

3. EXTERNAL ACTIVITIES

3.1 European Activities

3.1.1 Enlargement of the European Union

Since 1 May 2004, the European Union counts ten new Member States, namely the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovakia and Slovenia. From May 2004 onwards, the national central banks of the new Member States have been integrated into the ESCB and their respective Governors became full members of the General Council of the ECB. Moreover, these central banks have become parties to the agreement of 1 September 1998 between the European Central Bank (ECB) and the national central banks (NCBs) of the Member States outside the euro area, on the exchange rate mechanism in Stage Three of Economic and Monetary Union (ERM II). Like its predecessor, ERM II includes central rates, maximal fluctuation bands, intervention points and financing facilities. With effect from 28 June 2004, the Estonian kroon, the Lithuanian litas and the Slovenian tolar were included in ERM II.

The BCL participated in preparatory work, notably in the fifth central bank seminar on the EU accession process, jointly organised by the Banque de France and the European Central Bank (ECB) in March 2004.

The enlargement led to a new equilibrium in the ESBC. Moreover, it led to a clarification of the concept of the Eurosystem, which has been utilised since the introduction of the euro by 11 Member States on 1 January 1999. The Eurosystem was formally defined in the new Rules of Procedure of the ECB as approved by the Governing Council on 19 February 2004.

The enlargement is also the source of the modification of Article 10.2 of the Statutes of the ESCB and the ECB which became effective on 1 June 2004 upon approval by the 15 Member States. The purpose of this amendment is to maintain the Governing Council's capacity for efficient and timely decision-making in an enlarged euro area. When the number of countries having adopted the euro reaches 16, voting among the NCB governors who are members of the Governing Council will be subject to a rotation system. This system will respect five fundamental principles: (1) one member, one vote, (2) *ad personam* participation, (3) representativeness, (4) robustness and automaticity and finally (5) transparency. Governors will then be divided into two groups, until their number reaches 22, when they will be allocated between three groups.

The allocation of Governors among the different groups will be based on an indicator made up of two components:

- The relative weight of the economy, measured by GDP at market prices, of their country within the euro area;
- The relative weight of the aggregate balance sheet of monetary financial institutions of their country within the euro area.

This second component, particularly important for Luxembourg, reflects the necessity to allow for the relative importance of Member States' financial sectors when taking monetary policy decisions. Thus, a weighting of 5/6 is given to GDP at market prices and of 1/6 to the aggregate balance sheet of monetary financial institutions.

The first report on the convergence of the new Member States was adopted by the General Council of the ECB in October 2004.

Pursuant to Article 29 of the Statute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB), the proportions of the national central banks (NCBs) in the ECB's capital key are weighted according to the shares of the NCBs' Member States in the total population and gross domestic product of the EU, in equal measure, as notified to the ECB by the European Commission. These weightings are adjusted every five years and were last changed on 1 January 2004.

In accordance with Article 49.3 of the Statute of the ESCB, which was added to the Statute by the Treaty of Accession, the ECB's subscribed capital is automatically increased when a new Member State joins the EU and its NCB joins the ESCB. Therefore, on 1 May 2004 the subscribed capital of the ECB was increased to EUR 5 564 669 247.19.

Eurosystem NCBs are required to pay their subscribed capital in full. On 1 May 2004 the subscribed share of the BCL in the ECB's capital amounted to 8 725 401.38 euro. In percentage terms the share of the BCL was raised from 0.1492% on 1 January 2004 to 0.1708% but fell back to 0.1568% on 1 May 2004.

The total value of euro banknotes in circulation is allocated among the members of the Eurosystem by means of a banknote allocation key. In the case of the BCL, this key amounts, since 1 May 2004, to 0.2020%. The banknote allocation key means the percentage that results from taking into account the ECB's 8% share in the total euro banknote issue in circulation and applying the subscribed capital key to the Eurosystem's NCBs share in such total.

3. EXTERNAL ACTIVITIES

3.1.2 The Stability and Growth Pact

The debate concerning the Stability and Growth Pact, which was concluded in 1997 with regard to transition to the third stage of Economic and Monetary Union, has been at the centre of discussion in the context of economic governance of the European Union in 2004 until March 2005.

On 13 July 2004, the Court of Justice of the European Communities gave a judgement concerning the decisions adopted by the Council of the European Union on 25 November 2003 in respect to the excessive deficit procedures against Germany and France.

The European Commission published on 3 September 2004 a communication on the strengthening of economic governance and clarifying the implementation of the Stability and Growth Pact.

The Governing Council of the ECB insists on the importance of the Stability and Growth Pact; it considers the propositions of the European Commission useful as far as the improvement of the implementation of its preventive arm is concerned. It is opposed to formal changes to the Stability and Growth Pact, insisting notably on the respect of the excessive deficit procedure.

The debate led to a reform of the Stability and Growth Pact in March 2004. More particularly, the European Council meeting of 22 and 23 March 2005 endorsed the report of the Council of the European Union on the improvement of the implementation of the Stability and Growth Pact, approving the conclusions and propositions figuring therein. Council regulations (EC) No 1466/97 and 1467/97 need to be amended.

The Governing Council of the ECB is seriously concerned about the proposed changes to the Stability and Growth Pact.

Sound fiscal policies and a monetary policy geared to price stability are fundamental for the success of Economic and Monetary Union, constituting prerequisites for macroeconomic stability. It is imperative that all parties concerned fulfil their respective responsibilities and that the revised rules of the Stability and Growth Pact are implemented in a rigorous and consistent manner conducive to the conduct of prudent fiscal policies.

3.1.3 Consultative Committees

3.1.3.1 The Economic and Financial Committee (EFC)

A BCL representative participates in EFC meetings. The EFC is composed of representatives from the Finance Ministries and central banks of EU Member States, the European Commission and the ECB. According to the Treaty on European Union, the EFC is to "review the economic and financial situation of the Member States and of the Community and to report regularly thereon to the Council and to the Commission". The EFC contributes to multilateral surveillance in order to monitor the compliance of Member States' economic policies with the broad economic policy guidelines and with the Stability and Growth Pact. Moreover, the EFC was consulted concerning the central rates of the Estonian kroon, the Lithuanian litas and the Slovenian tolar vis-à-vis the euro in ERM II and concerning the compulsory intervention rates as of 28 June 2004. The EFC also contributed to streamlining the annual economic and employment policy coordination procedures. Finally, the EFC worked on economic policy issues discussed at informal ECOFIN meetings, which are attended by the BCL's Governor.

The EFC meets six times a year in plenary composition but meets also in restricted composition. It is worth noting that the ECB participates in the Eurogroup Working Group, where it represents the Eurosystem.

3.1.3.2 The Committee on monetary, financial and balance of payments statistics

Regarding European statistics and within the context of EUROSTAT's mission, the Committee on monetary, financial and balance of payments statistics (CMFB) has notably the task of taking a position as to the development and coordination of the different types of statistics required by the Council, the Commission and the different committees which assist them. Within the CMFB, the central banks, the national statistical offices as well as the Commission and the ECB are represented. Under the aegis of the CMFB, work groups and task forces carry out specific missions. The BCL contributed actively to the activities of the CMFB in 2004. Progress was made with regard to the statistics on financial accounts, balance of payments, financial services, public finances as well as national accounts.

3.2 National Activity

3.2.1 Legal Activities

3.2.1.1 Securitisation

The previous annual report (see section 3.3.1.1) presented the draft law on securitisation, submitted by the Minister of Treasury and Budget, as well as the opinion rendered by the ECB in this respect. This draft was adopted as securitisation law on 22 March 2004.

3.2.1.2 Prevention of money laundering and terrorist financing

The Luxembourg legal framework has been supplemented by the law of 12 November 2004 aimed at combating money laundering and the financing of terrorism, transposing Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001, amending Council Directive 91/308/EEC on the use of the financial system for the purpose of money laundering, and amending: 1. the Criminal Code; 2. the Code of Criminal Procedure; 3. the law of 7 March 1980 on the organisation of the judicial system, as amended; 4. the law of 23 December 1909 setting up a Commission for Supervision of the Financial Sector, as amended; 5. the law of 5 April 1993 on the financial sector, as amended (...);

The "second money laundering Directive" (2001/97) of the European Parliament and Council of 4 December 2001 extends the scope of the money laundering predicate offences and widens the scope of persons targeted by the prevention of money laundering and the financing of terrorism. The Luxembourg legislator anticipated this development by means of the law of 11 August 1998 creating and introducing into the Criminal Code the offence of membership of a criminal organisation as well as the offence of money laundering. Since the national law was already in line with this Directive, the new law of 11 November 2004 on combating money laundering and the financing of terrorism merely provided some additional adaptations.

The BCL has a duty to report any indications of money laundering or terrorist financing to the Public Prosecutor of the Luxembourg District Court according to Article 33 (3) of its organic law of 23 December 1998.

Following a decision by the BCL's Executive Board in September 2004, the Bank has reinforced the supervision of the issuance of monetary signs to the public and to professionals and updated its internal procedure relating to public counter transactions. As a member of the Eurosystem and as a public institution, the BCL has established an internal verification procedure similar to the procedures in place in credit institutions and investment firms. Thus, transactions exceeding 15 000 euro require prior approval by the compliance officer after a detailed identification of the client.

This reinforcement of supervision is without prejudice to the powers of the Bank in the supervision of payment systems and securities settlement systems according to the official statement of the ECB of 1 October 2001 (see also BCL Circular 2002/172).

At the request of the Council of the European Union, the ECB provided an opinion on the proposal for the "third money laundering Directive" in February 2005. The ECB welcomed the draft and requested central banks to be covered in their specific capacity rather than by way of assimilation to other professionals. For payment systems, the ECB requested - based on the Luxembourg experience and the Bank's Circular in this matter - that operators ensure the traceability of ingoing and outgoing payment orders within their systems.

The new Directive defines its scope of application broadly, combining, for the qualification of serious offences, a detailed list of offences and a general definition of offences, including those offences punishable by imprisonment for a minimum of six months.

For the application of this provision, Member States need to adopt the principle of double incrimination, in both the requesting Member State and in the requested Member State where an infringement occurs.

3. EXTERNAL ACTIVITIES

3.2.1.3 The mobilisation of bank loans in favour of the Banque centrale du Luxembourg

A study published in the 2004/3 bulletin of the BCL deals with the mobilisation of bank loans in favour of the BCL in the light of the Luxembourg banking secrecy rules.

This study follows approval by the Governing Council of the principle of the integration into the single list of securities provided as collateral, of bank loans of the whole euro zone. The lawyers committee of the BCL discussed the said study.

Information to be received by the BCL upon the mobilisation of bank loans will be linked to the customer (identity, localisation, possibly its rating by the bank, etc.) and its estate, in particular its debt vis-à-vis the bank, which is represented by the bank loan. This kind of information is covered by the banking secrecy rules.

3.2.1.4 Modifications to the Institutional Framework

Within its field of competence, the Bank lends assistance to any amendment to the institutional framework relevant to Luxembourg's financial centre.

At a European level, regulation and coordination will be enhanced in the financial field, particularly in areas of financial stability as well as in crisis prevention and management. Such enhancements call for measures at a national level with a reinforcement of the cooperation between the central bank and the public authorities.

The 2004 modification of the Luxembourg constitution, which includes an article allowing the bestowing of regulatory power to public authorities, opens useful prospects.

In July 2004, the President of the ECB wrote to the Luxembourg Government in order that the legal framework be put in place for the due implementation of new measures decided by the ECB imposing data gathering upon a large number of economic actors such as investment funds, insurance companies or issuers of securities which, until then, had not been subject to reporting requirements from the central bank.

Another object may be modified in the organic setting law of the central bank. In a recommendation dated 21 October 2004, the ECB invites each Member State of the euro area to adopt specific legislation granting immunity of execution, on its territory, to assets including at least foreign exchange reserves belonging to or held by foreign central banks.

3.2.2 **BCL Committees**

The consultative committees of the BCL regroup experts with the view of assisting the Bank in specific areas of activity.

These are:

[The Information Technology Committee](#)

[The Legal Committee](#)

[The Fiduciary Money Committee](#)

[The Market Operations Committee](#)

[The Statistics Committee](#)

[The Settlement and Clearing Systems Committee](#)

[The Balance of Payments Consultative Commission](#)

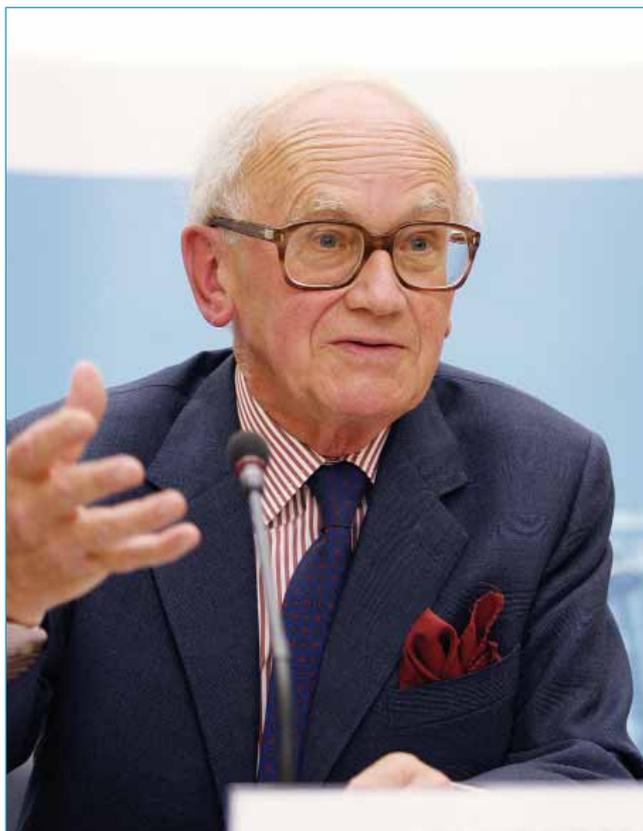
[The Monetary and Financial Statistics Consultative Commission](#)

3.2.3 The BCL's training initiatives

The BCL organised a series of internal courses on subjects falling directly within its competence, such as "EMU and the BCL", "Monetary Policy: Strategy and Instruments" and "Payment and Settlement Systems". Under certain conditions these courses can also be given outside the BCL.

The BCL is a shareholder of the Agency for the Transfer of Financial Technology (Agence de Transfert de Technologie Financière or ATTF), which celebrated its fifth birthday in 2004. The ATTF organises training courses, relying, *inter alia*, on the network of central bank cooperation. Members of the BCL staff made presentations during ATTF seminars to bankers and executives coming from Bosnia-Herzegovina, Egypt, Mongolia, Serbia and Uzbekistan.

During 2004, about ten staff members from the Bank of Mongolia completed brief internships at the BCL. In the context of exchange programmes, the BCL welcomed Japanese and Polish students.



Baron Alexandre Lamfalussy

On 26 October 2004, Baron Alexandre Lamfalussy was the speaker at the second Pierre Werner Lecture, organised on the premises of the BCL, on the theme of *Central Banks and Financial Stability* and which covered the contribution of central banks to the supervision of financial intermediaries and the financial system. For the speaker, central banks have an essential role to play in the area of crisis management. It is up to them to supply the financial system or individual institutions with liquidity. They play an essential role in the area of payments and they contribute to boosting the system's resilience. The specific role of central banks in banking regulation and supervision is very topical. New arrangements at the national levels and progress at the European level are being contemplated. These could also be boosted by the strengthening of the Eurogroup. Mr. Lamfalussy suggests making use of the possibilities of the Treaty of Madrid to widen the functions currently fulfilled by the Eurosystem.

3.2.4 Activities with the International Monetary Fund (IMF) and other international organisations

The BCL handles Luxembourg's financial transactions with the IMF. For this purpose, it manages Luxembourg's assets and liabilities vis-à-vis the IMF in both the general account and the Special Drawing Rights (SDR) account. On 31 December 2004, Luxembourg's quota, entirely recorded in the BCL balance sheet, amounted to SDR 279.1 million, whereas the reserve position (the difference between Luxembourg's total quota at the IMF and the euro-denominated assets held by the IMF at the BCL) represented 32.13% of the Luxembourg quota.

The IMF's operational budget defines the currencies to be made available to its members on a quarterly basis and the distribution of reimbursements among its members. During 2004, the BCL was instrumental in making advances for 52.7 million euro related to IMF operations and was reimbursed 11.5 million euro.

At the end of 2004, Luxembourg held 58% of its SDR allocation (48.9% in 2003) following the accumulation of net interests received on the SDR account and on the reserve position. On 31 December 2004, the amount recorded on the SDR account was SDR 9.8 million.

The BCL also participated in several working groups of the Organisation for Economic Cooperation and Development (OECD) and the Bank for International Settlements (BIS). Besides its contributions to the area of financial stability, it concentrated on the work of the OECD Financial Markets Committee (FMC) and the BIS Committee on the Global Financial System (CGFS).

3. EXTERNAL ACTIVITIES

3.2.5 External events

3.2.5.1 Extra-European relations

The Governor of the BCL participated in the 11th annual meeting of the governors of the central banks of the French-speaking countries that was organised in June 2004 by the Banque de France. Some 30 governors discussed, *inter alia*, the impact of new international standards on financial stability and international cooperation in the fight against money laundering. The BCL's Governor delivered a speech "Financial stability - From the challenge of new international standards to the role of central banks".

In July 2004 the Governor of the BCL went to Asia on mission. In Hong Kong the Governor met representatives of the financial institutions. He also visited Mongolia in order to strengthen bilateral relations with the Bank of Mongolia, notably in the area of technical assistance. On 16 July 2004, Mr. Mersch participated in an EMEAP-Eurosystem high-level seminar in Singapore with eleven central bank governors from the Executives' Meetings of East Asia-Pacific (EMEAP), the President of the ECB and 11 other governors from the ESCB. The governors exchanged views on issues relevant to both Europe and the East-Asia region. They reviewed, *inter alia*, the emergence of East Asia in the global economy as well as the role of international currencies, including the use of such currencies in trade and investment flows in Asia.

In Latin America, the BCL's President took part in the second high-level seminar of the Eurosystem and Latin American central banks that was held on 26 November 2004 in Rio de Janeiro. This seminar was hosted by the Banco Central do Brasil and jointly organised together with the ECB and the Banco de España. It aimed at continuing the policy dialogue between central bankers of Europe and Latin America that was initiated at the first seminar in Madrid in 2002. The discussions focused on the fiscal, external and financial environment in which central banks operate.

The BCL participated in autumn 2004 in official missions to the People's Republic of China and the Gulf states. During the year, cooperation with other central banks, in particular with the *Banco de Cabo Verde* and the *National Bank of Cambodia*, was strengthened.

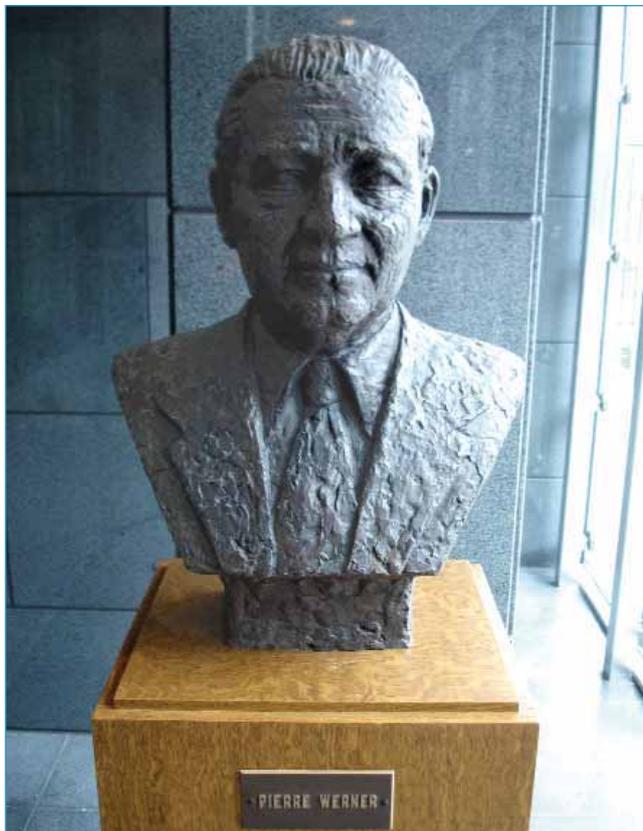
3.2.5.2 Meetings in Luxembourg of Committees and Working Groups

The Committee on Payment and Settlement Systems (CPSS) of the BIS held the fifth meeting of its working group, *Oversight of Payment and Settlement Systems*, on 8-9 June 2004 at the BCL. This working group was set up in order to analyse and compare the oversight activity concerning payment and securities settlement systems carried out by central banks. Central banks contribute directly to financial stability by providing accounts for the settlement of payments and for the settlement of the cash leg of securities transactions as well as by exercising oversight concerning those systems. A significant number of central banks have specific responsibilities in the field of financial stability.

The Banknote Committee (BANCO) of the ECB met on 17 and 18 June 2004 at the BCL. The current tasks of BANCO consist of coordinating the production of euro banknotes, including questions related to research and development issues, as well as the management and surveillance of circulation, including the management of stocks, the quality of the notes in circulation and counterfeiting.

The BCL maintained contacts with the European institutions and organisations based in Luxembourg. In December 2004, the bank's Executive Board received the six Luxembourg members of the European Parliament, who were elected on 13 June 2004.

3.2.5.3 Miscellaneous



The bust, sculpted by the artist Amar Nath Sehgal and offered by the Werner family to the BCL, is exhibited in the entrance hall of the building that is named after Mr. Werner.

In early January 2005, the BCL's Executive Board and staff decided to make a donation to help the victims of the tsunami that hit Asia. The BCL's gift goes to a special fund created by the Honorary Consul of Sri Lanka in Luxembourg that will finance the reconstruction of the village of Kosgoda in Sri Lanka.

3.3 The BCL's communication

3.3.1 Mission Statement of the Eurosystem and positioning of the BCL

In January 2005, in order to give specific and tangible indications as to how it executes its missions and fulfils the aims that the Treaty and the ESCB's statutes assigned to it, the Eurosystem published its mission statement, its strategic intents and its organisational principles as approved by the Governing Council.

The BCL harmonised its mission statement, which it had already formulated in October 2002, with the Eurosystem's statement. The BCL, which contributes fully to the missions assigned to together with the ECB and the other NCBs having adopted the euro, shares the objectives, the values and the principles of the Eurosystem. The BCL intends to be a centre of competence and of excellence, whose performance merits the public's confidence. Its corporate values are professionalism, quality, stability, objectivity and integrity.

3.3.2 Periodical bulletins

In 2004 the BCL published four bulletins, one of which covered financial stability. Besides topical messages and economic and financial reports on the European and Luxembourg economies, the BCL's bulletins included the following analyses:

Bulletin No 2004/1

- *Le secteur financier luxembourgeois en 2003 ;*
- *Risque de contagion du marché interbancaire luxembourgeois ;*
- *Crises management.*

Bulletin No 2004/2

- *Les finances publiques luxembourgeoises : état des lieux et perspectives ;*
- *La courbe de Phillips néo-keynésienne : résultats empiriques pour le Luxembourg.*

3. EXTERNAL ACTIVITIES

Bulletin No 2004/3

- *La mise en garantie de prêts bancaires auprès de la Banque centrale du Luxembourg au regard du secret bancaire luxembourgeois ;*
- *Impact des mesures prises par les autorités publiques sur les prix à la consommation ;*
- *Die Eurobargeldeinführung und regionale Preisunterschiede: Ist seitdem etwas passiert?;*
- *La persistance de l'inflation au Luxembourg : Une analyse au niveau désagrégé.*

Bulletin No 2004/4

- *Utilisation des instruments de paiement au Luxembourg ;*
- *Evolution de l'impact des fusions bancaires sur l'emploi dans les banques ;*
- *La position extérieure globale du Luxembourg ;*
- *Rigidités nominales et persistance de l'inflation.*

3.3.3 Working Papers

The BCL's working papers present the research of BCL staff. In 2004, two working papers were published on the following subjects:

Nr. 11: The new Keynesian Philips curve: empirical results for Luxembourg, by Leva Rubene and Paolo Guarda, June 2004

New Keynesian Phillips curve estimates for Luxembourg using the Galí and Gertler (1999) hybrid form suggest that firms change prices often but tend to use backward looking rules-of-thumb instead of resetting prices optimally using forward-looking expectations. In terms of policy implications, although the results suggest that prices in Luxembourg are relatively flexible, the prevalence of backward-looking price setting implies greater inflation persistence and a higher sacrifice ratio attached to disinflationary monetary policy. From the perspective of individual firms, backward-looking price setting may be a rational response in a very small open economy because of its vulnerability to external shocks. Small size and openness plausibly imply higher costs for collecting information and lower benefits from optimal price setting.

Nr. 12: Inflation persistence in Luxembourg a comparison with EU 15 countries at the disaggregate level, by Thomas Y. Mathä and Patrick Lünemann, November 2004.

For monetary authorities and central banks, it is important to know how sluggishly inflation returns to its long-run equilibrium level after a disturbance, in order to assess the short-term impact of monetary policy decisions. A vast literature has emerged analysing the degree of inflation persistence. Working paper 12 analyses the degree of inflation persistence in Luxembourg using disaggregate price index data from the Harmonised Index of Consumer Prices. The degree of inflation persistence is then compared to estimates for the EU15 and for the euro area as well as for the individual member countries according to a unified approach.

3.3.4 The BCL's Website

The BCL's website, www.bcl.lu, carries news as well as information on the Bank's organisation and the services it provides. It contains links to the ECB and of the other central banks of the ESBC.

A new version of the site, aimed at a wider public, went online in 2004. Aside from presentational improvements, the site benefits from a new structure and updated technology. The new version offers visitors a performing research engine, individualised mailing lists, as well as clearly structured information tailored to the different categories of web users: financial sector professionals, media, academics, numismatists...

The new website is designed to play an increasing role in the dissemination of the BCL's publications. It exists in a French and an English version. Documents are published in their original language (French, English, German).

All BCL publications may be consulted and downloaded on www.bcl.lu. Hard copies can be obtained while stocks are available.

3.3.5 The Library

In 2004 the BCL inaugurated its new library. Thanks to its cooperation with the *Bibliothèque nationale* (BnL), the BCL was able to join the network of Luxembourg libraries and to adopt the Aleph programme for library management, which is used by many other central banks. At this stage, the library consists of some 9 000 publications covering monetary, financial, economic and legal matters pertaining to the euro area. These are mainly published by international organisations (BIS, European Commission, IMF, OECD, World Bank...) and central banks. The library stocks numerous CD-ROMs (of specialised publications, analyses, statistics, legislation...) and offers access possibilities to various databases.

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

