interests.

These two half-year interest rates are calculated on the basis of the marginal interest rate resulting from the tender procedure for the main refinancing operations applied by the ECB for its most recent main refinancing operation, conducted prior to the first calendar day of the first or the second half of 2012. In both cases, such rate was 1%.

1.8.2.3 Draft bills

1.8.2.3.1 Draft bill approving the Treaty on Stability, Coordination and Governance in the EMU ('TSCG') (number 6449)

The draft law limits itself to one article, the objective of which is to approve the Treaty on Stability, Coordination and Governance in the EMU, as signed on 2 March 2012 in Brussels. The Explanatory Memorandum reflects a summary of the TSCG, indicating that the Government regrets that the intergovernmental instrument was chosen in this case.

The Opinion of the Council of State (Conseil d'Etat) of 21 December 2012 raises no objection against the ratification of the TSCG. However, the Council of State considers that article 3 (2) and article 8 of the TSCG impose a vote of the draft law in compliance with the majority rules foreseen by article 114 of the Constitution.

As regards the fiscal rules and independent institutions, the Explanatory Memorandum of the draft law unfortunately limits itself to a description of the TSCG's content, without mentioning the manner in which the Government envisages to transpose the details defined in the TSCG into Luxembourg law. Following the ratification of the TSCG and its entering into force on 1 January 2013, the contracting parties are obliged to put into place, in conformity with article 3(1) and (2) of the TSCG, the budget balancing rules and automatic correction mechanisms.

In this respect, the BCL reiterates its position reflected in the 2012-1 Bulletin (pp. 101 ss.) as well as in its Opinion with regard to the draft law on the budget of the income and expenses of the State for 2013. More specifically, a reinforcement of the Grand-Duchy of Luxembourg's budgetary framework is considered necessary, thus implying an amendment of the law of 8 June 1999 on the budget, the accounting and the treasury of the State and, as the case may be, of the Constitution.

1.8.2.3.2 Proposal for a revision of the Constitution (number 6030)

A proposal for a revision of the Constitution was filed by the Member of Parliament Paul-Henri Meyers on 21 April 2009. The constitutional reform is still ongoing.

The BCL is not purposefully targeted by these reform proposals.

However, it draws the attention to the fact that, in conformity with article 3(2) of the TSCG[19], it could be envisaged to introduce a budgetary rule in the Constitution of the Grand-Duchy, even if the Constitution does not impose it formally. This provision would have to be accompanied by a special legislation with regard to public finance, thus assuring the multiannual programming and compliance with the European rules as well as policies (with the introduction of the majority of two-thirds of the members of Parliament on matters governing the rules on the establishment and the execution of accounts and public budgets).

This option would have the advantage of stability while creating legal constraints guaranteeing that a future amendment would only occur with hindsight and after the required reflection.

Reference could also be made to an independent body.

1.8.2.3.3 Draft bill to approve the Protocol regarding the immunities of the BIS (n° 6506)

Since Luxembourg became shareholder of the Bank for International Settlements (BIS) in 2011, it has been invited to adhere to the Protocol of Brussels regarding the immunities of the BIS signed on 30 July 1936, the depositary of which is the government of the Kingdom of Belgium. This resembles what other States, which are also members of the international organisation based in Basel, such as Germany, Belgium or France, have done in the past.

The Grand Duchy of Luxembourg's ambassador to the Kingdom of Belgium signed this protocol, subject to ratification, in Brussels on 22 September 2011.

The draft bill n° 6506 that foresees the approval of the signature of the protocol was introduced before Parliament on 28 November 2012.

The regime of immunities that is provided for by the protocol aims to avoid that claims against the BIS hinder the accomplishment of its tasks concerned with public interest. This regime of immunities is common under international public law and is similar to the immunity from enforcement regime that applies to accounts opened by the BCL in accordance with national law (Art. 27-1(2) of the organic law of the BCL).

1.8.2.3.4 The BCL's capital increase

During 2012, the exchange of views between the BCL and the government on the recapitalisation of the Bank continued. A proposal for a draft bill that would increase its capital to up to € 1 500 000 000 was sent to the ECB for consultation; nine hundred million (€ 900 000 000) would be immediately paid out. The ECB issued

19 Reference is made to ' binding rules, preferably at constitutional level [...] '.

an opinion on 7 September 2012[20] suggesting some clarifications on the proposed draft bill. Further to this opinion, the proposal has continued to be discussed between the BCL and the government.

1.8.2.3.5 Draft bill N° 6327 on dematerialised securities

On 12 September 2011, the draft bill N°6327 on dematerialised securities (the 'draft bill') was introduced before Parliament. It aims to regulate the dematerialisation of securities that are subject to Luxembourg law, whether they are equities, debt instruments issued by companies incorporated under Luxembourg law or debt instruments issued under Luxembourg law by companies incorporated under a foreign law. Dematerialised securities are designed as an additional category of securities, which supplements the existing categories of bearer securities and registered securities. The draft bill introduces a procedure for the conversion of existing bearer or registered securities into dematerialised securities as well as the issuance of new securities in dematerialised form.

In its Opinion of 24 January 2012 on the draft bill (CON/2012/3), the ECB welcomed the amendments made to the law of 1 August 2001 on the circulation of securities and other fungible instruments (the '2001 Law'), which strengthen the protection and the enforcement of rights of the securities holders who maintain securities in a securities settlement system, a liquidation body, a central account keeper or an account keeper in Luxembourg. The ECB also welcomed in particular the amendment to Article 16 of the 2001 Law, which allows for the mitigation of credit risk taken by the financial intermediary financing the acquisition of securities by its customers. The ECB considered that such amendment has particular relevance to TARGET2-Securities (T2S), the Eurosystem's future settlement platform. Moreover, the ECB acknowledged that the amendment made to Article 15 of the 2001 Law aims to address specific situations encountered during 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 could not discharge its obligations, and where the parties could not immediately agree on the bilateral cancellation of such a transfer order.

In this respect, the ECB recommended in its Opinion the clarification of the scope as well as the relationship of the newly introduced provision with regard to the settlement's irrevocability safeguarded by Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality payment and securities settlement systems. The ECB also recommended that the draft bill define the manner in which the statutory discharge of obligations may be aligned with the rules of the securities settlement system operator.

The minutes of the meeting of 27 November 2012 of the Finances and Budget Commission (hereafter 'the Commission') specified that Article 15 of the draft bill was amended in order to clarify the situation following the recommendations of the ECB in the aforementioned Opinion of 24 January 2012.

The ECB feared that the parties could agree to abandon their obligations on a certain date, without the securities settlement system and thus also the T2S operator having knowledge of such an agreement and that subsequently the securities settlement system and, thus T2S, could continue to attempt to settle the transaction after such a date, which may produce legal uncertainty as to the status of such transaction. The Commission considered that such fear could be dispelled for mainly two reasons.

Firstly, the Commission considered that, in accordance with the doctrine of privacy of contracts, the agreement between the purchaser and the seller of the securities is not binding upon the securities settlement system. Hence, the securities settlement system may continue to act as long as it has not received from the seller and/or purchaser a notification of a modification of the settlement instructions. Secondly, the Commission considered that Article 15 reserves expressly title V of the law on payment services and, accordingly, once an order is entered into the securities settlement system (Article 111 of the law on payment services), it becomes irrevocable notwithstanding any agreement to the contrary.

20 Opinion of the European Central Bank of 7 September 2012 on the capital increase of the Banque centrale du Luxembourg (CON/2012/69).

In order to take into account the Opinion of the ECB and to avoid any ambiguity, the Commission decided to add a subparagraph to Article 15 of the 2001 Law which specifies that the rules of the securities settlement system prevails over the arrangements of the parties.

1.8.3 Legal acts of the ECB

1.8.3.1 An overview of the non-standard collateral regime

By virtue of Article 18 of the Statute of the ECB and the ESCB, Eurosystem credit operations with counterparties are 'based on adequate collateral'.

In view of the significant challenges generated by the financial crisis and the subsequent sovereign debt crisis, adaptations had to be made to the Eurosystem's monetary policy instruments and in particular to the collateral framework.

Although the Eurosystem already had a relatively broad collateral framework in place, the list of eligible assets had to be widened further temporarily so as to ensure that collateral did not constitute a constraint after the introduction of the fixed rate procedure with full allotment, which formed part of the non-standard measures.

As from 22 October 2008, the minimum rating threshold for marketable assets, other than asset-backed securities, and non-marketable assets was lowered from A- to BBB-, leaving unchanged the threshold of A- imposed for asset-backed securities.

Moreover, debt instruments denominated in foreign currencies such as the US dollar, the Japanese yen and the British pound became eligible and debt instruments issued by credit institutions and traded on certain non-regulated markets recognised by the ECB also became eligible. Finally, subordinated debt instruments, which were secured by an acceptable guarantee and fulfilling all other eligibility criteria, could also be used as collateral.

The extension of the list of eligible assets generated an increase of eligible collateral which amounted to a volume of approximately EUR 870 billion. This amount was further increased by a significant amount of credit claims which became eligible when the rating threshold was lowered to BBB-.

In view of the improved conditions, a phasing-out of such measures was initiated in late 2009, as the collateral framework was to some extent tightened and some non-standard refinancing operations were not renewed. For instance, eligibility requirements for asset-backed securities became more stringent and the expiry date for the temporary expansion of the list of eligible assets, which was initially set for end of 2009, was prolonged until the end of 2010. The emergence of the sovereign debt crisis prompted, however, the reassessment of such phasing-out process.

On 8 December 2011, an additional temporary widening of the collateral framework was decided upon by the Governing Council. The purpose of this decision was to facilitate the access to central bank liquidity. The additional asset types included in the single list of eligible assets were aiming to improve, in particular, the refinancing conditions for smaller banks financing small and medium-sized enterprises of particular importance to the euro area.

The adopted measures may be summarised as follows:

First, the rating threshold applicable to certain asset-backed securities was reduced to A- (at issuance). Second, national central banks were allowed on a temporary basis to accept as collateral credit claims satisfying specific criteria, which are additional to those eligible pursuant to the common Eurosystem eligibility criteria. On 9 February 2012, the Governing Council approved a first wave consisting of seven additional credit claim frameworks submitted by national central banks.

The ECB Guideline of 2 August 2012 has further extended the eligibility criteria regarding certain additional asset-backed securities, which are now eligible as collateral for Eurosystem monetary policy operations, provided that they have two ratings of at least BBB at issuance and at any time subsequently.

In addition, NCBs can also accept as collateral – upon prior approval by the Governing Council – credit claims that do not satisfy the Eurosystem eligibility criteria, but which are compliant with the specific eligibility criteria and risk control measures imposed by NCBs that accept them.

Furthermore, the Governing Council announced that the Eurosystem had the intention to strengthen its internal credit assessment capacities and to encourage potential external credit assessment providers and the commercial banks using internal rating systems (IRB) to request the approval of the Eurosystem within the Eurosystem Credit Assesment Framework (ECAF) system.

On 6 September 2012, the Governing Council decided to adopt additional measures aiming to preserve collateral availability for counterparties (e.g. suspension of the minimum credit rating threshold for marketable debt instruments issued or guaranteed by the central government, countries that are eligible for Outright Monetary Transactions or are under an EU-IMF programme and comply with the conditionality as assessed by the Governing Council; the eligibility of the securities issued and held in the Euro zone but denominated in US dollar, pound sterling or Japanese yen).

1.8.3.2 Amendments to Guideline ECB/2011/14 of the European Central Bank of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem

Guideline ECB/2011/14 of the ECB of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem ('General Documentation') has been amended by the ECB Guideline of 26 November 2012 (ECB/2012/25) with effect as of 3 January 2013 ('Guideline ECB/2012/25'). The General Conditions of the operations of the BCL and, in particular, Annex 8 have been updated and complemented, in order to implement Guideline ECB/2012/25.

Beside a number of technical adjustments, with the aim of streamlining and strengthening the collateral and risk control framework in place for the Eurosystem operations, Guideline ECB/2012/25 includes the following changes.

As announced on 6 July 2012, the reporting requirements related to the loan-level data for asset-backed securities have been laid down in Section 6.2.1.1 and in the new Appendix 8 of the General Documentation.

Moreover, the Eurosystem has streamlined the coupon types of eligible marketable instruments in Section 6.2.1.1. Specifically, floating-rate coupons must be linked to a single standard euro interest rate reference or to a euro area inflation index. Complex coupon structures and inverse floaters are excluded.

A certain number of amendments have also been made to the provisions relating to covered bonds.

On the one hand, the Eurosystem decided (Section 6.2.1.1) that, as from now, the cover pools of eligible covered bonds may only contain asset-backed securities to the extent that (i) these comply with the requirements of Directives 2006/48/EC and 2006/49/EC, (ii) were originated within the same consolidated group and (iii) the securities are used as a technical tool to transfer mortgages or guaranteed real-estate loans from the originating entity into the cover pool. A grandfathering period of two years (starting as of 3 January 2013) for covered bonds already issued has been put in place.

On the other hand, the Governing Council decided to amend the provisions of Section 6.2.3.2 relating to the close-link requirements in place for the own-use of covered bonds as collateral. Henceforth, only the following covered bonds will be eligible for own-use:

- covered bonds issued in accordance with the criteria set out in annex VI, Part 1, points 68 to 70 of Directive 2006/48/EC;or
- covered bonds issued in accordance with the criteria set out in Article 52(4) of the UCITS Directive (Directive 2009/65/EC) and offering a comparable protection to the criteria set out in annex VI, Part 1, points 68 to 70 of Directive 2006/48/EC, such as in the case of the non-marketable RMBD which are not

securities or covered bonds for which all criteria set out in Part 1, points 68 of annex VI to 70 of Directive 2006/48/EC are complied with, except for the limits on guaranteed loans in the cover pools.

Furthermore, the acceptance of unrated UCITS-compliant covered bonds issued prior to 1 January 2008 has been phased out (Section 6.3.2).

Finally, two other modifications shall be underlined.

The first one resulting from the decision of the Governing Council according to which the providers of credit assessment systems accepted within the ECAF will be required to submit performance monitoring data on a disaggregated basis. Also, credit assessment systems will be required to provide a signed certificate confirming the accuracy and validity of the performance monitoring information provided.

The second one consisting in the introduction of a new information requirement for counterparties (Section 6.2.3) which are required to inform the Eurosystem (i) one month in advance of any planned modification to an asset-backed security which it has submitted as collateral and (ii) upon submission of an asset-backed security, of any modification made to that asset in the six months prior to its submission, if the asset-backed security is own-used.

1.9 COMMUNICATION

1.9.1 Publications

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

In 2012, the BCL also published four Bulletins and one Financial Stability Review.

In its working papers the BCL publishes the results of research conducted by its staff. Working papers can be accessed via the internet, on the BCL's website. Each working paper contains a non-technical summary. In 2012, 10 working papers were published.

1.9.2 Training at the BCL

The BCL continued its cooperation with the University of Luxembourg where staff members gave lectures in law and economics. Other staff members also gave lectures concerning European economic integration (MUDEC – Miami University John E. Dolibois Center), economics (Catholic University of Louvain), foreign exchange risk management (Strasbourg Institute of Political Studies), econometrics and time series analysis (University Metz).

The BCL also organised ad hoc presentations for various groups of students (ULB-Solvay, RWTH Aachen University, BTS Bank of Orleans) either upon direct demand by the universities themselves or in the framework of presentations on the financial sector organised by Luxembourg for Finance (LFF).

The BCL is a shareholder of the Agence de Transfert de Technologie Financière (ATTF). This agency, established in 1999 at the initiative of the Luxembourgish government, aims to render Luxembourg's know-how in financial matters accessible to other countries, in particular emerging countries. Upon demand of the ATTF, presentations were organised in favour of delegations from Uzbekistan, Mongolia, China and from countries in the South Pacific. The BCL also welcomed a high-level delegation of the National Development and Reform Commission of the People's Republic of China in the context of a work visit organised by the Minister of foreign affairs as well as a high-level delegation from the financial sector of Casablanca in the framework of a mission organised by LFF.

Finally, the BCL organises presentations on the Eurosystem and the BCL for economics students in their last two years of secondary school. 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 subjects can also be addressed with regard to the students' questions and the teachers' requests.

1.9.3 The BCL's website

The BCL's website, www.bcl.lu, provides information about the Bank's activities and services 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. The publications can also be obtained upon request in hard copy, depending on availability.

The website is in English and in French. The documents are published in their original language (English, French or German).

In 2012, the BCL decided to renew its website which is expected to go online in 2013.

Overall, around 112 000 people visited the BCL's website in 2012 (more than 14, 3 million consulted pages). The most often downloaded document remains the numismatic programme which was downloaded about 32 000 times. The numismatic products' electronic shop (eshop.bcl.lu), which is directly accessible through the BCL's website, attracted more than 39 000 visitors in 2012.

1.9.4 The library

The library of the BCL, inaugurated in 2005, uses the ALEPH library management system which is connected to the public libraries in Luxembourg.

The library mainly contains economics and law publications. Most documents refers to monetary, economic, financial and legal issues in the euro area.

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

1.9.5 Press relations

The Governor of the BCL gave eight interviews to the international and national press in 2012. Seven press conferences were held, on the occasion of the presentation of the BCL's Annual Report, financial accounts, as well as its Bulletins, Financial Stability Review and Opinion regarding the state budget motion for the year 2013. A total of 109 press releases were issued.

1.9.6 The BCL research programme

BCL research activities are organised in six main research areas:
- 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

The BCL's research output is regularly disseminated through its working paper series, the BCL Bulletin and the Financial Stability Review. In 2012, BCL staff members published several studies in peer-reviewed scientific journals (Journal of Economic Dynamics and Control, Journal of Productivity Analysis, Journal for Labour Market Research, Economic Modelling, Economic Inquiry, Economic Letters, Advances in Statistical Analysis, Brussels Economic Review). BCL staff members also presented their work in seminars and workshops organised, among others, by the University of Luxembourg, the Eurosystem, the European University Institute, the Austrian Economic Association, and the Swedish Network for European Studies in Economics & Business.

Since December 2006, the BCL is a member of the research network of European central banks called Household Finance and Consumption Network (HFCN). This network conducted a harmonised survey on Household finance and consumption in the euro area. The Luxembourg part of this survey was carried out by the BCL in collaboration with CEPS/Instead. First results were published as BCL working papers or as text boxes in BCL bulletins.

Since June 2010, the BCL also participates in a second European central bank research network called MaRs (Macro-prudential Research Network). In this context, the BCL contributes to the work in two workstreams: one concentrates on macro-financial models, with a focus on the link between financial stability and economic performance, and the other focuses on early warning systems and systemic risk measures.

Since March 2012, BCL is also a member of a third European central bank research network called Compnet (Competitiveness Research Network). In this context, the BCL contributes to two workstreams: one focuses on the macroeconomic dimension of competitiveness (global and sectoral indicators and their link to export performance), the other analyses competitiveness at the firm level using micro-data.

In October 2012, BCL organised an international conference in Luxembourg on the subject 'Disaggregating the Business Cycle' in collaboration with CEPR and the Euro Area Business Cycle Network. In November 2012 a second conference was held on the subject 'Financial Stability, Bank Risk and Regulation in the Light of the Crisis' in collaboration with the LSF, University of Luxembourg, the Journal of Financial Stability and other institutions. This second conference served to present BCL's work in the context of the multi-year research project RISKADBS (Measuring financial stability in Luxembourg: risk adjusted balance sheets) conducted in collaboration with the LSF and partially financed by the Fonds national de la Recherche (FNR).

External Presentations

- Seminar on 'Best Practices in Forecasting Public Revenues' (Ministère des Finances and Statec), Luxembourg, January 2012
- Séminaire du midi, University of Luxembourg, February 2012
- OECD technical seminar on 'Inequalities and social mobility' (Ministère de l'économie et du commerce extérieur), April 2012
- EUI-nomics, European University Institute, Florence, Italy, April 2012
- Annual meeting of the Austrian Economic Association, Vienna, Austria, May 2012
- Workshop on 'Taxing Cross-Border Commuters: Öresund and Beyond', Uppsala, Sweden, May 2012
- Annual conference of the Swedish Network for European Studies in Economics and Business (SNEE), Mölle, Sweden, May 2012
- Macro-prudential Research Network (MaRs), workstream 1 conference, Frankfurt, May 2012
- Conference of RETEL (Réseau d'étude sur le marché du travail et de l'emploi), Mondorf, May 2012
- ESCB seminar in preparation of the ECB surveillance reports, Frankfurt, ECB, June 2012.

- Conference on 'Demographic Trends, Saving and Retirement Security: Stylized Facts and Behavioural Responses,' Munich, June 2012

- 7th European Workshop on Labour Markets and Demographic Change, University of St. Gallen, Switzerland, August 2012

- Presentation to the Working Group on Econometric Modelling, ECB, Frankfurt, September 2012

- Central Bank Macroeconomic Modelling Workshop on 'Modelling Imbalances', Warsaw, September 2012

- Presentation to the Working Group on Forecasting, ECB, Frankfurt, September 2012

- Short and medium-term impact of structural reforms and their implications for macroeconomic projections, workshop of the Working Group on Forecasting, ECB, Frankfurt, in October 2012

- CEPR/Euro Area Business Cycle Network conference on 'Disaggregating the Business Cycle,' Luxembourg, October 2012.

1.9.6.2 The BCL Foundation

Created in 2011, the BCL Foundation aims to promote research and higher education in the BCL's fields of activity. For 2011-2012, its Board of Directors set the priority on research in financial stability, a subject of current interest for researchers as well as policymakers. The Foundation offered a € 5 000 grant to finance visits to the BCL by researchers active in this domain and also a € 2 000 prize for the best PhD thesis defended in 2011 in this domain. The Foundation also contributed to the organisation of the BCL Financial Stability Seminar in April 2012 and the international conference on 'Disaggregating the business cycle' in collaboration with CEPR and the Euro Area Business Cycle Network.

The Foundation's bylaws were approved by the Règlement grand-ducal of 12 March 2011. On 1 December 2012, the Board of Directors included 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 BCL Executive Director - Managing Director

Mr. Hans Helmut Kotz, Senior fellow at the Centre for Financial Studies, Goethe Universität, Frankfurt, Honorary Professor at Freiburg University (D) and former member of the Deutsche Bundesbank Board of Directors - Director

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

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

M. Romain Schintgen, member of the Council of the BCL - Director

M. Henri Sneessens, Professor at the University of Luxembourg - Director

M. Christian Wolff, Professor at the University of Luxembourg, Director of the Luxembourg School of Finance - Vice-President

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

Given his appointment to the ECB's Executive Board, Mr. Mersch resigned his position as Director and President effective as of 7 December 2012.

1.9.7 Conferences and events

The BCL was involved in the organisation of the following conferences and events:

- A Seminar was organised on the occasion of the presentation of the BCL's Financial Stability Review to the press, on 25 April, in the presence of several central bank governors and of other high-level guests, such as members of the Luxembourgish and European financial sector, as well as representatives of the academic world. The seminar concluded with a panel discussion on a national approach to a macro prudential architecture and policy, in which Aerdt Houben of the Central Bank of the Netherlands, as well as Lars Nyberg, former Vice-Governor of the Swedish Central Bank, Claudio Borio, Deputy Head of the Economic and monetary department and Director of research and statistics at the Bank for International Settlements (BIS), Vitor Constancio, Vice-President of the ECB, Charles Goodhart, Director of the research program of financial regulation at the London School of Economics, André Sapir, Professor at the *Université libre de Bruxelles* and Ignazio Visco, Governor of the Bank of Italy, participated.

- Seminar of the European Supervisor Education Initiative (ESE) organised in Luxembourg from 24 to 26 April 2012. The seminar dealt with the subject 'Importance of the liquidity risk management for the stability of individual banks and the financial system.' The association European Supervisor Education Initiative, of which the BCL has been a member since 2010, aims to train supervisors in Europe and to promote the convergence of micro-prudential supervisory practices at the European level.

- Following the launch, at the end of 2010, of the ECB Charity Initiative, the Governor of the BCL donated € 6 500 to Marc de Geest, Director of *Autisme Luxembourg asbl*, on the occasion of a ceremony organised at the BCL on 9 May. The association, created in 1981, arranges and manages accommodation, medical, employment and leisure services for people affected by autism. The donations come from funds received in the last few years in the framework of external activities of the members of the ECB Executive Board and of other members of the ECB, which are then equally distributed amongst the national central banks of the Eurosystem.

- Organisation by the *Bridge Forum Dialogue* association on 7 June at the European Commission of a conference on the subject: 'Immigration and integration in Europe'. Cem Özdemir, co-president of the 90 Alliance/the Greens and Jan O. Karlsson, former President of the European court of Auditors and Former Swedish Minister for Migration and Development Cooperation, expressed their views. The conference was chaired by Vitor Manuel da Silva Caldeira, Vice-President of *The Bridge Forum Dialogue* association.

- Conference by the Bridge Forum Dialogue association on 2 July at the EIB on the subject: 'Which energy policy for Europe?', under the chairmanship of Werner Hoyer, Vice-President of *The Bridge Forum Dialogue* association. The conference's main speaker was Günther Hermann Oettinger, European Commissioner for Energy.

- Prize award ceremony of € 2000 for the best PhD. thesis presented in 2011 in the field of financial stability to Ms Agnese Leonello, of the European Institute of Florence, on 8 October. The ceremony took place at the same time as the conference 'Disaggregating the Business Cycle' which was organised by the BCL in collaboration with the Euro Area Business Cycle Network. This research network, founded in 2002, gathers academic researchers and researchers from central banks and other institutions involved in the empirical analyses of the euro area. The BCL is one of the 19 central bank members of this research network.

- Organisation, jointly with the Luxembourg School of Finance, the University of Luxembourg, the *Fonds National de la Recherche Luxembourg*, the Journal of Financial Stability, the University of Fordham and the central banks of Finland and Turkey of the conference 'Financial Stability, Bank Risk and Regulation in the Light of the Crisis' on 15 and 16 November at the BCL. The conference gathered university and central bank decision-makers and practitioners together, to allow for an exchange of views and presentations on the latest achievements regarding the functioning of banking and financial markets as well as monetary, economic and financial stability.

- Ceremony organised at the BCL on 21 December in honour of the nominations of Mr. Yves Mersch to the ECB Executive Board and of Mr. Gaston Reinesch to the BCL. The introductory speech was given by Mr. Jean-Claude Juncker, the Prime Minister. The ceremony was attended by the BCL staff as well as by the current and former members of the BCL Council and invited guests, notably Mr. Laurent Mosar, President of the Chamber of Deputies, Mr. Jean Asselborn, Vice-Prime Minister and Minister of Foreign Affairs, Mr. Victor Gillen, President of the State Council and Mr. Luc Frieden, Minister of Finance.

1.10 EUROPEAN ACTIVITIES

1.10.1 Activities at the level of the ECB

In 2012, the Governor of the BCL participated in 23 meetings of the Governing Council and in four meetings of the General Council. Members of the Governing Council act in their personal capacity and not as national representatives when taking decisions, which is reflected in the principle 'one member, one vote'.

The Governing Council usually meets twice a month at the ECB's headquarters in Frankfurt. At its first meeting, the Governing Council assesses economic and monetary developments and takes its monthly monetary policy decision, whilst at its second meeting the Council discusses mainly issues related to other tasks and responsibilities of the ECB and the Eurosystem. The General Council comprises the ECB President and Vice-President as well as ESCB Governors and meets in Frankfurt four times a year.

In 2012, more than 500 Executive Board proposals were adopted by the Governing Council by written procedure, including opinions relating to draft laws at the European or national level, according to article 127 paragraph 4 of the Lisbon Treaty.

The 17 Eurosystem/ESCB Committees assist the decision-making bodies of the ECB in the fulfillment of their tasks. The Governing Council or the Executive Board may ask Committees to conduct analyses on specific topics. Committees were established under article 9.1 of the ECB's rules of procedure and report to the Governing Council through the ECB's Executive Board. Committees are mainly composed of members of the Eurosystem but may also include, for some issues, ESCB members. Each member is appointed by the Governor of his/her national central bank or, in some cases, by the ECB's Executive Board. Working groups or task forces have also been established with specific objectives in accordance with their related Committee's mandate. The Governing Council has further created High Level Groups to consider particular issues.

1.10.2 Economic and Financial Committee (EFC)

The Economic and Financial Committee (EFC) is composed of representatives of the finance ministries and the central banks of EU Member States, as well as representatives of the European Commission and the ECB. In this Committee, the BCL is represented by one of the members of its Executive Board.

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 2012, the EFC continued to closely follow 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), as well as the progress achieved in setting up a single supervisory mechanism for the banks.

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.

1.10.3 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 CMFB rules in particular 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 has contributed actively in 2012 to this committee. Progress has been made particularly in terms of financial accounts, balance of payments, financial services and public finance statistics as well as national accounts.

1.10.4 Other activities at the European level

On January 20, the Governor of the BCL received the Luxembourg members of the European Parliament for a debate on the ongoing reforms and discussions, at the EU level, linked to economic governance and financial stability in the European Union and in the euro area.

In the context of the nomination procedure of a new member of the ECB Executive Board, the BCL Governor, in his quality of candidate, appeared in front of the Economic and Monetary Affairs committee of the European Parliament, on 22 October, for a hearing.

1.11 NATIONAL AND EXTERNAL ACTIVITIES

1.11.1 National activities

1.11.1.1 Relations with Parliament

On 16 November, the BCL presented its Opinion on the state budget motion to the Financial and Budget Commission of the Luxembourg Parliament.

1.11.1.2 BCL committees

The Operational Crisis Prevention Group (OCPG)

The BCL established the Operational Crisis Prevention Group (OCPG) with the mandate of enhancing the financial sector's preparation with regard to large-scale operational disruptions. Members include the ABBL, the CSSF and systemically important market participants.

The group held three meetings in 2012. It took part in the pan European exercise *Cyber Europe 2012* which was conducted by the European Network and Information Security Agency (ENISA). Its members are currently working at establishing communication procedures for crisis situations.

The Lawyers' Committee (Comité des Juristes)

The Lawyers' Committee met five times in 2012.

The Statistics Committee

The Statistics Committee has been set up by the BCL to ensure a constant dialogue between the representatives of entities subject to statistical data collection and the main users of such data. The Committee is regularly consulted on issues relating to the statistical reporting in the financial sector.

The Monetary and banking statistics consultative commission

This consultative commission has been set up by the BCL in order to assure an efficient collection of monetary and banking statistics and to enhance the dialogue with reporting credit institutions. In 2012, the Commission was informed and consulted on various conceptual issues concerning the revision of the statistical data collection.

The Balance of payments statistics consultative commission

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 position. The Commission ensures an efficient organisation of data collection in order to avoid redundancies and to limit the collection charge for the entities requested to submit statistical data. In 2012, the commission has not been consulted due to the absence of new projects.

The Economic and financial statistics consultative commission

The Economic and financial statistics consultative commission has been set up by the BCL in order to ensure an efficient organisation of the data collection in the area of economic and financial statistics as well as to enhance the dialogue between financial intermediaries and the central bank. In 2012, the Commission was not consulted due to the absence of new projects.

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 (Commission de l'indice des prix à la consummation)

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.

Committee Comptabilité bancaire

The committee *Comptabilité Bancaire* set up by the *Commission de surveillance du secteur financier* (CSSF), aims at ensuring an exchange of views between the supervisory authority, the BCL and the stakeholders of the Luxembourg financial centre. The committee is consulted during the development of CSSF circulars concerning bank accounting issues.

Higher Council for Statistics of Luxembourg

The Higher Council for Statistics carries out advisory functions on behalf of the national statistical institute of Luxembourg (STATEC) and is mandated to assess STATEC's annual programme. The BCL contributes in two ways to the work of the Higher Council for Statistics: on the one hand, it provides its opinion on the documents submitted at the meetings; on the other hand, it provides STATEC with data collected on the financial centre to enable the latter to achieve its work programme.

XBRL Luxembourg

XBRL (eXtensible Business Reporting Language) is a financial reporting standard based on XML, the main objective of which is to improve the accuracy, transparency and efficiency of internal and external reporting. The non-profit association XBRL Luxembourg 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 reporting collected from companies of the Luxembourg financial sector.

1.11.2 External activities

1.11.2.1 The BCL's multilateral activities

Activities at the level of the IMF

Luxembourg is a founding member of the IMF. In 2012, the BCL Governor, being also the Alternate Governor for Luxembourg at the IMF, attended the Annual Meeting of the IMF and the meeting of the International Monetary and Financial Committee (IMFC). A BCL member is on secondment to the IMF.

The IMF's Executive Board is composed of 24 Executive Directors. In the framework of the amendments to the IMF's Articles of Agreement, which aim notably at reducing the representation of advanced European countries by two seats, Belgium and Luxembourg joined the constituency chaired by the Dutch Executive Director on 1 November 2012. Henceforth, the Netherlands and Belgium will designate an Executive Director on a rotating basis, thereby reducing by one the number of Executive Directors of advanced European countries. For Luxembourg, the position of its seconded staff member was upgraded to that of Senior Advisor. Apart from the Netherlands, Belgium and Luxembourg, the other 12 members of this constituency, in the decreasing order of their quotas are: Ukraine, Israel, Romania, Bulgaria, Croatia, Cyprus, Bosnia-Herzegovina, Georgia, Moldova, Macedonia, Armenia and Montenegro.

The BCL handles Luxembourg's financial transactions with the IMF. It holds Luxembourg's assets and liabilities with regard to the IMF in both the General Resources Account and the Special Drawing Rights (SDR) account.

On 31 December 2012, Luxembourg's quota, recorded in full on the BCL's balance sheet, amounted to SDR 418.7 million. On the same date, Luxembourg's reserve position -i.e. the difference between Luxembourg's total quota in the IMF and the euro-denominated assets detained by the IMF at the BCL- was of SDR 109.8 million, equivalent to 26.2% 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. At the end of the year, the credits granted by Luxembourg under the New Arrangements to Borrow (NAB), reached SDR 114.6 million.

At the end of the year 2012, Luxembourg held SDR 244.1 million, or 98.98% of its SDR allocation, in comparison with 98.87% end 2011.

In the framework of the 14th General Review of Quotas, the IMF's total quotas will double from SDR 238.4 billion to SDR 476.8 billion. Luxembourg's quota will increase from SDR 418.7 million to SDR 1 321.8 million, an increase of 216%. This increase of SDR 903.1 million is regulated by the law of 10 October 2012, which authorises the government to participate in the general review of quotas of the IMF Member States, approved by Resolution n° 66-2 of the Board of Governors on 15 October 2010 and approving the amendment to the IMF's Articles of Agreement in regard to the same resolution.

The review of the quotas and the amendment to the IMF's Articles of Agreement are linked and will enter into force when Member States representing at least 85% of the voting rights have adopted them. Following the doubling of the IMF's quotas, the NAB will be rolled back from around SDR 370 billion to about SDR 182 billion. Luxembourg's participation in the NAB will be reduced from SDR 970.59 million to SDR 493.1 million.

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 Governing Board, the IILM's main decision-making body. The Governing Board 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 2012.

Activities at the level of the Bank for International Settlements (BIS)

In 2011, the BCL became 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, notably by the regular organisation of high-level meetings including the governors of central banks and experts. It also contributed to the establishment of international standards in banking areas. The BIS has at present about sixty members from advanced and emerging countries.

The BCL is 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 is 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.

In 2012, the discussions that took place in the framework of BIS meetings addressed the economic and financial crisis and the global financial system, as well as the definition and use of macro-prudential instruments and the enhancement of the BIS' international banking statistics.

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

The Financial Stability Board was established in 2009 in order to coordinate the work of national financial authorities and the organisations that elaborate standards in the field of financial stability. It consists of three committees which are dedicated respectively to the assessment of vulnerabilities, cooperation in supervisory and regulatory matters and the implementation of standards.

With regard to the FSB's work related to financial system vulnerabilities and measures aiming at enhancing financial stability, the FSB has set up since 2011 so-called 'Regional Consultative Groups' (RCG) which allow exchanges of views between financial sector authorities from FSB member and FSB non-member jurisdictions. The Governor of the BCL, who was elected at the end of 2011 as co-chairman of the RCG for Europe by the non members of the FSB, co-chaired the meetings of this group in 2012 and also attended, in his quality of co-chairman, the plenary meetings of the FSB, which were held in May in Hong Kong and in October in Tokyo, in the margins of the IMF and World Bank Annual Meetings. These meetings addressed the vulnerabilities of the financial system as well as the G20's work programme in this regard and the implementation and follow-up of the Basel standards and the recommendations targeting shadow banking activities.

Participation in seminars or high-level conferences

- Participation of the BCL Governor in the 4th *Welt-Wirtschaftsgipfel* in Berlin on 11 January. This fourth summit, jointly organised by the press group *Die Welt* and Axel Springer S.A, reunited, in the framework of non public sessions, leading actors of the economic and political world in a manner that permitted a frank and confidential dialogue, in the context of the euro area sovereign debt crisis. Around 50 people were present; with such names as Chancellor Dr. Angela Merkel, the Minister of finance Dr. Wolfgang Schäuble as well as other members of the German government and the President of the World Bank, Robert B. Zoellick. Mr. Mersch addressed the subject: 'The Euro in the crisis: risks, solutions and strategies'.

- Participation of the BCL Governor in a round table, on 24 October in Berlin, concerning the subject *Leistungsfähige Finanzplätze - Politk und Banken in gemeinsamer Verantowortung* at the main headquarters of *Bankenverband*.

- Participation of the BCL Governor, upon invitation by Mr. Rundheersing Bheenick, Governor of the Central Bank of Mauritius, in the 19th Conference of French-speaking central banks, from 23 to 26 May, on the topic: Central banks: new role, new missions in a world economy undergoing major changes. Mr. Mersch delivered a short speech on the euro crisis and its impact on the rest of the world, notably the French-speaking countries.

- Participation of the BCL Governor, from 12 to 13 July, in the High-Level Eurosystem Seminar with Mediterranean Countries' Central Banks which was held in Casablanca. The subjects discussed essentially concerned economic and financial developments in the Mediterranean countries of the euro area and on the monetary policy implementation, macro-prudential policies as well as financial stability.

- Participation of the BCL Governor, from 30 August to 1 September, in the symposium organised by the Federal Reserve of Kansas City in Jackson Hole, United States. This worldwide famous event has taken place every year since 1978 and regroups central bankers and other high-level personalities of the economic, financial and academic world, in order to discuss current economic issues. In 2012, the discussions focused on the following subject: 'The Changing Policy Landscape'.

- Speech by the BCL Governor, on 23 October, on the occasion of the session entitled '*Europa und der Euro-ein Währungsraum mit Zukunft?*' (Europe and the euro – a currency area with a future?) in the context of the 6th *Deutscher Maschinenbau Gipfel* organised in Berlin, alongside Dr. Wolfgang Schäuble, Federal minister of finance and of Mr. Torsten Hinrichs, Managing Director of Standard & Poor's Credit Market Services Europe Ltd.

1.11.2.2 Bilateral relations

The BCL Governor signed a Memorandum of Understanding with Mr. Abdellatif Jouahri, Governor of the Central Bank of Morocco, on 12 July, in the margins of the High-Level Eurosystem Seminar with Mediterranean Countries' Central Banks which took place in Casablanca from 12 to 14 July. The agreement concerned the cooperation between both institutions in the fields of technical assistance and training.