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Circular

Brussels, 5 October 2021

Reference: NBB_2021_20

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Circular on the practical rules for the application of Article 36bis of the Royal Decree of 23 September 1992 on the annual accounts of credit institutions, investment firms and management companies of undertakings for collective investment

Scope

- *Credit institutions governed by Belgian law.*

Dear Sir,
Dear Madam,

This Circular sets out the practical rules for the application of Article 36bis of the Royal Decree of 23 September 1992 (hereinafter referred to as "the Royal Decree of 23/09/1992")[1] as amended by the Royal Decree of 29 August 2021 (hereinafter referred to as "the Royal Decree of 29/08/2021")[2].

In particular, it lays down the conditions and formalities to be fulfilled in order to obtain the Bank's authorisation, as well as the transitional provisions applicable to institutions that have a derogation from Article 36bis on the date of publication of the Royal Decree of 29/08/2021. Furthermore, this Circular clarifies the consequences of non-compliance with these conditions on the reporting closing date, and describes the Bank's recommendations on the information to be included in the annexes to Scheme B. Finally, it outlines the expectations for accredited statutory auditors regarding the submission of application files and the performance of their half-yearly reviews. These clarifications apply from the date of publication of this Circular.

More specifically regarding the transitional period, the Royal Decree of 29/08/2021 provides that all individual derogations from Article 36bis granted by the Bank (or previously by the CBF/CBFA) pursuant to Article 38 of the Royal Decree of 23/09/1992, remain valid until 31 December 2022[3]. This means that institutions which have obtained such a derogation:

(a) may immediately apply the accounting rules laid down in §§ 3 and 4 of Article 36bis, particularly with regard to the hedging transactions previously covered by the derogation, and

(b) must, if they wish to continue to apply § 4 after 31 December 2022 to macro-hedging transactions, apply for authorisation from the Bank by 31 March 2022 at the latest, in accordance with § 1bis of Article 36bis and under the terms described in Chapter 5 of this Circular.

Structure

Introduction

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Chapter 5 - Conditions and formalities to be fulfilled to obtain and maintain an authorisation

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Chapter 7 - Role of the accredited statutory auditors

1 Royal Decree of 23 September 1992 on the annual accounts of credit institutions, investment firms and management companies of undertakings for collective investment.

2 Royal Decree of 29 August 2021 amending the Royal Decree of 23/09/1992, as published in the Belgian Official Gazette of 7 September 2021.

3 This date corresponds to the end of the grandfathering period set out in the Uniform Letter of 18 November 2014 (as amended by Uniform Letter NBB_2020_32 of 28 July 2020, which extended the duration of the former until 31 December 2022).

Introduction

Article 36bis of the Royal Decree of 23/09/1992, which relates to the accounting treatment of interest rate derivatives, was amended by the Royal Decree of 29/08/2021. Those amendments are intended to provide a regulatory basis for the accounting practice developed within the framework of the derogations from Article 36bis granted previously by the prudential supervisor, and to settle various technical issues that have emerged in the meantime, particularly regarding voluntary or involuntary termination or ineffectiveness of macro- and/or micro-hedging transactions. The new Decree puts an end to the former derogation regime as defined in the Uniform Letters of the Bank of 18/11/2014 and 29/12/2015. Consequently, these Uniform Letters are abrogated and replaced by the new provision of Article 36bis, as supplemented by this Circular.

This Circular lays down the practical rules for the application of Article 36bis, in particular the conditions and formalities to be fulfilled in order to obtain the Bank's authorisation, as well as the transitional provisions applicable to institutions that had a derogation on the date of publication of the amended Accounting Decree.

Chapter 1 - Description of forward interest rate transactions and general accounting approach

1. Default category (Article 36bis, § 2)

By default, interest rate derivates or forward transactions that do not meet the conditions to qualify as hedging transactions are revalued in the income statement on the reporting closing date according to the valuation principles of the trading book, i.e., at market value (mark-to-market) if traded on a liquid market or by allocation of the unrealised losses if traded on a non-liquid market.

2. Forward interest rate transactions used for hedging

2.1. Forward interest rate transactions used for interest rate risk micro-hedging (Article 36bis, § 1)

For these hedging transactions, profits and losses are recognised in the income statement in a symmetrical manner to the allocation of the income or expenses of the hedged item, in accordance with Article 36bis, § 3. To qualify as hedging transactions, three conditions must be met:

- the hedged item or the homogeneous set of hedged items must expose the credit institution to the risk of interest rate fluctuations[4] ;
- the hedging transaction must be designated as such in the books from the outset[5];
- there must be a close correlation between the value changes of the hedged item and those of the affected hedging transaction. In the case of options intended for hedging, there must be a correlation between the value changes of the hedged item and those of the underlying financial instrument.

The Royal Decree of 29/08/2021 amended § 3 of Article 36bis to bring it into line with the new § 4 and with current practices in interest rate risk hedging. The new § 3 maintains the principle that forward interest rate transactions not subject to daily settlement should also be recognised on a mark-to-market basis through a suspense account. However, it clarifies that it is also possible to recognise these transactions on a pro-rata basis (see below), as for macro-hedging (unless the hedged item is itself valued on a mark-to-market basis), on the express condition that this is disclosed in the notes to the financial statements. For the sake

[4] As with macro-hedging transactions (Article 36bis, § 1bis), micro-hedging can also relate to highly probable future cash flows.

[5] This condition does not prevent the micro-hedge from being applied prospectively using existing derivatives, provided that the micro-hedge is designated (and documented) as such at the start of the hedging relationship (see also IAS 39 on this subject).

of consistency, this disclosure in the notes is subject to the same rules as for macro-hedging transactions (new § 5). The disclosure in the notes should be aggregated for the relevant micro-hedging transactions but presented separately from the macro-hedging transactions. Finally, it should be noted that the new § 3 provides for the same rules on voluntary or involuntary termination or ineffectiveness for micro-hedging transactions as for macro-hedging transactions.

2.2. ***Macro-hedging*** *transactions concluded as part of the institution's overall ALM management of interest rate risk (Article 36bis, § 1bis)*

These transactions are conducted in the context of the overall management of interest rate risk (ALM). Previously, these transactions were covered by the derogation regime set out in the Uniform Letters of the Bank of 18/11/2014 and 29/12/2015. Unlike the hedging transactions referred to in Article 36bis, § 1, these transactions relate to (a) a homogeneous or non-homogeneous set of hedged items (e.g., in terms of duration or rate characteristics), whereby (b) this set can evolve over time (e.g., by including new loans granted and removing other loans reimbursed before maturity); and (c) the hedging transactions can also evolve (e.g., they are not necessarily designated as such in the books from the outset).

As was the case under the derogation regime, macro-hedging transactions pertain to both fair value hedges and cash flow hedges. This typology is also used in the new rules on disclosure in the notes to the financial statements.

Under the amended Article 36bis, these transactions no longer fall under a derogation scheme, but are covered by Article 36bis itself (as supplemented by this Circular with regard to the practical rules for its application).

In terms of accounting treatment, the new § 1bis of Article 36bis enshrines the former accounting practice that is based on the principle of accounting symmetry with the hedged instruments. Thus, for these transactions, hedging instruments are included among the rights and commitments in the off-balance sheet items at their notional amount. It follows that positive and/or negative changes in the market value of these hedging instruments are neither recognised in the income statement (as provided for in § 2 of Article 36bis) nor in a suspense account (as provided for in § 3 of the same Article). Receivables, payables, interest expenses and interest income resulting from these hedging instruments should continue to be recognised in accordance with the other provisions of the Decree (this concerns in particular accrued interest, option premiums or margin calls cashed out by the institution). The application of this specific accounting regime is subject to a set of conditions described in the new § 1bis of Article 36bis, in particular obtaining prior authorisation from the Bank.

By extension, transactions that are intended to manage interest rate risk without taking on additional risk and which are concluded as part of a securitisation carried out in the context of liquidity risk management with a vehicle consolidated by the credit institution, should be treated in a similar manner but are subject to specific conditions in terms of authorisation, organisation, internal documentation and specific monitoring which make it possible to verify the ongoing neutrality of these transactions in relation to the institution's overall interest rate risk.

Chapter 2 - Rules for the application of the conditions set out in Article 36bis, § 1bis

In order to be accounted for according to the rules of § 4 of Article 36bis, the macro-hedging transactions referred to in § 1bis of the Article must fulfil several conditions:

- the transactions and instruments concerned are eligible (36bis, § 1bis, first paragraph, 1°)
- the institution has an adequate internal organisation in place (governance conditions) for managing and monitoring interest rate risk, that allows the related transactions to be accurately represented in the financial statements (36bis, § 1bis, first paragraph, 2°)
- detailed documentation is maintained on the aforementioned internal organisation, including the institution's policy on interest rate risk management (36bis, § 1bis, first paragraph, 3°)
- the hedging transactions are highly effective, and the institution has an appropriate internal organisation and adequate methods, criteria, and monitoring tools to verify the effectiveness of the hedge and to adopt the necessary corrective measures when this effectiveness is no longer assured on both a retrospective and a prospective basis (36bis, § 1bis, first paragraph, 4°)

By extension, transactions that are intended to manage interest rate risk without taking on additional risk and which are concluded as part of a securitisation carried out in the context of liquidity risk management with a vehicle consolidated by the credit institution, are treated in a similar manner to the aforementioned transactions but are subject to own specific conditions in terms of authorisation, organisation, internal documentation and specific monitoring which make it possible to verify the ongoing neutrality of these transactions in relation to the institution's overall interest rate risk (36bis, § 1bis, second paragraph).

For all these transactions, Article 36bis, § 1bis imposes a general condition of obtaining prior authorisation from the Bank, which must verify compliance with the aforementioned conditions (ex ante and ex post, as these conditions must be met at all times).

Article 36bis, § 1bis, third paragraph instructs the Bank to set out, by means of a circular, the practical rules for applying the above conditions, including the type of eligible hedging instruments and the procedures to be followed to obtain the aforementioned authorisation. Such is the purpose of this Circular.

Article 36bis, § 1bis, third paragraph also empowers the Bank to impose additional conditions for obtaining or maintaining the above authorisation when the individual situation of the institution or market conditions so require. For example, significant weaknesses in the institution's governance or in its solvency, liquidity and profitability position may be considered in refusing to authorise the use of hedge accounting.

Finally, this Article empowers the Bank to require the institution to adopt the necessary corrective measures within a period of time determined by it, when it finds that the above conditions are not complied with. If such non-compliance is not remedied, the Bank may suspend or withdraw the authorisation.

Section 1 - Transactions and instruments eligible for the application of the accounting principles set out in Article 36 bis, § 4

In accordance with the provisions of § 1bis of Article 36bis, transactions must have one of the following objectives to be eligible:

- the reduction of the interest rate risk to which the institution is exposed; or
- the hedging of highly probable future cash flows.

By extension, this also includes transactions that are intended to manage interest rate risk without taking on additional risk and which are concluded as part of a securitisation carried out in the context of liquidity risk management with a vehicle consolidated by the credit institution.

1.1. Interest rate risk

The Bank specifies that this Circular uses the term interest rate risk as defined in the Guidelines of the European Banking Authority (EBA) on the management of interest rate risk arising from non-trading book activities[6], which were adopted in full by the supervisory authority (see Circular NBB_2019_18). This risk comprises gap risk, basis risk and option risk.

The Bank therefore excludes hedging transactions that are not motivated solely by an economic objective to reduce interest rate risk, but also by other considerations such as any accounting arbitrage.

1.2. Cash flow hedging

The institution shall document how the hedged cash flows were established and how it assessed that they were highly probable on the reporting closing date.

If the hedged cash flows are no longer assessed as being highly probable, they are disqualified as hedging instruments. This assessment shall be justified, particularly if the institution considers that the hedged future cash flows still remain probable and postpones the recognition of the effective part of the hedge in the income statement until these flows occur (event E1 in Chapter 3)[7].

1.3. Transactions concluded as part of a securitisation without taking on additional risk

Forward interest rate transactions concluded with special purpose vehicles (SPVs) consolidated by the credit institution may be accounted for according to the accounting principles laid down in § 4, subject to the Bank's prior **and specific** authorisation **for each securitisation transaction** and provided that the following conditions are met:

a) the institution is able to justify that these forward interest rate transactions *overall* do not lead to an effective increase in interest rate risk;

b) the institution is able to demonstrate that these transactions are part of the overall interest rate risk management and, as such, meet the governance criteria in point B below;

c) the institution is able to document the specific monitoring implemented for these transactions, which allows it to verify their ongoing neutrality in relation to the institution's overall interest rate risk (no deterioration);

d) the institution at all times has sufficient resources in terms of systems and competences to perform this specific monitoring with regard to both underlying risks and accounting entries.

The Bank specifies that the term "overall" in this specific context means "at the consolidated level" of the institution (accounting consolidation in which transactions concluded directly or indirectly between the credit institution and the SPV used for the securitisation transaction are completely eliminated). This presupposes that the institution manages its interest rate risk effectively and efficiently at the consolidated level. The use of hedge accounting can only be authorised/maintained if this can be demonstrated to be the case.

In practice, the Bank expects applying credit institutions to demonstrate that the interest rate risk managed at group level does not deteriorate (all other things being equal) before and after the conclusion of

[6] EBA/GL/2018/02, Guidelines on the management of interest rate risk arising from non-trading book activities, 19 July 2018.

[7] By analogy with the principles of IAS 39 on hedging of future transactions (in particular paragraphs 88(c) and 101(c)).

derivatives between the credit institution and the consolidated SPV, at any times for the entire duration of the transaction (neutrality condition).

It should be noted that for "total return swaps", which transfer interest rate risk and any residual income from the SPV to the credit institution, institutions can also request to apply the accounting principles set out in § 4 of Article 36bis. However, as this type of instruments entails other risks besides interest rate risk, the Bank expects the applying institution to demonstrate in its application file that it provides appropriate cover and/or adequate provisions for these other risks, taking into account the other provisions of the Royal Decree and particularly the principle of prudence.

The Bank also clarifies that an authorisation granted for derivatives concluded with a special purpose vehicle is strictly tied to the characteristics of the issues planned at the time of submission of the application file. This means that any subsequent issue through the same SPV shall be requested in a separate application and is therefore not de facto covered by the original authorisation.

1.4. Eligible hedging instruments

The eligible instruments are forward or optional interest rate instruments (derivatives), excluding options issued, because they expose the institution to an unlimited risk.

By way of derogation from this general principle, options issued together with other instruments (e.g. tunnels) are also eligible, provided the institution can demonstrate that they do not increase its interest rate risk[8].

Given the dynamic nature of macro-hedging of interest rate risk, instruments can initially qualify as hedging but be disqualified later and documented in a new hedging relationship.

As indicated above, the requirement for micro-hedging transactions to be designated as such from the outset does not prevent the micro-hedge from being applied prospectively using existing derivatives, provided that this micro-hedge is designated (and documented) as such at the start of the hedging relationship (see also IAS 39 on this subject)

Section 2 - Governance conditions (§ 1bis, first paragraph, 2° and 3°)

With regard to governance, the credit institution should demonstrate that:

- its management committee approved the designated transactions as well as the limits and governance (including internal control and internal audit) related to the management of these positions;
- the transactions concerned and the associated risks are assessed periodically (at least half-yearly) by its management committee, considering the risk and volatility of these positions.

  The management committee shall document this assessment in its annual report prepared pursuant to Circular NBB_2011_09. This assessment shall comprise an analysis of the adequacy of the hedging strategies, including an independent analysis of the correlation between the risks related to the items to be hedged and the hedges, so as to ensure that the strategies put in place make it possible to effectively reduce the risks being hedged. In addition, it shall be demonstrated that the hedging transactions are carried out in accordance with the policies and procedures described above. For the Bank, an independent analysis is an analysis carried out by the independent control functions established within the institution pursuant to the Banking Law of 25 April 2014.
- more in general, it complies with the provisions of Circular NBB_2019_18 on the management of interest rate risk arising from non-trading activities;

8 For derivatives concluded as part of a securitisation, this should be demonstrated on a consolidated basis.

- it has the necessary resources and systems to accurately represent the hedging transactions in its statutory financial statements according to the provisions of the Royal Decree of 23/09/1992.

Section 3 - Documentation and measurement of effectiveness

For micro-hedging transactions, Article 36bis, § 1 requires the existence of a close correlation between the value changes of the hedged item and those of the affected hedging transaction. Article 36bis, § 1bis, which pertains to macro-hedging transactions, goes even further, and requires the hedge to be *highly effective*. While the general principle is the same (hedge effectiveness), the rules for their application are different, as the more extensive and dynamic nature of macro-hedges justifies the use of stricter monitoring tools (as indicated in the Report to the King of the Royal Decree of 29/08/2021 about the amendment of Article 36bis). This does not prevent institutions from using the same effectiveness tests for micro-hedges where appropriate.

As in the Uniform Letter of the Bank of 2014, the below principles for effectiveness tests are based on the requirements of IAS 39 as applied in the European Union (references to IAS 39 are provided in brackets). This reference to IAS 39 for macro-hedging should not be interpreted to mean that the IFRS rules have replaced the Belgian banking accounting standards for the accounting for hedging transactions. The latter remain fully applicable.

3.1. General conditions

Hedging transactions must meet the following conditions regarding documentation and measurement of effectiveness:

a) at the inception of the hedge, there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. This documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. [IAS 39, 88(a)]

b) the hedge is expected to be highly effective (see point 3.2 below) in achieving offsetting changes in the fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship. [IAS 39, 88(b)]

c) the effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured. [IAS 39, 88(d)]

d) the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated. [IAS 39, 88(e)]

3.2. Definition and measurement of effectiveness[9]

In this respect, Article 36bis, § 1bis, first paragraph, 4° stipulates that hedging transactions shall be highly effective and that the institution must have an appropriate internal organisation and adequate methods, criteria and monitoring tools to verify the effectiveness of the hedge and to adopt the necessary corrective measures when this effectiveness is no longer assured on both a retrospective and a prospective basis. If the derivatives are intended to hedge future cash flows, these flows must be highly probable. The effectiveness of the hedge should be verified at least on a quarterly basis.

[9] It should be noted that this only applies to transactions intended for general and dynamic interest rate risk hedging, and not to securitisation transactions which, as mentioned in Article 36bis, § 1bis, second paragraph, are subject to special conditions in terms (…) of specific monitoring to verify the ongoing neutrality of these transactions in relation to the institution's overall interest rate risk (see Section 1, point 1.3 above).

A hedge is only considered to be **highly effective** only if both of the following conditions are met:

(a) at the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with the past changes in the fair value or cash flows of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge;

(b) the actual results of the hedging transaction are within a range of 80 to 125 %. For example, if the actual results are such that the loss on the hedging instrument is CU 120 and the gain on the cash instruments is CU 100, offset can be measured by 120/100, which is 120 % or by 100/120, which is 83 %. In this example, assuming the hedge meets the condition in (a), the entity would conclude that the hedge has been highly effective. [IAS 39, AG105]

This approach does not impose a single method for assessing the effectiveness of a hedging transaction. The method an entity adopts for assessing the effectiveness of the hedge depends on its risk management strategy. For example, if the entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. In some cases, an entity may adopt different methods for different types of hedges. An entity's documentation of its hedging strategy shall include its procedures for assessing hedge effectiveness. Those procedures shall state whether the assessment includes all of the gain or loss on a hedging instrument or whether the instrument's time value is excluded. [IAS 39, AG107]

Sometimes the hedging instrument offsets only part of the hedged risk. For example, a hedging transaction would not be fully effective if the hedging instrument and hedged item are denominated in different currencies that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk. [IAS 39, AG109]

The hedge must therefore relate to a specific identified and designated risk, and not merely to the entity's general business risks, and must ultimately also affect the entity's income statement. [IAS 39, AG110]

Effectiveness shall be assessed quarterly. The effectiveness tests shall be documented on a quarterly basis, as shall any necessary corrective measures.

3.3. Test failure and grace period

Where, at the end of a quarter, the credit institution finds that it no longer complies with the aforementioned effectiveness conditions (on both a prospective and retrospective basis), it has three months to remedy this situation (the so-called grace period), provided that the following conditions are met:

- the non-compliance may not be structural, i.e., the institution is able to demonstrate that it is temporary and that there is a reasonable and motivated expectation that it will be remedied before the end of the following quarter;
- an action plan has been drawn up, specifying any corrective measures to be taken as well as the time frame within which these will be implemented and should be able to take effect;
- the institution's solvency position meets the expectations of the supervisory authority, particularly with regard to the prudential coverage of its interest rate risk;
- the institution immediately notified the Bank and its accredited statutory auditor in writing of its non-compliance; this notification should at least include documentation showing that the above conditions are met.

If the above non-compliance continues beyond the end of the following quarter, the Bank expects the hedge to be adjusted, resulting in either the disqualification or the termination of the hedging instruments.

The accounting consequences of failing the effectiveness tests at the end of the grace period are discussed in the next chapter.

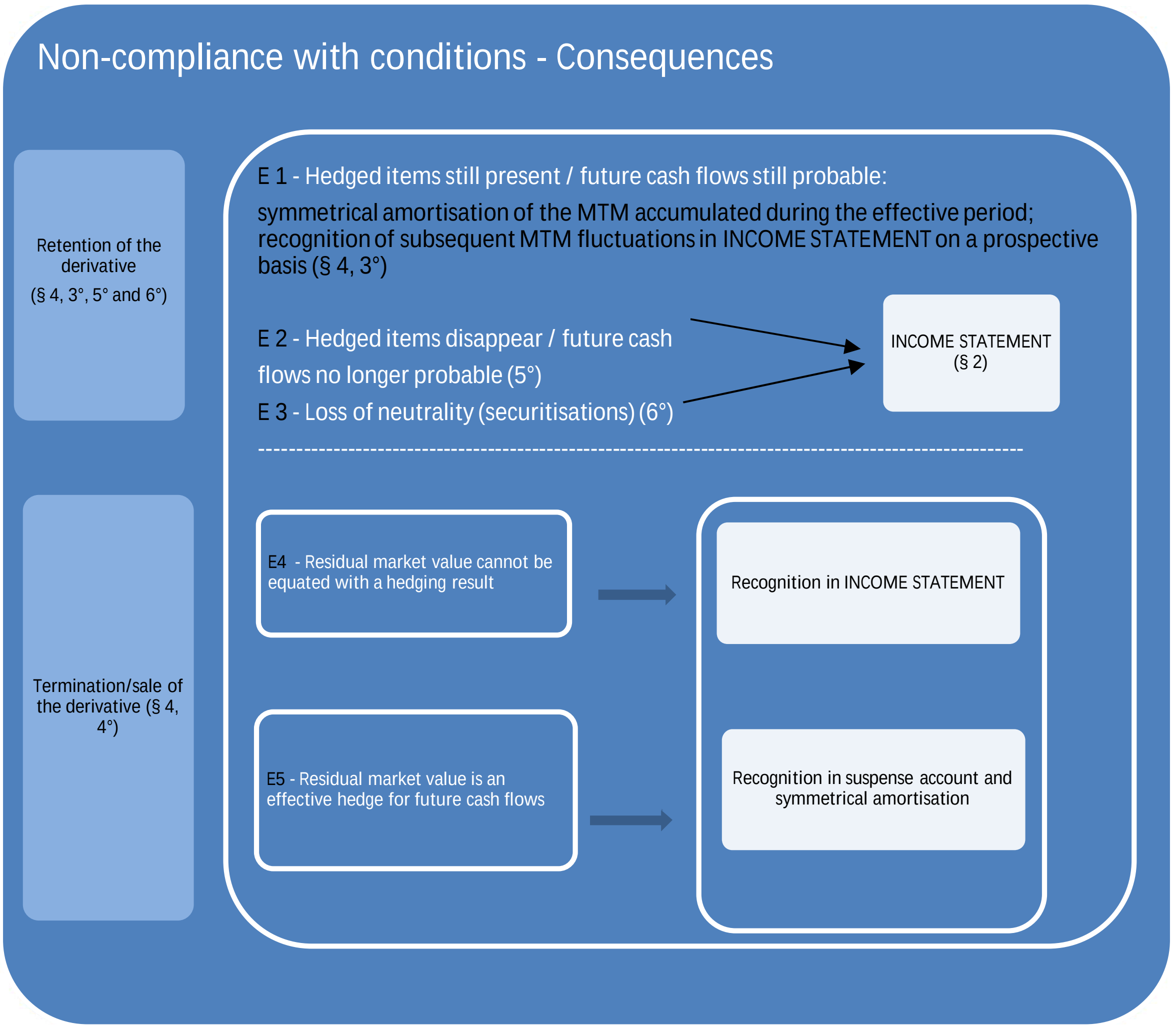
Chapter 3 - Consequences of non-compliance with the conditions for symmetrical accounting

Chapter 1 describes the general accounting approach that applies as long as the hedge remains in place and is effective. This chapter deals with the accounting treatment to be applied when the hedge does not meet – or no longer meets – the conditions of Article 36bis, § 1bis for obtaining (and maintaining) an authorisation from the Bank. The relevant forward interest rate transactions should be accounted for in accordance with Article 36bis, § 4, depending on the underlying cause of the non-compliance (hereinafter referred to as the "event"):

- disappearance of (some of) the hedged instruments, or the probability of the future cash flows can no longer be demonstrated
- maturity, termination or novation of the hedging instruments
- it can no longer be demonstrated that the derivatives concluded with the special purpose vehicle(s) are neutral in terms of interest rate risk at consolidated level
- other.

Failure of the effectiveness tests at the end of the grace period (see Chapter 2, Section 4) not resulting from one of the first three events above should be treated according to the consequences this failure has for the derivatives: termination or retention.

The diagram below summarises the events that may occur on the reporting closing date, as well as their accounting consequences.



E1 – The conditions are no longer met, but both hedged and hedging instruments remain on the balance sheet (or future cash flows remain probable)

Hedging instruments that are no longer designated as such in the books but which remain part of the institution's assets, are valued at their market value at that time and recognised at that value in the balance sheet under an asset or liability item, as appropriate; this value is counterbalanced in a suspense account under the item "regularisation accounts"; the balance of this suspense account is charged to the income statement symmetrically to the allocation of the income or expenses of the hedged item(s), over the shorter period of:

(i) the remaining term of the hedge as originally planned, and

(ii) the actual residual term of the hedged items; these instruments are then recognised in a prospective manner in income statement, according to the default accounting treatment (§ 2)

The allocation to the income statement is made through an interest income or assimilated expenses account.

E2 – All or some of the hedged items have disappeared or the hedged future cash flows are no longer probable

Hedging instruments that remain part of the institution's assets are disqualified and revert to their default accounting treatment: their residual market value is charged to the income statement in accordance with the provisions of § 2.

E3 – Neutrality (no degradation of interest rate risk) of transactions concluded with a consolidated special purpose vehicle can no longer be demonstrated

This event results in the automatic return to the default accounting treatment of charging the market value to the income statement (§ 2).

E4 – The hedging instruments are no longer part of the institution's assets and the residual market value cannot be equated with a hedging result

If the residual market value cannot be equated with a hedging result, it is recognised directly in the income statement (accounts 414/513).

A hedging result here refers to a result realised on instruments managed and documented as a hedge of the interest rate risk of an item or set of items that are still part of the institution's assets on the reporting closing date, and which effectively hedges the hedged results that have not yet had an impact on the income statement.

E5 – The hedging instruments are no longer part of the institution's assets and the residual market value can be equated with a hedging result on the hedged instruments retained in the balance sheet

The residual market value is charged to a suspense account under the item "regularisation accounts"; the balance of this account is charged to the income statement symmetrically to the allocation of the income or expenses of the hedged item(s), over the shorter period of:

(i) the remaining term of the hedge as originally planned, and

(ii) the actual residual term of the hedged items.

As specified in the Report to the King, only the remaining actual term of the hedged items should be taken into account. This means that institutions must set up monitoring procedures to verify whether the hedged assets actually remain on the balance sheet and whether the amortisation period provided for in the income statement is consistent with those assets.

Specific case: Interest rate benchmark reform

Through Commission Regulation (EU) 2020/34 of 15 January 2020 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard (IAS) 39, International Financial Reporting Standards (IFRS) 7 and 9, the European Commission has adopted the changes made by the IASB to the hedge accounting requirements so that institutions can continue to meet the requirements assuming that the existing interest rate benchmarks are not altered due to the interest rate benchmark reform.

The Bank considers that institutions that meet the conditions laid down by the IASB for the application of these temporary and limited “derogations” at the level of their consolidated financial statements and that are able to demonstrate this, may also apply them for the calculation of the effectiveness tests referred to in Chapter 2, Section 4, without having to obtain prior authorisation.

Chapter 4 - Transparency obligation - Information to be included in the notes to the financial statements (Scheme B)

As stipulated in § 5 of Article 36bis, institutions which have obtained one or more of the authorisations referred to in § 1bis of Article 36bis shall disclose this in the notes to the financial statements. The same disclosure is required of institutions that apply the alternative method provided for in § 3 of Article 36bis. This disclosure should be accompanied by a description of the instruments being hedged, the economic risks hedged and the hedging methods used, including the measurement of their effectiveness.

Furthermore, the following statements and information should be included in Annex XXIV:

A. A statement showing the following amounts, valued on the financial statements closing date, by type of hedge (micro/macro-hedge, fair value hedge or cash flow hedge) and by type of financial instrument:

   1. the notional reference amounts to be received and delivered;

   2. the fair market value at maturity of the hedging instruments, compared to their book value, specifying the portion relating to accrued pro-rata interest recognised under the item “regularisation accounts” and broken down by assets and liabilities;

B. For each type of hedge referred to in point A, the amount of hedge ineffectiveness not recognised in the income statement, specifying the calculation method used;

C. An identical statement on the assimilated transactions referred to in Article 36bis, § 1bis, second paragraph, including the names of the special purpose vehicles with which these transactions are concluded;

D. A description of the financial instruments that have been disqualified as hedging transactions, but which remain part of the institution’s assets, specifying the type of hedging, their current classification (banking or trading book) and the instruments originally hedged. This description shall be accompanied by a statement of the balance of the suspense account still to be amortised on the financial statements closing date, in accordance with § 4, 3° or 4°, broken down according to the remaining term;

E. The balance of mark-to-market valuations recognised on hedging instruments that are no longer part of the institution’s assets, but which constitutes a hedging result and is amortised symmetrically with the hedged income and expenses in accordance with the provisions of § 4, 4° of Article 36bis; this balance shall be broken down by maturity and specify the type of instruments hedged.

The following tables illustrate the information to be included in Annex XXIV.

1. Transactions qualifying for micro-hedging (Article 36bis, § 1)

1.1. Fair value hedge

	Notional amounts		Market value (A)	Balance sheet value (B)	Of which pro-rata interest		(A-B) (**)
Financial instruments	To be delivered	To be received			Assets	Liabilities	
IRS Forward swaps Swaptions Interest rate options Other							

Amount of ineffectiveness not recognised in the income statement at the financial statements closing date

Comments/description: method of calculating the ineffectiveness

1.2. Cash flow hedge

	Notional amounts		Market value (A)	Balance sheet value (B)	Of which pro-rata interest		(A-B) (**)
Financial instruments	To be delivered	To be received			Assets	Liabilities	
IRS Forward swaps Swaptions Interest rate options Other							

Amount of ineffectiveness not recognised in the income statement at the financial statements closing date

Comments/description: method of calculating the ineffectiveness

(**) Specify the difference, where appropriate including explanatory comments
A and B: Enter positive values for assets, negative values for liabilities

2. Transactions qualifying for macro-hedging (Article 36bis, § 1bis, first paragraph, 1°)

2.1. Fair value hedge

Financial instruments	Notional amounts		Market value (A)	Balance sheet value (B)	Of which pro-rata interest		(A-B) (**)
	To be delivered	To be received			Assets	Liabilities	
IRS Forward swaps Swaptions Interest rate options Other							

Amount of ineffectiveness not recognised in the I income statement at the financial statements closing date

<u>Comments/description</u>: method of calculating the ineffectiveness

2.2. Cash flow hedge

Financial instruments	Notional amounts		Market value (A)	Balance sheet value (B)	Of which pro-rata interest		(A-B) (**)
	To be delivered	To be received			Assets	Liabilities	
IRS Forward swaps Swaptions Interest rate options Other							

Amount of ineffectiveness not recognised in the L income statement at the financial statements closing date

<u>Comments/description</u>: method of calculating the ineffectiveness

(**) Specify the difference, where appropriate including explanatory comments

A and B: Enter positive values for assets, negative values for liabilities

3. Hedging results on disqualified transactions deferred in suspense accounts and yet to be amortised - Breakdown by remaining term

Perimeter: the transactions referred to in § 4, 3° and 4°

3.1. Transactions referred to in § 4, 3° - Instruments that remain part of the institution's assets

		<= 3 months	> 3 months <= 1 year	> 1 year <= 5 years	>= 5 years	Total
Suspense account assets	Micro					
	Macro					
Suspense account liabilities	Micro					
	Macro					

3.2. Transactions referred to in § 4, 4° - Instruments that are no longer part of the institution's assets

		<= 3 months	> 3 months <= 1 year	> 1 year <= 5 years	>= 5 years	Total
Suspense account assets	Micro					
	Macro					
Suspense account liabilities	Micro					
	Macro					

4. Transactions intended to manage interest rate risk without taking on additional risk, concluded with a special purpose vehicle consolidated by the credit institution (Article 36bis, § 1bis, second paragraph)

	Notional amounts		Market value (A)	Balance sheet value (B)	Of which pro-rata interest		(A-B) (**)
Financial instruments	To be delivered	To be received			Assets	Liabilities	
IRS Forward swaps Swaptions Interest rate options Other							

Comments/description: disclosure of the securitisation transactions / special purpose vehicles concerned

(**) Specify the difference, where appropriate including explanatory comments
A and B: Enter positive values for assets, negative values for liabilities

Chapter 5 - Conditions and formalities to be fulfilled to obtain and maintain an authorisation

A. Authorisation application file – Content

The authorisation application file must at least contain all information enabling the Bank to verify that the above-mentioned conditions are met or, where appropriate, will be met before the inception of the hedging transactions.

Particular attention should be paid to the following elements:

- the practical implementation of the governance and documentation principles laid down in Sections 2 and 3 of Chapter 2, including an action plan in the event that the limits are exceeded;
- a description of the institution's overall interest rate risk management strategy/strategies. This should at least include the methods of identifying the economic risks to be hedged and the economic hedging methods in place or planned, specifying for each specific hedged and designated risk the underlying hedged instruments and the precise nature of the hedging instruments used;
- a reasoned description of the procedures that will be implemented and the methods and criteria that will be used to calculate and monitor prospective and retrospective effectiveness tests;
- for securitisation transactions, effectiveness tests should be replaced by evidence that the transaction overall does not lead to an increase in interest rate risk, based on a comparison of the interest rate risk before and after the conclusion of derivatives between the credit institution and the SPV;
- an indication of the portfolios/books where the relevant derivatives will be booked and the corresponding IAS/IFRS strategy if applicable at the consolidated reporting level;
- the accounting treatment of the instruments concerned, including in case of test failure and reclassification (see Chapter 3);
- the accredited statutory auditor's report, prepared in accordance with Chapter 7 below.

B. Suspension or withdrawal of the authorisation

The authorisation given has no expiry date but as already mentioned, all conditions specified must be complied with at all times. As stipulated in Article 36bis, § 1, when the Bank finds that these conditions are not complied with, it may require the institution to adopt the necessary corrective measures within a period of time determined by it. If such non-compliance is not remedied, the Bank may suspend or withdraw the authorisation.

The Bank therefore stresses the importance of the documentation proving that the conditions initially imposed have been met, not only at the time of submission of the application file but also subsequently, so as to reflect the economic management of interest rate risk actually conducted within the institution on the reporting closing date.

Credit institutions that have obtained an authorisation should therefore immediately inform the Bank and their accredited statutory auditor of any material changes in their management of interest rate risk compared to what was documented in the initial application file, as well as of any new securitisation transactions not fully covered by an existing authorisation (see Chapter 2, Section 1, point 1.3).

Chapter 6 - Entry into force and transitional period

The Royal Decree of 29/08/2021, which amends Article 36bis, entered into force on the day of its publication in the Belgian Official Gazette, i.e., 7 September 2021.

It follows that the accounting principles laid down by that Decree came into force immediately and are applicable to the accounting period in progress at that time.

The amendments regarding the annexes to the annual accounts will be applicable at the latest as from the first accounting period following the entry into force of this Decree. Early application is allowed.

The Decree provides that any individual derogations from Article 36bis granted by the Bank (or previously by the CBF/CBFA) pursuant to Article 38 of the Decree remain valid until 31 December 2022[10]. This means that institutions which have obtained such a derogation:

(a) may immediately apply the accounting rules in §§ 3 and 4 of Article 36bis with regard to the hedging transactions previously covered by the derogation, and

(b) must, if they wish to continue to apply § 4 after 31 December 2022, apply for authorisation from the Bank in accordance with § 1bis of Article 36bis and under the terms described below.

Institutions in this situation must submit an application to the Bank by 31 March 2022 at the latest. The content of the application file will depend on the date on which the existing derogation was obtained:

A. Derogation obtained before 01/01/2016

In this case, the application file must contain the elements listed in point A of Chapter 5, supplemented by:

- evidence that the hedge has been continuously assessed based on effectiveness tests performed during the two accounting quarters prior to the application being submitted;
- Annex XXIV to Scheme B as drawn up based on the situation at the end of the last six months prior to the application being submitted.

B. Derogation obtained after 01/01/2016

The institutions concerned must provide the Bank, by 31 March 2022 at the latest, with an updated version of the file submitted to obtain the derogation, considering the new conditions laid down in the amended Accounting Decree.

Note: in order to facilitate the transition, ongoing transactions that were previously covered by a derogation but which do not meet the conditions of the new Royal Decree, may continue to be recognised in accordance with Article 36bis, § 4 subject to the Bank's prior authorisation. These transactions must be explicitly mentioned in the application for authorisation, including their unwinding term and the reason for maintaining them.

[10] This date corresponds to the end of the grandfathering period set out in the Uniform Letter of 18 November 2014 (as amended by Uniform Letter NBB_2020_32 of 28 July 2020, which extended the duration of the former until 31 December 2022).

Chapter 7 - Role of the accredited statutory auditors

Regarding applications for authorisation (Article 36bis, § 1bis)

The authorisation application file referred to in Article 36bis, § 1bis must be accompanied by a special report from the accredited statutory auditor specifying:

- that the information provided by the institution in its application is accurate and complete;
- whether they are aware of any facts or information that might call the institution's statements into question;
- for institutions that obtained a derogation before 1 January 2016, that effectiveness tests were indeed conducted during the transitional period and that these tests did not reveal any structural problems that would call into question the effectiveness of the hedge in place and which would have resulted in repeated non-compliance with the limits of the new policy.

Additional guidance for accredited statutory auditors' ongoing tasks

In accordance with Article 225, first paragraph, 2° of the Banking Law, accredited statutory auditors must report twice a year to the supervisory authority on the results of their full-scope audit or limited review of the periodic statements submitted by credit institutions. As part of this review, they should in particular verify the compliance of these periodic statements with the applicable accounting and valuation rules. For the periodic statements drawn up at the statutory level, these rules are derived from the Royal Decree of 23 September 1992 (except for a derogation allowing the use of IFRS for prudential reporting).

For the half-yearly review of the periodic statements, the accredited statutory auditor's supervisory task systematically includes checking compliance with the conditions and rules set out in the new § 1bis of Article 36bis. In particular, accredited statutory auditors are expected to check the accuracy of the institution's motivations and documentation in case of failure of the effectiveness tests. This should include an assessment of the nature of the non-compliance observed (whether it is one-off or structural, whether or not it compromises the close correlation required), the credibility of the measures planned or taken by the institution and the justifications received.

The annual circumstantial report referred to in point C.I.A.5 of Circular NBB_2017_20 on the duty of cooperation of accredited statutory auditors shall contain an explanation of any non-compliance found as well as any material changes made by the institution to the procedures implemented and/or the methodologies and criteria used by the institution in the context of the application of Article 36bis. Depending on the circumstances, accredited statutory auditors shall explain the procedures carried out in this respect and clarify any remarks they may have regarding the justifications obtained (even if these do not call into question their opinion on the periodic statements).

As part of their early warning function, accredited statutory auditors shall immediately inform the Bank of any material non-compliance with these conditions. In this regard, particular attention shall be paid to compliance with the conditions for hedge effectiveness, and especially whether it has been found that the institution continues to apply hedge accounting even though it failed the tests at the end of the grace period.

A copy of this Circular is being forwarded to your institution's accredited statutory auditor(s).

Yours faithfully,

Pierre Wunsch
Governor