

2. OTHER BCL FINANCIAL ACTIVITIES

2.1 Monetary policy

In Luxembourg, the BCL is in charge of the execution of monetary policy as formulated by the ECB for the whole euro area. Refinancing operations, also called open market operations, provide liquidity against collateral to counterparties i.e. the credit institutions of Luxembourg's financial centre.

Open market operations are divided into:

- main refinancing operations -(MROs) which are conducted regularly through weekly standard tenders, with a maturity of one week.
- longer-term refinancing operations -(LTROs) which are conducted regularly through monthly standard tenders with a maturity of three months.

In 2004, several operational features of the monetary policy framework were modified. These changes were intended to minimise speculation on rate changes occurring during the reserve maintenance period.

- The calendar of reserve maintenance periods was modified in order to always start the new period on the settlement day of the MRO following the Governing Council meeting at which the monthly assessment of the monetary policy stance is scheduled.
- Since 10 March 2004, the maturity of MROs has been shortened from two weeks to one week.
- Since 26 February 2004, the LTROs are normally allotted on the last Wednesday of each month.
- Rate modifications for standing facilities now occur in principle on the first day of a new reserve maintenance period.

The ECB also improved its communication policy with counterparties. On announcement days of MROs the ECB continues to publish its autonomous liquidity factors forecast and, in addition, it has started to publish an updated version on the allotment day. Furthermore, on both the announcement and the allotment day, the ECB now communicates a neutral allotment amount forecast, i.e. the allotted amount enabling the banking system to respect its reserve requirements.

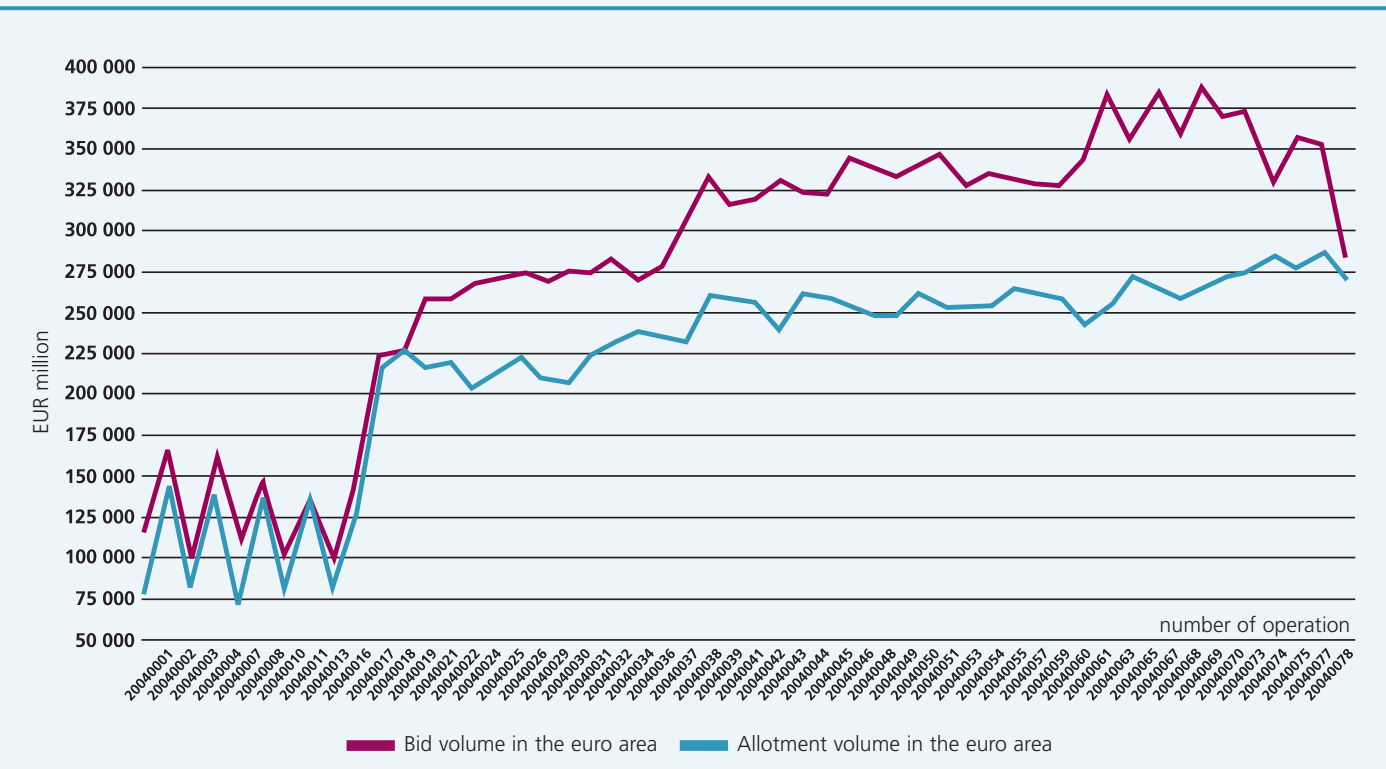
Since the shortening of the maturity of MROs to one week, fluctuations of allotted amounts decreased considerably. The weekly average variation dropped to 7 billion euro since the implementation of the changes in the operational framework, compared to an amount of 33 billion euro for the period between June 2000 and March 2004.

2. OTHER BCL FINANCIAL ACTIVITIES

- The main refinancing operations (MROs)

Main refinancing operations of the Eurosystem are conducted as variable rate tenders, using the multiple rate auction procedure.

GRAPH 1: MROs IN 2004 - BID AND ALLOTMENT VOLUME IN THE EURO AREA



Following the implementation of changes as of 10 March 2004, the bid and allotment volumes of MROs increased more than twice.

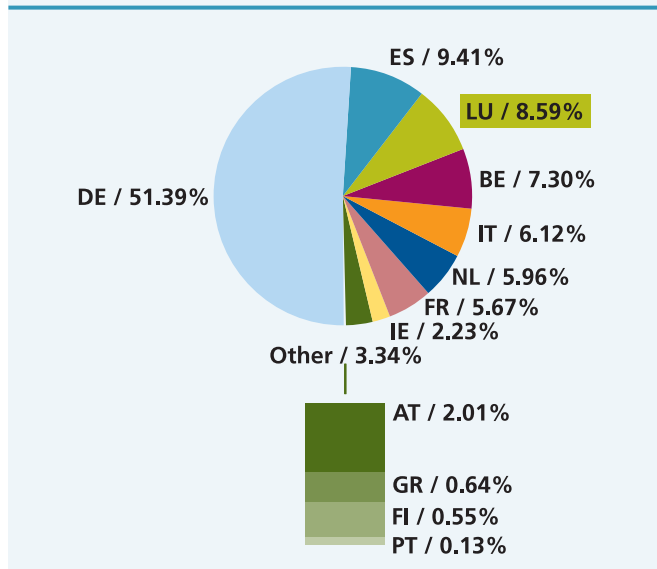
In 2004, Luxembourg ranked third in the allotment volume behind Germany and Spain with, on average, 8.59% of the total euro area volume. This ranking was confirmed during the first quarter of 2005, when Luxembourg's allotment volume amounted to 8.00%.

Compared to 2003, the average percentage allotted in Luxembourg decreased from 9.97% to 8.59%.

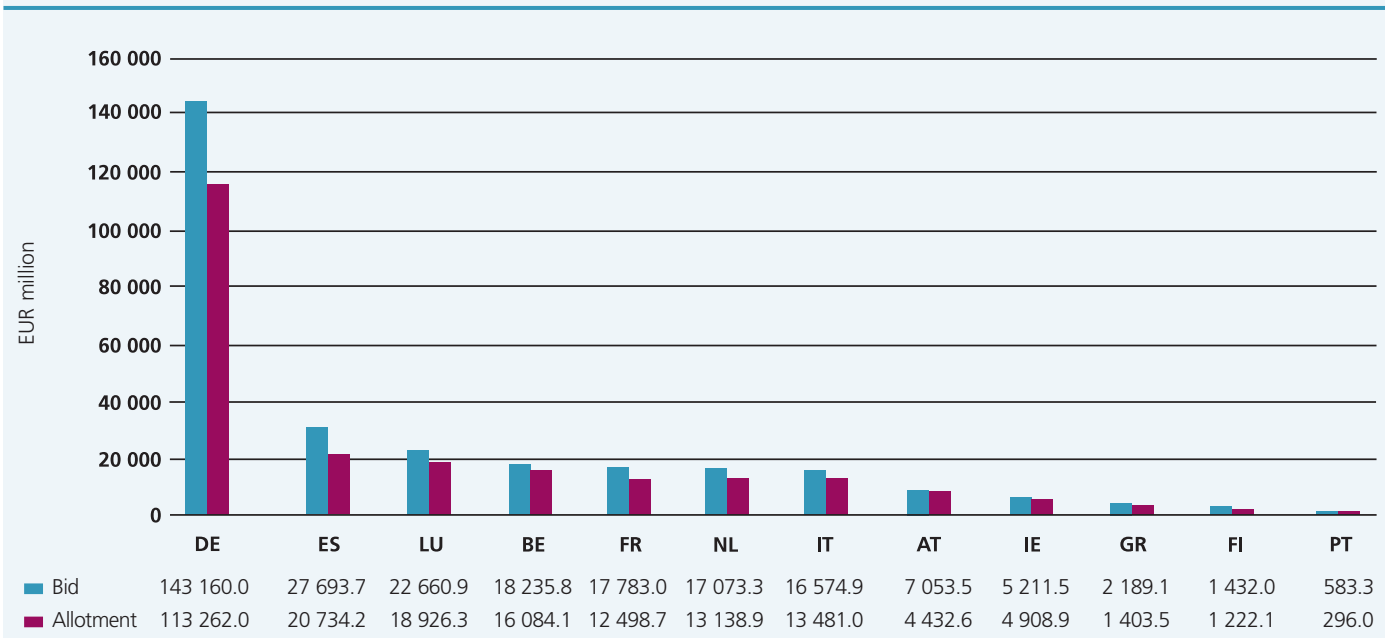
In 2004, the number of counterparties participating in MROs remained broadly stable in Luxembourg with an average of 20 banks in comparison with 19 in 2003 and 18 in 2002. In the euro area, the number of participating counterparties rose, on average, from 266 in 2003 to 339 in 2004, reversing the declining trend observed since 1999. The reason of this increase in the euro area could well be explained by the reduction of the maturity from two weeks to one week and by the simplification of the new framework.

During the first quarter of 2005, the average number of participating counterparties in MROs remained stable with 19 banks in Luxembourg and 340 banks in the euro area.

GRAPH 2: MROs IN 2004 - AVERAGE ALLOTMENT VOLUME IN THE EURO AREA



GRAPH 3: MROs IN 2004 - AVERAGE BID AND ALLOTMENT VOLUME IN THE EURO AREA

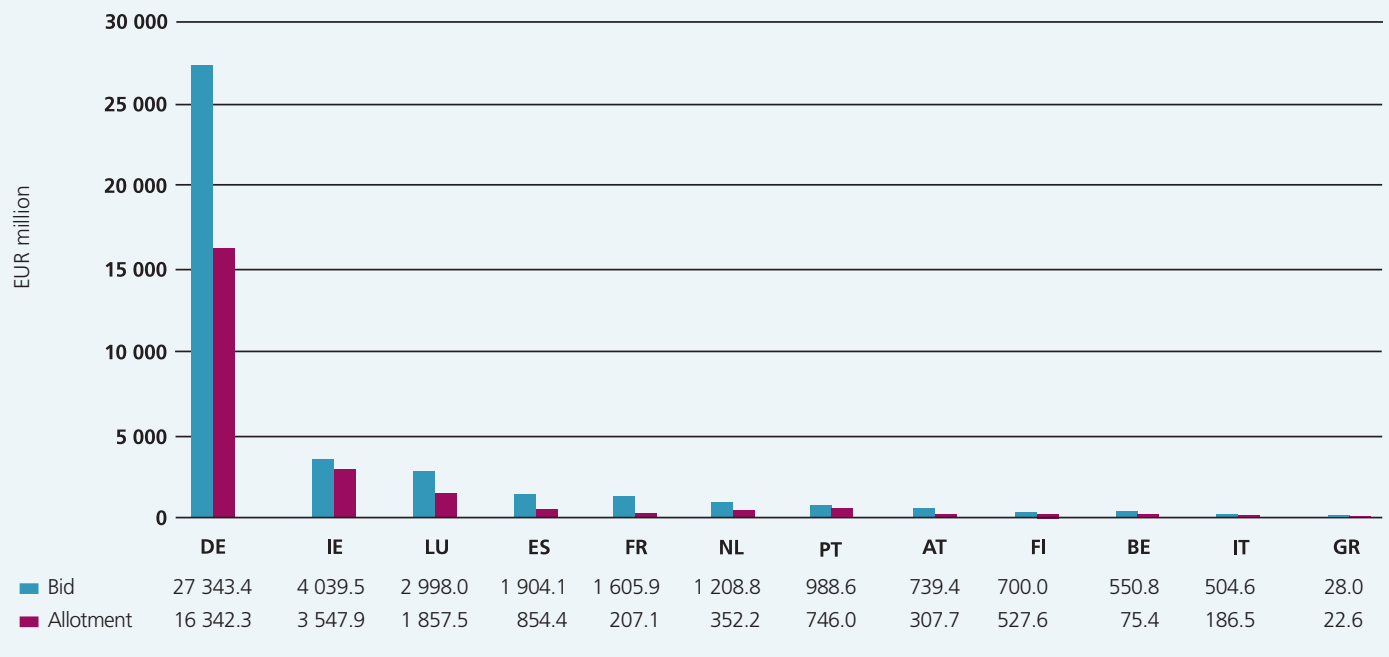


2. OTHER BCL FINANCIAL ACTIVITIES

- The Longer Term Refinancing Operations (LTROs)

With regard to the allotment volume in the whole euro area, Luxembourg ranked, on average, third in 2004 and in the first quarter of 2005. The average number of participating counterparties remained broadly unchanged with 7 banks in 2004 and 8 in the first quarter of 2005 in comparison to 7 in 2003.

GRAPH 4: LTROs IN 2004 - AVERAGE BID AND ALLOTMENT VOLUME IN THE EURO AREA



In January 2005, the ECB Governing Council decided to raise the allotment amount from 25 to 30 EUR billion euro for each LTRO.

- Fine-tuning operations

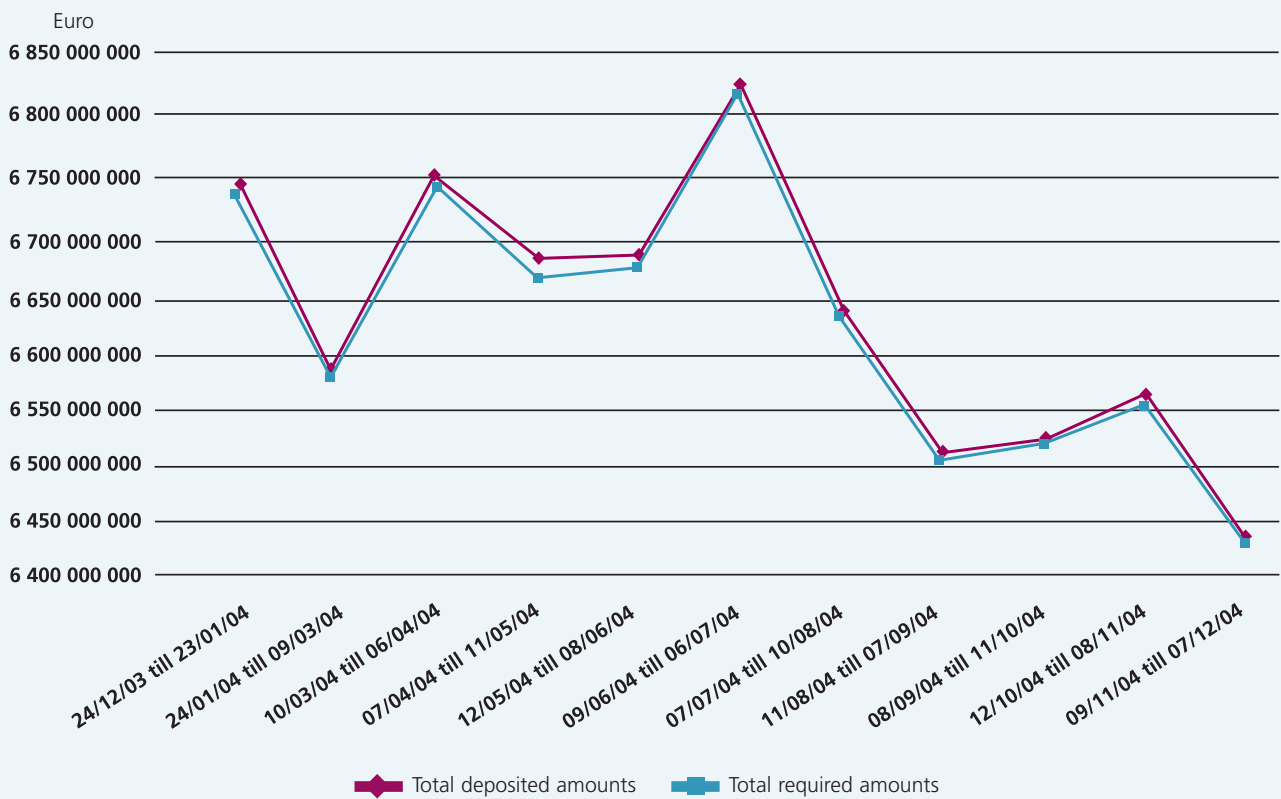
While the volatility of EONIA rate decreased during 2004, short-term rate fluctuations increased during the last days of reserve maintenance periods. This reflects the fact that, as the allotment of the last MRO during a reserve maintenance period now occurs eight days before its end, the risk of a liquidity imbalance is thereby increased. In order to restore neutral liquidity conditions, the ECB carried out several fine-tuning operations during the last day of minimum reserve periods. Three fine-tuning operations were conducted in 2004 (May, November and December) and 3 in the first quarter of 2005 (January, February and March).

The minimum reserves system

From 24 December 2003 until 7 December 2004, the average amount of minimum reserves held by credit institutions in Luxembourg was estimated at 6.6 billion euro.

The deposited amounts are remunerated at the average MRO rate of the ECB during the reserve maintenance period.

GRAPH 5: DEVELOPMENT OF THE AVERAGE REQUIRED AND DEPOSITED MINIMUM RESERVES



2. OTHER BCL FINANCIAL ACTIVITIES

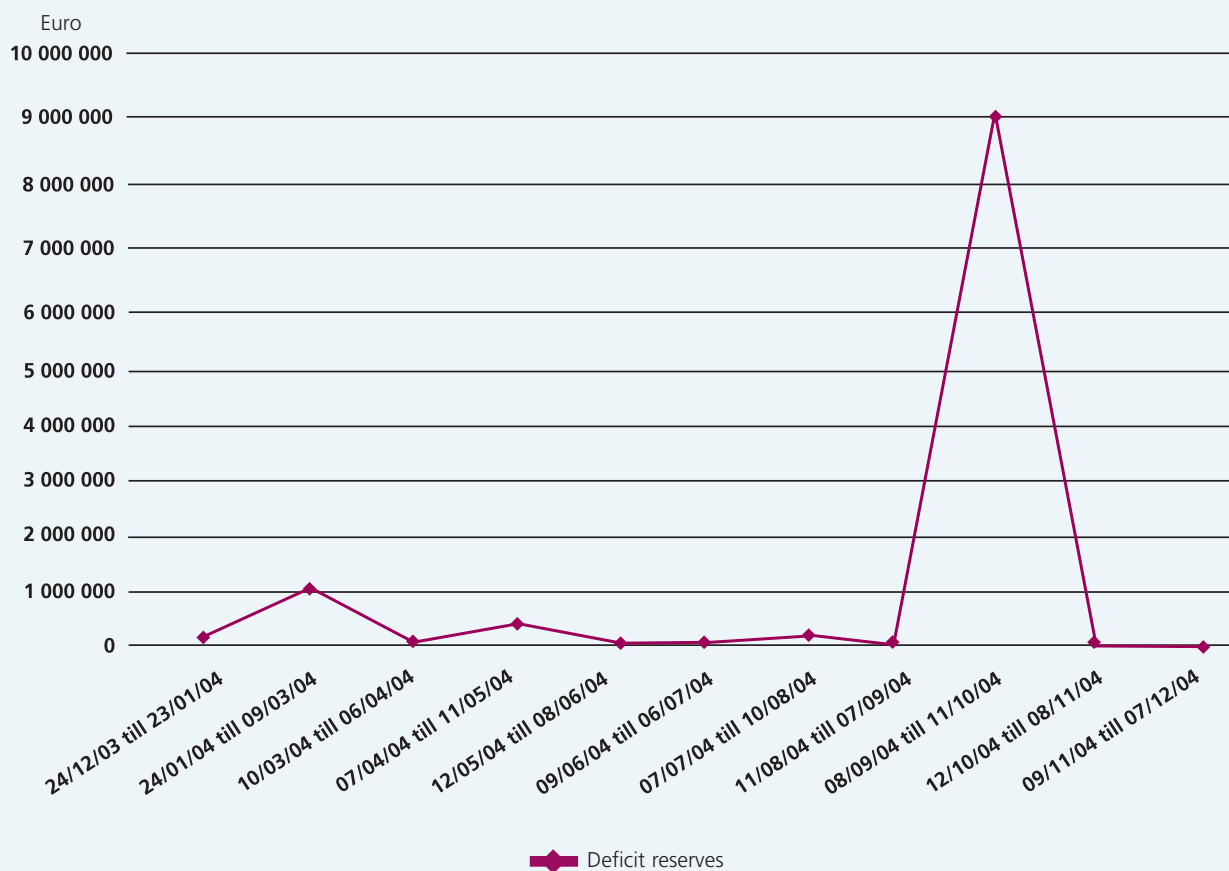
Evolution of the remuneration rate in 2004

The rate at which minimum reserves were remunerated increased from 2.02% at end-2003 to 2.05% at end-2004.

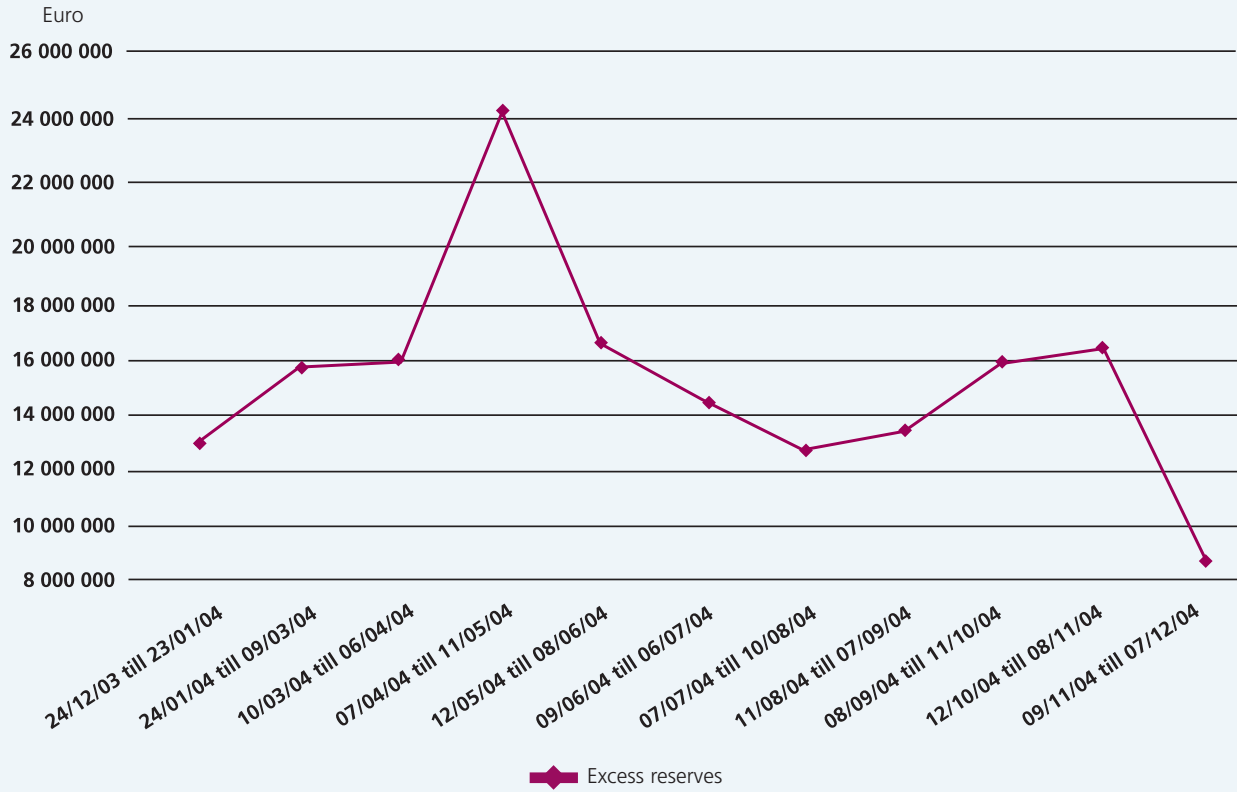
Period	24/12/03 23/01/04	24/01/04 09/03/04	10/03/04 06/04/04	07/04/04 11/05/04	12/05/04 08/06/04	09/06/04 06/07/04	07/07/04 10/08/04	11/08/04 07/09/04	08/09/04 11/10/04	12/10/04 08/11/04	09/11/04 07/12/04
Rate (%)	2.02	2.00	2.00	2.00	2.00	2.00	2.01	2.02	2.02	2.03	2.05

Counterparties paid seven sanctions for not respecting minimum reserves requirements in 2004, compared to 6 in 2003.

GRAPH 6: DEVELOPMENT OF AVERAGE DEFICIT RESERVES



GRAPH 7: DEVELOPMENT OF AVERAGE EXCESS RESERVES



Excess of minimum reserves -that are not remunerated- remained at a high level during the whole year.

2. OTHER BCL FINANCIAL ACTIVITIES

2.2 Foreign exchange reserves management by the BCL

In accordance with the Statute of the Eurosystem and in line with its capital key in the ECB, the BCL transferred to the ECB an amount of 74.6 million euro in foreign exchange assets, which corresponded to 0.1492% of the ECB's capital on 31 December 2003.

The ECB's foreign exchange reserves have been managed in a decentralised way by NCBs since January 1999. As a result of the EU's enlargement on 1 May 2004, the BCL's share of the ECB's capital rose to 0.1568%; an additional amount of 12.6 million euro was transferred to the ECB. As of 31 December 2004, the total market value (accrued interest included) owned by the BCL corresponded to 76.2 million euro.

One goal of the foreign exchange reserves management of the ECB is to make sure that, if required, the ECB has a sufficient amount of liquidity available to intervene in the foreign exchange markets. Security and liquidity are therefore basic requirements for the management of these reserves.

A "tactical benchmark" is set up for each currency by taking into account the orientation of the "strategic benchmark". This "tactical benchmark" reflects the ECB's risk/return medium term preference with reference to financial market conditions. A change in the "tactical benchmark" may affect different risk categories (for example modified duration or liquidity risk). The modified maturity of the "tactical benchmark" may differ from the modified maturity of the "strategic benchmark" in the context of fluctuation margins announced in advance by the ECB.

In the management of this portfolio, the prime task of the BCL is to invest the foreign exchange reserves on behalf of the ECB within the prescribed fluctuation bands and fixed risk limits with an objective of return maximisation. The amount of assets in gold that are managed actively is fixed by the ECB by taking account of strategic considerations as well as market conditions.

2.3 Management of BCL's assets

2.3.1 Institutional structure

Asset management is based on a structure implying 5 intervention levels:

- The Council (level 1),
- The Executive Board (level 2),
- The Asset and Liability Management committee (ALCO) (level 3),
- The tactical committees (level 4),
- The portfolio manager (level 5).

■ Level 1: The Council

The Council approves the guidelines of the asset management framework. Thus, the Council enabled the BCL to provide asset management services to third parties, to hold own funds asset portfolios in order to diversify the Bank's income and to establish a pension fund. The mitigation of the risk framework applied to asset management is also part of the guidelines. This framework includes two kinds of risk mitigation: institutional mitigation and operational mitigation.

■ Level 2: The Executive Board

The Executive Board defines the risk management framework and sets corresponding parameters. Thus, the Executive Board determines the maximal 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 determines warning thresholds, which can trigger emergency meetings for assessment and arbitrage purposes.

As such the Executive Board sets the limits of the framework annually.

■ Level 3: The Asset and Liability Committee (ALCO)

The ALCO determines the **strategic benchmark** in accordance with the annually fixed framework decided by the Executive Board by examining the impact of each risk profile (market, credit and liquidity risk) resulting from the proposed investment policies, with respect to the overall balance sheet and with respect to the profit and loss accounts of the BCL. During the year, the ALCO regularly assesses the results of the investment policy.

- **Level 4:** The tactical committees

The tactical committees monitor the evolution of the portfolios on a shorter-term basis and work out proposals for **tactical benchmarks** complying with the limits imposed by the strategic benchmark.

The tactical committees are 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 tactical benchmark committee for the pension fund of the BCL.

- **Level 5:** The portfolio managers

The portfolio managers implement 'in fine' the decisions of tactical committees within the limits of the approved investment policy. The transactions are executed in strict compliance with the limits set, covering both the overall and specific investment limits.

In addition, the important role played in the asset management framework by the Organisation and Risk Management unit (OR) and the Internal Audit unit (AI) should be emphasised.

The OR unit¹ monitors all positions of the portfolios in order to assess risks and to control compliance with the predefined limits. This monitoring, carried out by an independent Unit of the Front Office is done on a daily basis. The AI unit completes the control structure with specific missions at different levels of the organisation. In addition, the middle and back-offices also take part in the control process.

2.3.2 Conceptual framework

The investment policy objectives:

The investment policy aims to generate a high income on a regular basis and to enhance the total return in the long term by taking into account considerations such as capital safety, stability of securities and liquidity. In order to achieve its goals and with respect to the principle of risk diversification, the BCL applies a coordinated, progressive and pro-active investment policy based on modern portfolio theory.

The investment approach takes into account:

- The analysis of economies and international financial markets,
- The asset allocation decisions, by assessing the returns on different international markets,
- The definition 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:

- Technical and fundamental analyses, as well as on quantitative assessments,
- Market risks (interest rates, exchange rates, equity prices, commodity prices),
- Credit risks (minimum credit ratings criteria by international rating agencies),
- Liquidity risks (limits by sector, by issuer, by issue and by geographic diversification).

Performance measurement

The quality of investment decisions is measured by comparing the performances to the external benchmarks of leading investment banks. This permits the assignment of relative performances to all decision levels (strategical, tactical) as well as to daily management.

¹ At present the risk manager is a staff member of the OR unit.

2. OTHER BCL FINANCIAL ACTIVITIES

2.3.3 Structure of portfolios

The bulk of the BCL's own assets are invested in fixed income securities denominated in euro. The strategic orientation permits a diversification into other categories of assets.

BCL manages five kinds of portfolios: *Investment Portfolio*, *Liquidity Portfolio*, *Domestic Reserves Portfolio*, *Pension Fund Portfolio* and *Institutional Portfolios*.

"Investment Portfolio" (Portfolio 1)

This portfolio is composed of assets representative of own funds (with a longer term investment profile). The main goal of this investment portfolio is to maximise yield by taking into account the risk constraints as quoted above (cf. point 2.3.2). On 31 December 2004, the total market value (accrued interest included) amounted to 533.4 million euro.

In 2004, a significant proportion of the funds was invested in long-term bonds, as market conditions for that kind of investment were very favourable. However, around the end of the year the underlying duration of the portfolio was reduced.

It is worth noting that the securities included in this portfolio are largely diversified according to the issuer's geographic location and activity.

"Liquidity Portfolio" (Portfolio 2)

This portfolio represents the other assets that can, in large part, be attributed to a Eurosystem arrangement (Agreement on Net Financial Assets) in compensation of Target accounts and other liabilities. This portfolio, whose liability profile covers certain liquidity needs, also aims to maximise income. The instruments used are mainly fixed income short-term bonds, variable rate bonds and certificates of deposits (ECP), provided that they comply with strict and predefined rating criteria. As of 31 December 2004, the total market value (accrued interests included) amounted to 2.091 million euro.

"Domestic reserve portfolio"

The domestic reserve portfolio aims at maintaining 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. On 31 December 2004, the total market value (accrued interests included) of this not yet fully constituted portfolio in foreign currencies amounted to 105.4 million euro.

"Pension Fund Portfolio"

The management of this fund is described further in section 4.2.4 of this report.

"Institutional portfolios"

The BCL provides discretionary management services to public institutional clients and other central banks.

Since 1 January 2005, the Bank has acted as an ESP (Eurosystem service provider). Within the Eurosystem, a group of six Eurosystem central banks, including the BCL, provides a comprehensive range of reverse management services in euro. These standardised services are offered to institutional clients (central banks, public authorities, international organisations) in a new harmonised Eurosystem framework.

TABLE 1: ASSET ALLOCATION AS OF 31 DECEMBER 2004

MATURITY	Portfolio 1	Portfolio 2
0-1 year	43%	71%
1-3 years	21%	27%
3-5 years	26%	1%
5-10 years	10%	1%

2.4 Banknotes and circulation of fiduciary money

Euro banknotes are produced according to the needs of all the participating NCBs which have been aggregated by the ECB. The production of one denomination is assigned to no more than two NCBs. In 2004, the BCL was thus responsible for the production of 1.9 million 500-euro banknotes, for its own needs. The production of these banknotes has been entrusted to the specialised printing works *Bundesdruckerei* in Berlin.

In accordance with its organic law of 23 December 1998, the BCL has the task of putting euro coins into circulation. As of 1 May 2003, as a result of the new agreement between the Luxembourg Government and the BCL, the BCL has been entrusted with the production of Luxembourg euro coins. In 2004, the BCL put the Royal Dutch Mint (*Koninklijke Nederlandse Munt*) in charge of the production of 112.5 million coins, for the BCL's own needs. At the end of September 2004, the BCL signed an agreement with the Mint of Finland (*Rahapaja Oy*) for the production of 45.2 million Luxembourg euro coins dated 2005 in order to satisfy the demand for coins during that year.

2.4.1 Evolution of currency circulation

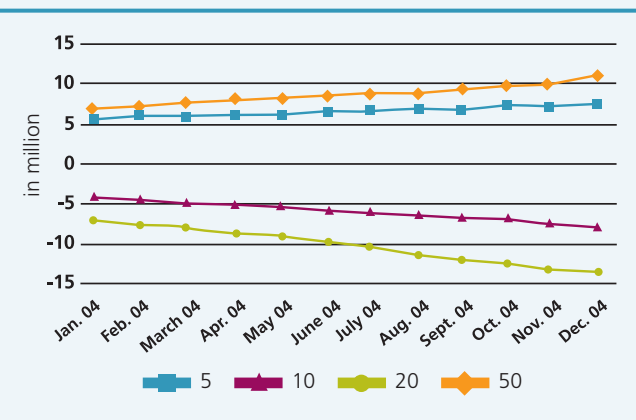
2.4.1.1 Euro coins and banknotes

The volume of euro coins and banknotes put into circulation by the BCL does not necessarily correspond to the volume effectively in circulation in Luxembourg, i.e. those used in the payment systems in Luxembourg. This is a result of the migration of euro banknotes and coins inside the euro area.

The total net volume of euro banknotes put into circulation by the BCL during 2004 amounts to 23.22 million notes, compared to 27.80 million banknotes in 2003; a decrease of 16.5%. The volume of 10-euro and 20-euro banknotes lodged at the BCL itself exceeds the total volume ever issued by the BCL and for the 20-euro denomination this development was accentuated as of mid-2004. This occurred as tourists and cross-border workers brought in these two denominations in massive quantities to pay for their everyday transactions in Luxembourg. In turn, credit institutions, which are BCL clients, deposited more 10- and 20-euro banknotes at the BCL than they withdrew.

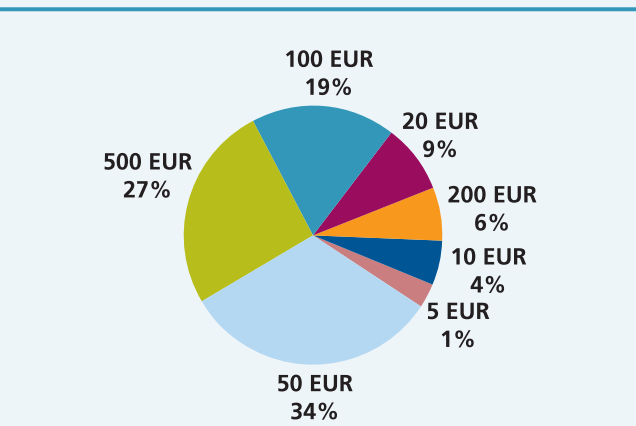
The graph below illustrates the divergent evolution in the volume of the denominations mainly used in everyday transactions:

GRAPH 8: EVOLUTION OF THE NUMBER OF EURO BANKNOTES USED FOR EVERYDAY TRANSACTIONS PUT INTO CIRCULATION BY THE BCL



In comparison with the whole euro area, the BCL has increased its contribution to the total volume of banknotes put into circulation by the Eurosystem, passing from 0.74% at end 2003 to 0.93% at end 2004. In Luxembourg and in the euro area, the year 2004 has been characterised by a steady demand for higher denominations, which are used mainly for hoarding purposes. This development can be seen as a sign of increased trust in the new currency. The total value of euro banknotes put into circulation by the Eurosystem increased by 14.93%, reaching 501.26 billion euro at the end of 2004 and with the following total value breakdown by denomination:

GRAPH 9: BREAKDOWN OF THE VALUE OF EURO BANKNOTES PUT INTO CIRCULATION BY THE EUROSYSTEM

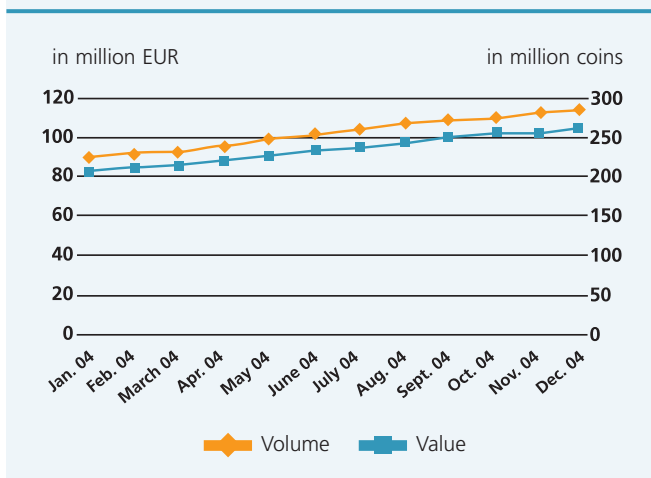


2. OTHER BCL FINANCIAL ACTIVITIES

Luxembourg euro coins have also been subject to important demand by the public. The total value of Luxembourg euro coins in circulation increased by 27.5% in 2004 passing from 81.30 million euro to 103.65 million euro. The volume of Luxembourg euro coins in circulation increased by 64.06 million coins (more than 300 tons of metal), or 29.2%, and amounted to 283.57 million coins at the end of 2004. This volume represents a total weight of 1 376 tons of coins, which statistically represents 3.06 kg or some 630 coins at a value of 230 euro per Luxembourg resident. As in 2003, Luxembourg euro coins have been subject to large demand from collectors.

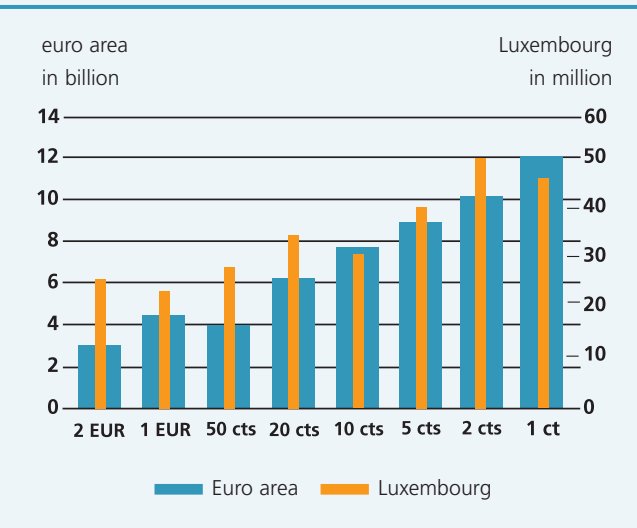
The average monthly volume of coins in circulation amounts to 254.42 million. The following graph shows the evolution of the volume and value of Luxembourg euro coins in circulation in 2004. The demand for Luxembourg coins has kept increasing, notably since July 2004, when the BCL put into circulation a 2-euro commemorative coin.

GRAPH 10: TOTAL VOLUME AND VALUE OF THE LUXEMBOURG EURO COINS IN CIRCULATION



Within the euro area, Luxembourg's contribution to the total number of coins put into circulation increased from 0.45% in 2003 to 0.50% in 2004, whilst Luxembourg contributes 0.68% of the total value issued by all the issuing authorities of the euro area. The average value of Luxembourg euro coins in circulation amounts to 36.6 cent in comparison to an average of 27.3 cent for the euro area coins. The following graph compares the volume of the different coin denominations put into circulation by Luxembourg to the corresponding volume in the euro area.

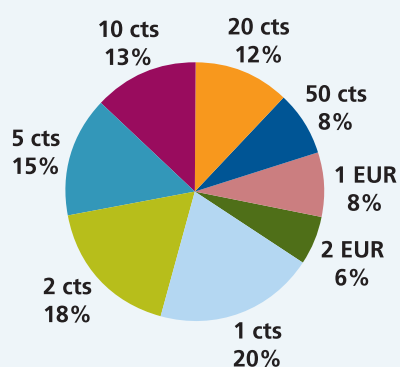
GRAPH 11: COMPARISON OF THE CIRCULATION VOLUME OF THE DIFFERENT EURO COIN DENOMINATIONS IN LUXEMBOURG TO THAT OF THE EURO AREA



As regards Luxembourg coins, the 2-cent denomination remained the most widespread in 2004. Compared to 2003, the ranking according to volume remained unchanged in 2004, confirming a public preference for the denominations with a face value starting with 2. The classification in descending order was as follows: 2 cent, 1 cent, 5 cent, 20 cent, 10 cent, 50 cent, 2 euro and 1 euro. The same classification for the euro area gave the following result: 1 cent, 2 cent, 5 cent, 10 cent, 20 cent, 1 euro, 50 cent and 2 euro.

The total value of euro coins put into circulation by the Eurosystem grew from 14.07 billion euro at the end of 2003 to 15.35 billion euro at the end 2004, whereas the total volume of coins reached 56.24 billion. The following graph shows the breakdown per denomination of this volume for the euro area:

GRAPH 12: BREAKDOWN PER DENOMINATION OF THE VOLUME OF EURO AREA COINS IN CIRCULATION



In 2004, the use of small denominations (1- and 2-cent coins) was subject to a debate in some euro area countries. The BCL is not the institution responsible for taking any decision in this matter. EC Council Regulation (EC) No 975/98 stipulates that the coins denominated in euro shall include eight denominations in the range 1 cent to 2 euro.

Thus, a decision on a possible withdrawal of the 1- and 2-cent coins falls within the competence of the Council of the European Union, namely the "ECOFIN" Council whose members are the Ministers of Finance.

The BCL notices a very sustained demand for the 1- and 2-cent coins in Luxembourg, and indeed they are the most widespread denominations. In the event that a decision to withdraw the legal tender status of these coins were taken, the BCL would stop their production and, in coordination with all the central banks of the Eurosystem, would organise the physical withdrawal and the reimbursement of the 1 and 2 cent coins in circulation within the country.

2.4.1.2 Luxembourg francs coins and banknotes

In 2004, the total value of Luxembourg currency¹ still in circulation and not yet exchanged decreased from 470 million to 452 million Luxembourg francs, or by 3.8%. The average monthly value for last year amounted to 462.8 million Luxembourg francs, against 479.2 million in 2003. The circulation of the 5 000-francs banknote decreased most strongly, that is to say by 6.3%, while that of the 1 000- and 100-francs banknotes decreased by 3.0% and by 0.5%, respectively. These figures show that collectors prefer lower denominations. The following table shows the evolution of the outstanding Luxembourg francs banknotes for the five last years:

TABLE 2: TOTAL VALUE OF LUXEMBOURG FRANCS BANKNOTES IN CIRCULATION BETWEEN 2000 AND 2004

End of period	in LUF				
	5 000 LUF	1 000 LUF	100 LUF	Withdrawn LUF banknotes abroad	Total
2000	3 054 750 000	676 114 000	153 731 500	-168 910 000	3 715 685 500
variation*	-4.3%	-20.8%	-9%		-8.3%
2001	2 398 720 000	435 327 000	141 357 900	-198 966 000	2 776 438 900
variation*	-21.5%	-35.6%	-8.1%		-25.3%
2002	93 855 000	83 749 000	83 781 100	0	261 385 100
variation*	-96.1%	-80.8%	-40.7%		-90.6%
2003	80 720 000	79 038 000	82 003 000	0	241 761 000
variation*	-14.0%	-5.6%	-2.1%		-7.5%
2004	75 625 000	76 702 000	81 592 200	0	233 919 200
variation*	-6.3%	-3.0%	-0.5%		-3.3%

* Relative to the previous year

¹ Coins and banknotes altogether, numismatic and commemorative coins included.

2. OTHER BCL FINANCIAL ACTIVITIES

It is worth noting that the global circulation volume of Luxembourg notes has decreased by 93.7% between the end of 2000 and the end of 2004. The flow back of the notes in 2004 took the form of a nearly linear curve, showing a stronger fall in July and December 2004.

The final deadline for the exchange of francs coins was 31 December 2004, and at the end of the year many people rushed to the BCL's counters. The value of francs coins that can no longer be exchanged amounted to 218.1 million francs at the end of 2004, including numismatic productions as well as collector coins. This profit is assigned to the Treasury and not to the BCL.

At the end of 2004, a total volume of 907 749 Luxembourg notes and 63.1 million coins were still in circulation and represented a global value of 418.5 million francs. The numismatic productions and the collector coins not yet exchanged amounted to 33.5 million francs.

The number of Luxembourg francs notes returned to the BCL by financial institutions came close to 2 100 notes, whereas the return of Belgian notes slightly exceeded 29 000.

Luxembourg and Belgian francs notes continue to be exchangeable at the counters of the BCL.

2.4.2 Management of fiduciary money

The number of euro notes returned by the financial institutions to the BCL reached 56.18 million. Expressed in the number of lodgement operations this required, the volume of returned notes represented more than 1 780 different operations managed and registered by the cash department. Furthermore, the number of withdrawals of euro notes by the financial institutions exceeded 4 430 operations managed and registered by the cash department in 2004.

The public also took advantage of the services offered by the BCL through its public counter for the exchange of notes and coins that had become unsuitable for circulation, and in order to buy numismatic products. More than 14 300 operations were handled at the public counter during 2004, averaging some 55.1 operations per workday. All in all, the total number of operations managed and registered by the cash department was more than 20 500.

The number of processed euro notes by sorting machines saw a substantial increase of some 10%, moving from 49.34 million notes in 2003 to 54.23 million processed notes in 2004. The sorting machines not only operate authenticity tests, but also soiling tests. Considering all denominations taken together, nearly 17.9 million notes were destroyed because of their unfitness for circulation. The reject/destruction rate progressed, rising from 29% in 2003 to 33% of the total number of euro notes sorted. Moreover, this rate showed important variations depending on the denomination, varying from 6% for the highest denomination to 58% for the 10-euro banknote.

In the field of counterfeit monitoring, the BCL has cooperated closely with the ECB and the competent national authorities in the analysis of discovered counterfeits.

2.4.3 Numismatic issues

The opportunity for the issuing authorities to issue, as of 2004, a 2-euro commemorative coin showing a distinctive national side renewed the interest of collectors for all numismatic issues. The BCL took this opportunity to issue a 2-euro commemorative coin where the national side shows, beside the effigy of the Grand Duke Henri, his monogram (special letter "H" topped with a crown) in order to revive an 80-year-old tradition of issuing coins depicting the monogram of the sovereign.

In Luxembourg, the BCL put the following numismatic products into circulation during the course of 2004:

- The "2004 BU-set" displays the Luxembourg euro coins (1 cent to 2 euro, including the 2-euro commemorative coin with a distinctive national side), struck in "Brilliant Uncirculated" quality with the date 2004. The mintage is limited to 40 000 sets.
- The "2004 Benelux-set" contains the 2004 series of 8 euro coins of the three Benelux countries struck in "Brilliant Uncirculated" quality. This set also includes a silver medal specially conceived for the 60th anniversary of the Benelux.
- The "2004 Proof set" displays the nine Luxembourg euro coins (ranging from 1 cent to 2 euro, including the 2-euro commemorative coin), struck in Proof quality and dated 2004. This set is sold simultaneously with the Proof sets 2002 and 2003 which only contain the 8 usual coins. The mintage is fixed at 1 500 sets per issue year.
- The gold coin "the mask of Hellange", issued in November 2004 within the series "Cultural history of the Grand-Duchy of Luxembourg" (mintage: 5 000 coins) is the second Luxembourg collector coin in gold. Its theme is the visor of an iron helmet belonging to a Roman horseman. This coin has a face value of 10 euro and is minted in Proof quality with a gold fineness of Au999. Its diameter is 16 mm and its weight 3.11g.
- The silver coin "European Parliament", issued in July 2004 with a mintage of 10 000 coins, is the second Luxembourg collector coin in silver and commemorates the 25th anniversary of direct elections to the European Parliament. This coin has a face value of 25 euro and is minted with a silver fineness of Ag925. Its diameter is 37 mm and its weight 22.85g.

The euro collector coins in precious metal are only legal tender within the territory of the issuing Member State.



2. OTHER BCL FINANCIAL ACTIVITIES

2.5 Developments in the area of Statistics

2.5.1 Monetary and financial statistics

The introduction of ECB Regulations ECB/2001/13 and ECB/2001/18 in January 2003 allowed for a considerable improvement of the statistical framework in the monetary and financial sector.

Since January 2003, the BCL collects monetary financial institution (MFI) balance sheet data established according to the modified classification introduced by Regulation ECB/2001/13 on the consolidated balance sheet of the MFI sector. Detailed monthly information on loans and deposits as well as revaluation adjustments of balance sheet positions are collected via enlarged reporting forms. Monthly information is broken down by type of instrument for agreed loans to private household and non-profit institutions serving households (NPISH) and also by economic sector of the counterparty. Furthermore, revaluation adjustments allow for a considerable improvement in the statistical quality of derived flows calculated by the Eurosystem at a monthly frequency.

In parallel with the improved statistical reporting on consolidated MFI balance sheet data, the BCL has started collecting data on interest rates applied by credit institutions on loans and deposits for households and non-financial corporations in Luxembourg and the euro area.

Both statistics are the basis for regular publication of MFI aggregate balance sheet data and interest rates on loans and deposits applied by credit institutions, available on the BCL's website and in its periodic bulletin. Moreover, press releases informing on balance sheet totals, employment in the financial sector as well as minimum reserves requirements are regularly disseminated.

During 2004, the BCL continued its efforts to achieve better data quality by means of more detailed reporting instructions and by enhanced quality controls of statistical data.

2.5.2 Balance of payments and international investment position

Through its website and periodical publications, the BCL publishes quarterly statistics on the Luxembourg balance of payments, the international investment position (IIP) and reserve assets. Furthermore, the BCL and the STATEC communicate the most recent balance of payments data for Luxembourg by means of press releases.

During 2004, the BCL published for the second time Luxembourg's annual IIP data, and these were also analysed in great detail in the Bank's bulletin 2004/3. Additionally, the BCL started with a compilation of quarterly IIP data as well as with quarterly balance of payments statistics providing a detailed geographical breakdown. These substantial efforts made it possible for national compilers to respect the deadline fixed at 2 May 2003 by Recommendation ECB/2003/7 of the European Central Bank.

2.5.3 Financial accounts

Discussions were held with the Luxembourg government in order to set up the financial accounts of Luxembourg by the BCL. However, these discussions did not succeed, and consequently Luxembourg is likely to miss the deadline imposed by Council Regulation EC no. 2223/96 of 25 June 1996, supplemented by Guideline ECB/2002/7 of 21 November 2002 addressed to the BCL.

2.5.4 The IMF special dissemination standard

In 1996, the IMF introduced the Special Dissemination Standard (SDDS), which aims at improving the production and the publication of a large set of macroeconomic statistics. The objective is to improve economic analysis by enriching the scope and quality of published statistics at the disposal of policy-makers and financial markets.

In 2004, Luxembourg institutions have continued their efforts to adapt their statistical framework to this standard. Thus the BCL finalised statistics on the analytical accounts of the central bank, the monetary financial institutions (MFI) sector, the balance of payments (jointly with STATEC), the international investment position, and foreign reserve assets.

2.6 Payments and securities settlements systems

2.6.1 LIPS-Gross

2.6.1.1 Activity in 2004

Domestic payments

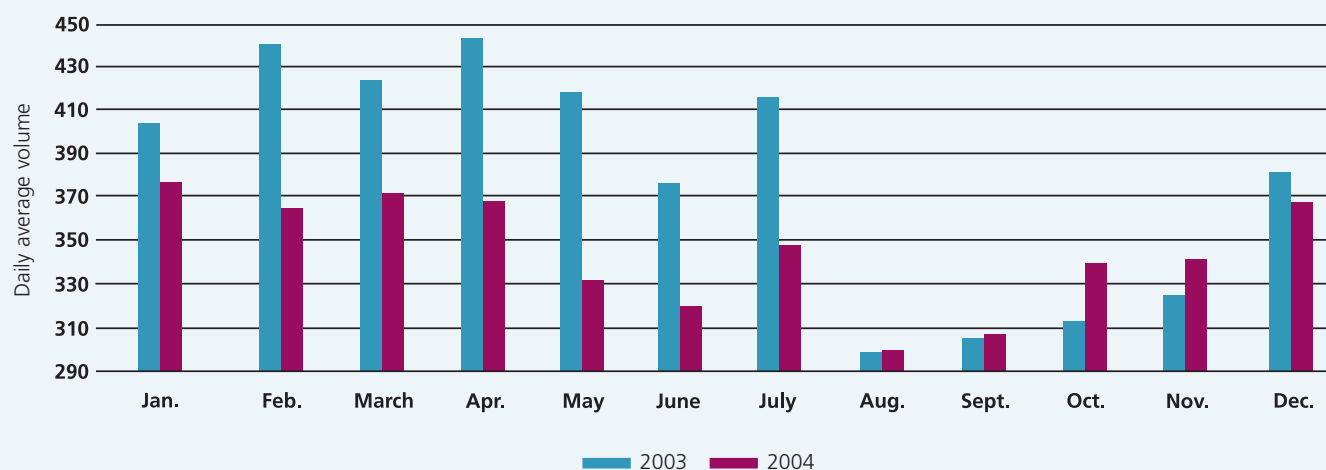
In 2004, LIPS-Gross participants exchanged a total of 89 128 payments (96 525 in 2003) for a total value of 2 258 billion euro (1 513 billion euro in 2003). In comparison to 2003, the volume decreased by 8% whereas the value exchanged increased by 49%. The average value per payment amounted to 25.3 million euro.

The following graphs show the evolution of the average daily volume and value of domestic payments.

In comparison to 2003, and independently of seasonal factors, domestic traffic decreased between 1 January 2004 and 1 August 2004. This decrease was mainly due to the reduction of the domestic activity of one participant since August 2003.

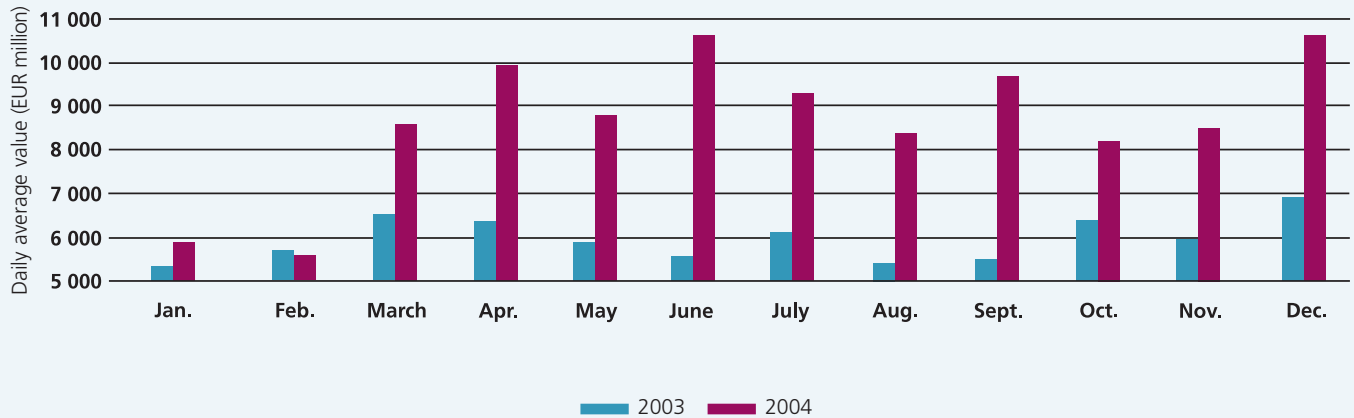
By contrast, values exchanged in 2004 were markedly higher than in 2003. The main explanation for this is to be found in a change in the Eurosystem's procedures regarding MROs, where the duration was reduced from two weeks to one. This modification, effective since February-March 2004, caused payments of the MROs to double as Banks that previously borrowed a given amount for 2 weeks now have to borrow twice the same amount for 1 week. Whereas the impact on the volume of payments is insignificant, the impact on the values exchanged in LIPS-Gross is substantial.

GRAPH 13: DOMESTIC PAYMENTS: EVOLUTION OF THE DAILY AVERAGE VOLUME



2. OTHER BCL FINANCIAL ACTIVITIES

GRAPH 14: DOMESTIC PAYMENTS: EVOLUTION OF THE DAILY AVERAGE VALUE (EUR MILLION)

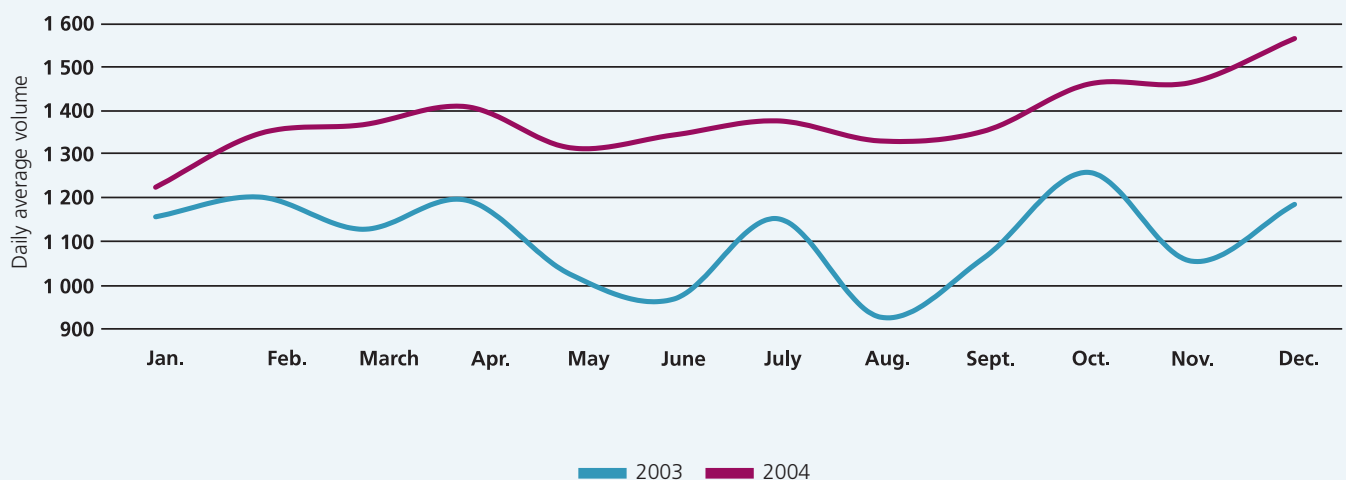


Cross-border payments

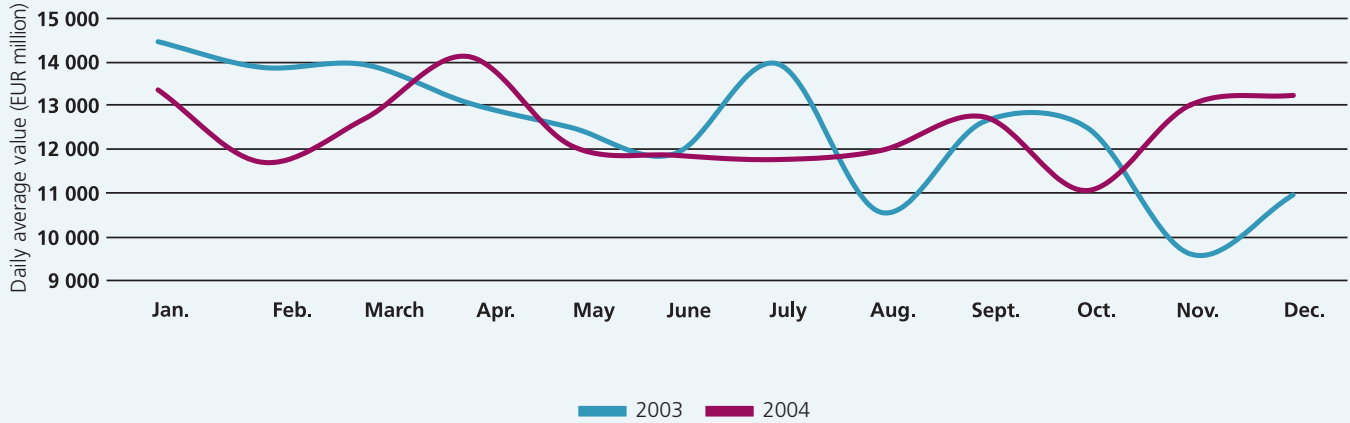
In 2004, LIPS-Gross participants sent 357 317 payments to other RTGS systems linked to TARGET (286 798 payments in 2003) for a total value of 3 241 billion euro (3 242 billion euro in 2003). They received 321 711 cross-border payments (307 246 payments in 2003) for a total of 3 242 billion euro (3 254 billion euro in 2003). The average value per payment was 9.1 million euro.

The following graphs show the evolution of average daily volumes and values of cross-border payments sent by Luxembourg participants.

GRAPH 15: CROSS-BORDER PAYMENTS: EVOLUTION OF THE DAILY AVERAGE VOLUME

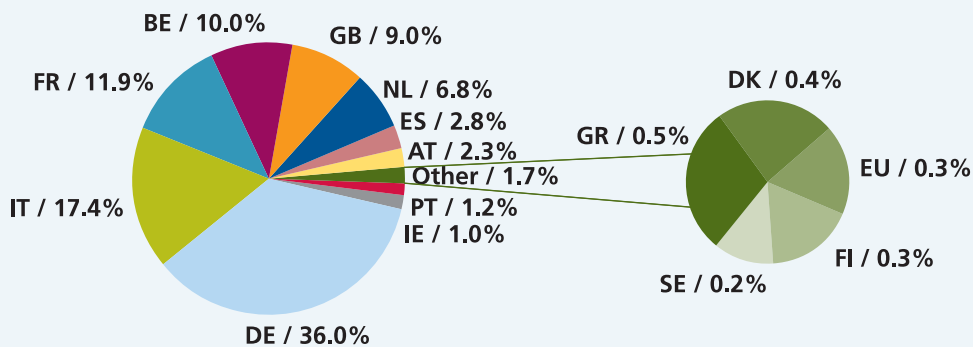


GRAPH 16: CROSS-BORDER PAYMENTS: EVOLUTION OF THE DAILY AVERAGE VALUE (EUR MILLION)



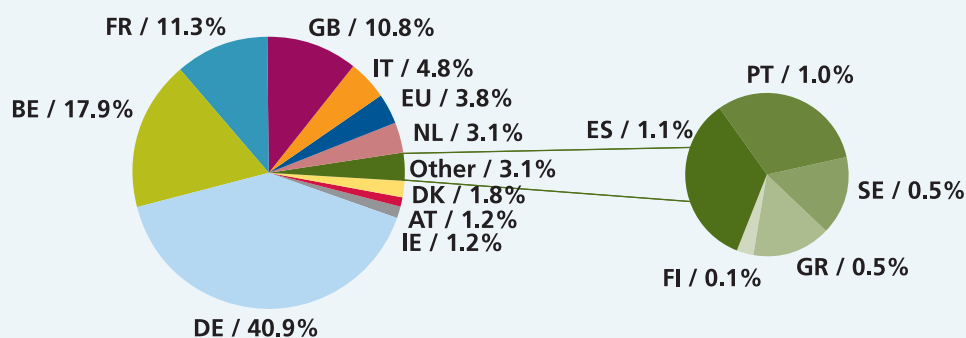
In 2004, the volume of cross-border payments sent increased by 24.6% whereas their value remained unchanged (-0.03%). Five participants increased their volume while two participants decreased payments in 2003. The increase in value generated by the 5 participants offset the decrease of value stemming from the 2 other participants.

GRAPH 17: NUMBER OF CROSS-BORDER PAYMENTS SENT BREAKDOWN BY COUNTRY



2. OTHER BCL FINANCIAL ACTIVITIES

GRAPH 18: VALUE OF CROSS-BORDER PAYMENTS SENT BREAKDOWN BY COUNTRY



In volume and in value, about 85% of cross-border payments are sent to 5 countries, among which are Luxembourg's 3 neighbouring countries.

Aggregated figures of domestic and cross-border payments

The following tables provide a global view of the average daily volume and value of payments in different years. The volumes and the values exchanged globally continued to increase.

In 2004, the tendency that members of the RTGS-L GIE received more payments than they sent was reversed.

TABLE 3: DAILY AVERAGE VOLUME OF PAYMENTS

	Domestic	Cross-border sent	Cross-border received	Total
2002	321	1 042	1 168	2 531
2003	379	1 125	1 205	2 708
2004	344	1 380	1 242	2 966

TABLE 4: DAILY AVERAGE VALUE OF PAYMENTS (EUR MILLION)

	Domestic	Cross-border sent	Cross-border received	Total
2002	4 826	12 539	12 544	29 908
2003	5 932	12 715	12 760	31 407
2004	8 717	12 515	12 519	33 752

LIPS-Gross compared to other systems connected to TARGET

In 2004, all national RTGS systems together executed a total of 52.4 million national payments (51.4 million in 2003) for a value of 297 857 billion euro (283 871 billion euro in 2003). With 89 128 national payments for a total of 2 258 billion euro, Luxembourg represented 0.17% of this volume and 0.76% of this value.

In addition, TARGET handled 16.8 million cross-border payments (15.2 million in 2003) for a total value of 146 137 billion euro (136 878 billion euro in 2003). Luxembourg contributed 2.03% to the volume and 2.24% to the value exchanged.

Availability of TARGET

The global availability of TARGET passed from 99.79% in 2003 to 99.80% in 2004. During the 6 years of TARGET's existence, availability averaged 99.67%.

After 99.74% in 2003, the availability of LIPS-Gross increased to 99.97% in 2004. The availability of LIPS-Gross was 100% for 11 months out of 12 in 2004. For the 6 years of the existence of LIPS-Gross, the average availability has been 99.65%. Since its creation 6 years ago, LIPS-GROSS' availability averaged is 99.65%.

Membership of the RTGS-L GIE

In 2004, the number of participants in LIPS-Gross remained unchanged at 31.

2.6.1.2 TARGET2

LIPS-Gross, the Luxembourg RTGS system, is connected to the other RTGS systems of member countries of the Eurosystem. Together they constitute the cross-border payment system TARGET. On 24 October 2002, the Governing Council of the ECB took a strategic decision with respect to the new generation of TARGET. TARGET2 will offer a single shared platform, to which all national central banks of the Eurosystem can move their respective RTGS systems. It is foreseen that TARGET2 will be operational as from 2 January 2007.

In close cooperation with the other central banks of the ESCB and taking into account the recommendations that the market issued during different consultation rounds three central banks, Deutsche Bundesbank, Banca d'Italia and Banque de France, elaborated a common concept for the construction of the TARGET2 platform. In 2004, the Governing Council of the ECB accepted the joint offer of the 3 central banks for the construction and the exploitation of the TARGET2 platform.

2.6.2 Evolution of the Interbank netting system LIPS-Net

The number of participants in LIPS-Net remained stable and amounted to 13 on 31 December 2004. The volume remained globally stable for the whole year.

Regarding the future of the interbank netting system, LIPS-Net participants launched in 2004 an analysis considering the evolution of the national clearing system in the framework of the "Single European Payments Area (SEPA)".

Concerning the volumes exchanged in 2004, the total number of transactions decreased by 1.36% to 13.24 billion. On the other hand, values exchanged in LIPS-Net showed an increase of 5% in comparison with 2003, the total value exchanged for 2004 being 56.78 billion euro. The daily average number of transactions exchanged amounts to 51 983. The highest volume was recorded on 2 March with 118 469 operations.

TABLE 5:

	2003	2004	Variation
Numer of credit transfers	13 131 658	13 043 626	-0.67%
Value of credit transfers (EUR million)	45 079	45 846	1.70%
Average value per credit transfers (EUR)	3 433	3 515	2.39%
Number of cheques	275 563	174 396	-36.71%
Value of cheques (EUR million)	3 182	2 567	-19.32%
Average value per cheques (EUR)	11 545	14 719	27.49%
Number of transactions related to the settlement of balances of debit and credit cards	21 841	28 951	32.55%
Value of transactions related to the settlement of balances of debit and credit cards (EUR million)	5 800	8 363	44.20%
Average value per transactions related to the settlement of balances of debit and credit cards (EUR)	194 893	267 775	37.40%
Total number of operations	13 429 062	13 246 973	-1.36%
Total value of operations (EUR million)	54 060	56 776	5.02%
Average value per operation (EUR)	4 026	4 286	6.47%

2. OTHER BCL FINANCIAL ACTIVITIES

Credit transfers

The year 2004 can be split in two: the first half of the year showed a 4.8% decrease in the number of credit transfers in comparison with the first half of 2003, whereas during the second half of 2004 volume increased by 3.7% in comparison with the corresponding period in 2003. This change of trend can be explained by the European Regulation on the pricing of credit transfers which came into effect on 1 July 2003 and led to a traffic decrease until 30 June 2004. The daily average number of credit transfers exchanged amounted to 51 183, whereas the daily average value amounts to approximately 180 million euro.

The value of credit transfers exchanged records a 1.7% increase.

Cheques

With regard to cheques, the significant decrease in volume since the withdrawal of the Eurocheque guarantee at the end of 2001 continued (-37% in comparison with 2003). At the end of 2004, the daily average number of cheques exchanged amounted to approximately 600, whereas the daily average value amounted to about 10 million euro.

The value of cheques diminished also, but to a lesser extent (-19%). The average value of cheques exchanged in LIPS-Net increased from 11 545 euro in 2003 to 14 719 euro in 2004.

Debit and credit card operations

In May 2003, the clearing of credit card balances was integrated in LIPS-Net, which already processed debit cards. As a result, settlement operations of balances between card issuers have considerably increased since this date. Unlike clients' payment transactions (credit transfers and cheques), this type of interbank settlement transaction is limited in volume (less than 1% of the volume), but represents a considerable share of the values exchanged in LIPS-Net (15%).

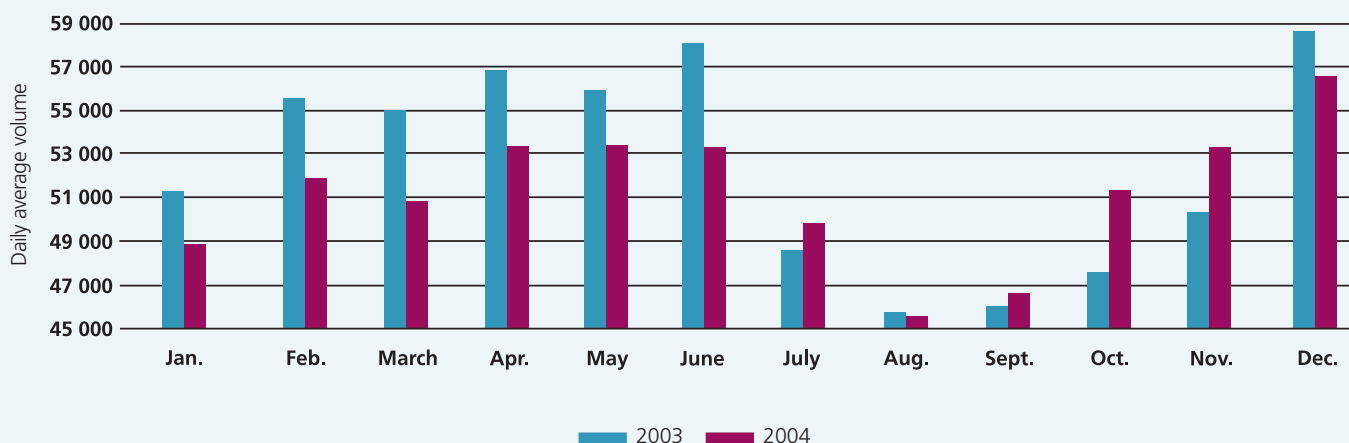
2.6.3 The general framework of eligible collateral in Eurosystem credit operations

2.6.3.1 The list of eligible assets

All credit operations of the ECB and the national central banks are effected "on the basis of adequate collateral"². Consequently, each counterparty guarantees the credit received from a Eurosystem central bank by providing securities as collateral. These securities have to fulfill specific eligibility criteria defined by the Eurosystem.

The Eurosystem has established a distinction between two categories of assets eligible for credit operations. The first consists of debt instruments fulfilling uniform euro area wide eligibility criteria specified by the Eurosystem. The second consists of additional assets that are of particular importance to national financial markets and banking systems.

GRAPH 19: CREDIT TRANSFERS: EVOLUTION OF THE DAILY AVERAGE VOLUME



² Article 18 of the Statute of the ESCB and the ECB, article 22 of the founding law of the BCL.

In order to further improve its collateral framework, the Eurosystem is preparing for the gradual implementation of a single list of collateral eligible throughout the euro area. In a public consultation launched by the Eurosystem a majority of banks has expressed overall support for this project. This was also the position taken by Luxembourg counterparties. A first measure taken in the context of the single list has been the exclusion of "out collateral" from the list of securities eligible for intraday credit operations in TARGET. The term "out collateral" refers to eligible securities deposited in a EU Member State, but issued in a country not part of the eurozone. As a second measure, it has been decided that bank loans will be included in the single list as of January 2007. The detailed procedures for the acceptance of bank loans - which include a minimum rating - and those required for the transfer of bank loans to the respective NCB are currently being worked out.

2.6.3.2 The Eurosystem as a user of securities settlement systems

Selection of depositories³ at the domestic level

In order to meet the requirement of "adequate collateral"⁴ the Eurosystem also assesses against specific safety criteria depositories that are safekeeping securities used in the framework of central bank credit operations. In 2004 the Eurosystem reviewed its assessment criteria (the User Standards) in order to adapt them to the changing landscape of depositories.

Cross-border use of collateral

Besides using eligible domestic securities settled via the national depository (Clearstream Banking Luxembourg - CBL - for Luxembourg counterparties), all Eurosystem counterparties may receive credit from their local NCB by using collateral issued in a depository located in another Member State of the European Union. The ESCB recognises two ways for such cross-border use of collateral. Counterparties may use

- the CCBM⁵; and
- links established between securities settlement systems.

In a given securities settlement system located in an EU country, these links make available securities issued in the system of another EU country, thanks to bilateral accounts that the two systems maintain between each other. In order to be used in the framework of Eurosystem credit operations these links have to be approved by the Governing Council of the ECB. Therefore, the links, just like national depositories, are assessed against safety standards set forth by the Eurosystem. On the basis of these links, a Luxembourg counterparty can pledge to the BCL on its account at CBL eligible securities issued into Clearstream Banking Frankfurt A.G., Euroclear, the National Bank of Belgium, Monte Titoli (Italy), OeKB (Austria), and Euroclear Netherlands.

2.6.4 **The Correspondent Central Banking Model (CCBM)**

In the framework of the CCBM each NCB acts on behalf of the other central banks as a custodian for securities held at the national depository. This procedure involves a central bank called a correspondent central bank (CCB) that is different from the central bank granting the credit to the counterparty. The CCB holds the account at the depository in which the securities deposited are registered. The home central bank (HCB) then grants the credit to its counterparty on the basis of confirmations received from the CCB.

In the beginning the CCBM was conceived as an interim solution to respond to the segmentation of European capital markets. As the model has been successful with counterparties and as it remains the main channel for the cross-border mobilisation of collateral, the Governing Council has decided to continue the CCBM until 2007. Moreover, the efficiency of the model has been further increased by the decision to limit the maximum processing time to one hour for each operation (this decision has taken effect as of 2004).

Across the eurozone the usage of the CCBM has remained extremely disparate. The most active correspondent central banks have been those from Italy (19%), Luxembourg (19%), Belgium (19%) and Germany (12%).

The most active home central banks have been those from Germany (61%), the Netherlands (10%), Ireland (7%), Luxembourg (5%) and from France (5%).

As in previous years the cross-border use of tier 2 assets has remained marginal.

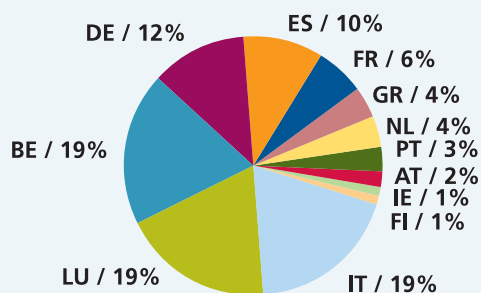
³ A depository is an institution that operates a securities settlement system.

⁴ Article 18 of the Statute of the ESCB and the ECB, article 22 of the founding law of the BCL.

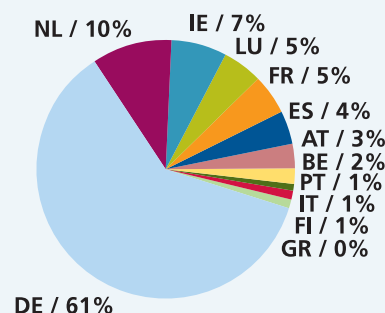
⁵ Correspondent Central Banking Model, see section 2.6.4.

2. OTHER BCL FINANCIAL ACTIVITIES

GRAPH 18: CORRESPONDENT CENTRAL BANK 2004



GRAPH 19: HOME CENTRAL BANK 2004



2.6.5 Night-time Link with Clearstream Banking Luxembourg

The procedure Night-Time Link (NTL) is a complementary service introduced by the BCL and CBL in 2002. This service enables Luxembourg banks to improve the use of their cash and securities deposited with BCL, while at the same time increasing the financial safety of the night-time securities settlement operated by CBL.

The NTL procedure is subdivided into 2 parts:

1. A customer of CBL can use its cash and collateral available at BCL to guarantee credit granted by CBL for the clearing process taking place at night. The guarantee is issued by BCL in favour of CBL on behalf of the customer.
2. At the end of the night-time processing, reimbursement of credit granted by CBL is automatically effected by BCL on behalf of the customer.

BCL considers that NTL, by offering new collateralisation possibilities to the banking community, contributes to improving the safety of securities transactions. This procedure also enables banks to manage their liquidity in a more centralised way.

2.7 Financial stability

2.7.1 Macro-prudential surveillance

2.7.1.1 Regular monitoring activities

Throughout 2004 the BCL has continued its ongoing analysis of major developments in the Luxembourg banking sector. This analysis is based in particular on a system of macro-prudential indicators, completed by a specific monitoring of systemically important institutions.

In 2004, the indicators measuring the return on assets and on equity of banks under Luxembourg law are globally at higher levels than in 2003. The share of the interest margin in total revenues of banks under Luxembourg law is decreasing while the share of commission revenues is rising. Banks under Luxembourg law remain well capitalised and their liquidity ratio remains stable, considerably above the prudential threshold. Net value adjustments in the banks' books have been reduced. Assets towards high-risk countries decreased against own funds, while exposures towards related entities have intensified, in particular at the level of interbank debt. The volume of credit outstanding towards non-financial corporations continued the decrease initiated in 2002, though at a slower pace.

Credit towards resident households is increasing, pushed in particular by the growth of mortgage loans. Overall the good quality of the sector's assets has been maintained; the share of non-performing loans in total large exposures has stabilised at a very modest level. The continuing reduction in the number of banks is mainly attributable to the mergers and acquisition processes that are going on in the banking sector. Nonetheless, the concentration of banking activities, measured by the total sum of balance sheets, remains stable.

Banks under Luxembourg law seem to be, globally, well positioned to face potential instability risks given the strengthening of profitability, the comfortable level of capital, the control of asset and market risks and the availability of liquidity. Certain signs of optimism are perceivable at the international and the national level. However, potential financial, economic or political turbulences remain possible. Moreover, the evolution of financial markets and of the regulatory framework, the outsourcing of certain activities as well as the consolidation or internationalisation of the banking sector imply challenges which need particular monitoring from a financial stability point of view. Market participants as well as authorities should remain vigilant. Crises risks are not obvious but their potential consequences could be very significant.

The macro-prudential indicators are published on a regular basis. A more detailed analysis has been published in April 2005 in the BCL's financial stability bulletin, and other detailed analyses have been published in 2002 and 2004.

The availability of qualitative information on the individual institutions, especially on those of systemic importance, would contribute to an enhancement of the quality of the analysis.

At an international level, the macro-prudential indicators become more and more of a prominent tool. The International Monetary Fund (IMF) has strengthened its efforts in this context and has developed a compilation guide on Financial Soundness Indicators (FSI). In addition, IMF staff have coordinated since 2004 the setting up of FSIs for about sixty countries. The BCL is the national coordinator in this context.

⁶ The Lamfalussy framework distinguishes 3 levels. Level 1, legislative, level 2, the 3 regulation committees in the different financial sectors assisting the European Commission, and finally level 3, the supervisory committees.

2.7.1.2 International cooperation

At the level of the European System of Central Banks (ESCB), the BCL contributes to the work of the Banking Supervision Committee that is, amongst others, analysing and monitoring the cyclical and structural developments in the European banking sector from a financial stability point of view.

Moreover, since 2004 the BCL participates in the work of the Committee of European Banking Supervisors (CEBS) set up by the European Commission as a level 3 committee within the framework of the Lamfalussy structure for banking supervision⁶.

2.7.2 **Oversight of payment and securities settlement systems**

2.7.2.1 Regular oversight activities

During 2004, the BCL continued its mission in the field of oversight of operators and technical agents of those payment and securities settlement systems notified by the BCL to the European Commission on 12 February 2001.

The following operators: RTGS-L Gie (Lips-Gross), SYPAL Gie (Lips-Net) and Clearstream Banking Luxembourg and the technical agents: BCL for Lips-Gross, Cetrel for Lips-Net and Clearstream Services for Clearstream Banking Luxembourg, are subject to BCL's oversight.

To avoid any conflict of interests between its operation and oversight functions in the field of payment systems and, in accordance with IMF principles, the BCL operates a strict internal separation between these two activities.

2. OTHER BCL FINANCIAL ACTIVITIES

2.7.2.2 International cooperation

Regarding the work undertaken at the ESCB level by the "Payment and Settlement Systems Committee" (PSSC), the BCL contributed on issues relating to financial stability and to systemic risks, notably in the oversight of retail and large value payment systems.

The BCL was also invited to participate in the work of the "Committee on Payment and Settlement Systems" (CPSS) of the Bank of International Settlements (BIS) in Basel with a particular focus on the comparison between different oversight practices in payment and securities settlement systems as implemented by central banks.

2.7.2.3 Standards for securities settlement systems

The BCL has actively contributed to the work of the joint working group ESCB-CESR (*European System of central banks - Committee of European Securities Regulators*) for the development of standards on clearing and securities settlement activities. These standards, approved by the ECB Governing Council and published in October 2004, will take effect after the development of an assessment methodology in this context. Work in this field is currently in progress.

2.7.3 Other activities

Besides its participation in the work of the ESCB relating to crises management, the BCL participates in the ESCB-CEBS joint task force whose major objective is the study of guiding principles for handling financial crises as well as of co-operation and information-sharing mechanisms between authorities at national and at European level.

At a national level, the BCL has proposed to the government the implementation of a co-operation scheme comprising of institutional, legal and contractual aspects linked to the prevention as well as to the management of financial crises.

