C. Regulatory and legal framework

1. Banks

During the year under review, the changes in banking legislation largely took place in the European Union, where work continued on the expansion and strengthening of the European Banking Union and the Capital Markets Union. Preparations for transposing the final points of the Basel III agreement into European legislation were also high on the agenda.

In line with this European work, attention focused at Belgian level on preparations for the transposition of all the changes to the European banking legislation (Risk Reduction Package) published in 2019 and the new European harmonised prudential framework for investment firms. There were also initiatives concerning the development of a more proportionate approach in banking supervision and in the legislation applicable to credit institutions. Finally, the Bank published a new Circular on outsourcing and paid close attention to the obligations concerning supervision of data quality under EMIR.

1.1 Further strengthening of the Banking Union and Capital Markets Union

Completion of the Banking Union and further work on the Capital Markets Union in the European Union continued to have a prominent place on the agenda of the regulatory bodies in 2019.

In regard to completion of the Banking Union, an extensive set of changes to the European banking legislation, commonly known as the Risk Reduction Package, was approved in June. These texts, which have already been explained in detail in previous annual reports, comprise the directly applicable Regulation on capital requirements (Capital Requirements Regulation – CRR 2), and two Directives which the Member States need to transpose into national law, namely the Capital Requirements Directive (CRD V) and the Bank Recovery and Resolution Directive (BRRD 2). The changes are intended to reduce the banking risks (risk reduction), a precondition for the conclusion of other European agreements on burden-sharing between Member States in cases where these risks actually materialise (risk-sharing).

One of the things necessary to facilitate this burden-sharing is the establishment of the third pillar of the Banking Union, namely the European Deposit Insurance Scheme (EDIS). In this connection, the Eurogroup examined the operation of the Banking Union and the various ways in which it could be completed. In order to obtain the fullest possible picture of how a completed Banking Union should look, the discussions were not confined to EDIS. They also concerned refinement of the supervision, resolution and liquidation framework (first and second pillars of the Banking Union), analysis of the barriers to cross-border banking, and the adoption of a more risk-based capital approach for credit institutions' exposures to governments. Each of these areas requires further technical work to define a roadmap for the political negotiations on EDIS and the completion of the Banking Union. In view of the presence in Belgium of major subsidiaries of European banks, the Bank pays special attention to the maintenance of local capital and liquidity buffers and to proposals for reducing those buffers in exchange for supplementary protection measures such as formalisation of the parent bank's support in EU legislation, or the harmonisation of certain parts of banking law concerning insolvency. In the event of resolution or liquidation, it is important that the creditors of local subsidiaries should have sufficient protection, both now and in the future.

Apart from the completion of the Banking Union, further steps were taken in 2019 for developing the Capital Markets Union, which is intended to facilitate deeper and better-integrated capital markets in the European Union. In that connection, the European Commission focused mainly on breaking down a range of market barriers and on harmonisation of procedures, in order to improve access to the financial markets. An efficient capital market also strengthens the financial system's resilience to shocks, as the risks are spread more widely among private players in different countries. The Capital Markets Union therefore largely complements the Banking Union.

During the year under review, the European Commission, the Council and the Parliament reached agreements on many questions[1], such as the reform of the prudential framework for investment firms (see below) and the European framework applicable to covered bonds, two subjects directly relevant for the Bank.

The full and consistent implementation of the Basel III standards in the EU is necessary to restore confidence in the European banking sector

The new framework for covered bonds comprises a Directive and a Regulation amending the CRR in regard to exposures to covered bonds (and indirectly to the underlying assets). The Directive's primary aim is to introduce minimum standards and promote the development of markets in covered bonds in the Member States whose markets are less developed or which lack a legal framework. The minimum standards concern structural characteristics (e.g. the conditions on the eligibility of assets as collateral for covered bonds and the coverage requirements) and supervision by the authorities. This Directive must be transposed into Belgian law by June 2021. During the transposition work, care must be taken to ensure that the high-quality standards of the current Belgian framework for covered bonds are maintained.

1.2 Transposition of Basel III in Europe

The conclusion in January 2019 by the Basel Committee on Banking Supervision of a final agreement on the further alignment of certain aspects of the capital requirements for market risk means that all elements of the Basel III framework are now complete. The final components of this framework, which have already been explained in detail in previous annual reports, aim to improve the credibility of the banks' risk-weighted capital ratios and, in particular, to reduce unjustified variability in the capital ratio calculated using internal models, namely by making significant changes to the method of calculating the ratio's denominator, i.e. the risk-weighted assets. The concluding element of the finalised Basel III package is the output floor. This requirement stipulates that the total risk-weighted assets calculated using internal models

1 See https://ec.europa.eu/commission/news/capital-markets-union-2019-mar-15_en.

Table 23

Change in the Tier 1 MRC[1]

(end of June 2018, in %)

	Number of banks	Total change in the Tier 1 MRC (in %)	Change in the Tier 1 MRC due to the output floor (in %)
All banks[2]	189	24.4	9.1
Large	104	25	9.5
of which: G-SIB[3]	8	28.6	7.6
Medium-sized	61	11.3	0.9
Small	24	5.5	0.0

Source: EBA.

1 In % of the total base MRC according to the target level, i.e. the combination of risk-based capital requirements and the leverage ratio based on the capital requirements, plus the capital conservation buffer and the G-SIB buffer, if appropriate.

2 Sample of 189 banks from 19 EU Member States; see the EBA impact study for the definition of large, medium-sized and small banks.

3 G-SIBs: Global Systemically Important Banks, as determined by the Financial Stability Board.

must not be less than 72.5% of the risk-weighted assets calculated according to the standard approach. The agreement states that these standards are to be introduced by 1 January 2022, with the output floor initially set at 50% and gradually rising thereafter to reach 72.5% in 2027.

Implementation of the revised Basel III framework in the EU will entail changes to the existing regulations, and in particular the CRR 2. On 5 August 2019, in response to the Call for Advice published by the European Commission on this subject, the European Banking Authority (EBA), in cooperation with the SSM and the national supervisory authorities, issued a detailed study on the impact of the Basel III framework in Europe[1]. Both within the European Union and in Belgium, the impact is significant, heterogeneous and more limited for medium-sized and small banks. In general, the study shows that full implementation of Basel III according to conservative (and not entirely realistic) assumptions) will lead, on average, to a 24.4% increase in the minimum required capital (MRC). The output floor represents a third of the average increase in the capital requirements.

At EU level, it can be said that the relatively high impact presents a distorted picture, given the share of that impact represented by a few large banks operating worldwide. Thus, the impact on medium-sized banks is only 11.3%, and for small banks it is just 5.5%. It should also be noted that this is the most conservative scenario which takes no account of the specific characteristics of the EU, even where the EU already deviates from the current Basel standards. Any future measures or behaviour that the banks might adopt to limit the impact in practice are also disregarded.

In Belgium, too, the impact on large banks is greater than on small ones, although it is more limited than elsewhere in the EU. In any case, that impact is still manageable, since the Belgian banks' current capital levels seem sufficient, even in the most cautious simulations, and there has therefore never been a capital shortfall.

The EBA – supported by the Bank – advocates full implementation of the Basel III standards with no deviations specific to the EU. The final Basel III standards reduce the risks and are vital to restore confidence in the calculation of the risk-weighted assets (and the risk-weighted capital ratios) held by large European banks. Together with the impact study, the EBA thus submitted a number of recommendations to the European Commission, whose proposals for the transposition of the final elements of the Basel III framework in the EU are expected in June 2020. That transposition will therefore also be a means of restoring confidence in the European banking sector.

1 See https://eba.europa.eu/eba-advises-the-european-commission-on-the-implementation-of-the-final-basel-iii-framework.

1.3 Transposition of the Risk Reduction Package and new prudential framework for investment firms

In June, the final legal texts of the Risk Reduction Package (CRR 2/CRD V/BRRD 2) were published (see above). This set of measures introduces a number of important elements of the supplementary regulatory standards in the Basel III package, such as the financial leverage ratio, the net stable funding ratio (NSFR), and new methods of calculating the capital requirements for counterparty risk and market risk (see also chapter D for an explanation of the changes concerning resolution). The new legislative framework for investment firms was also published; it likewise comprises a directly applicable Regulation (Investment Firm Regulation – IFR) and a Directive to be transposed (Investment Firm Directive – IFD). The revision of the prudential requirements for investment firms is also part of the development of the Capital Markets Union and is intended to make the capital, liquidity and other requirements concerning risk management for investment firms more appropriate, proportionate and risk-sensitive.

Transposition of the said Directives will take place mainly via adjustments to the Belgian Banking Law and will be a priority for the Bank in the coming year. In the case of CRDV, it will be necessary to provide for a new licensing regime for financial holding companies, the adoption of changes in the second pillar capital requirements for banks, and specific provisions concerning the interest rate risk inherent in activities other than the trading book, plus adjustments to the capital buffers of systemically important banks.

Under the IFD, only large, systemically important investment firms are subject to the banking regulations, while a new tailor-made regime has been designed for smaller investment firms.

1.4 Proportionality in banking supervision and banking legislation

The proportionality principle enshrined in the European and Belgian banking legislation means that the prudential requirements imposed on institutions are proportionate to the size, complexity and nature of their activities and the associated risk. That does not imply that there is a special regime for smaller, less complex institutions, but rather that they may be subject to simpler (but no less stringent) rules, more limited reporting obligations and less extensive supervision.

The proportionality principle is meant to gear the prudential requirements to the size, complexity and nature of the banks' activities and the associated risk

The new European Regulation, CRR2, pays particular attention to this proportionality principle. On the one hand, simpler regulatory standards were devised to complement the current regulations, e.g. for the liquidity or capital requirements relating to market risk, for small, non-complex institutions defined in the Regulation. Also, there were two initiatives to reduce the administrative burden and costs incurred by the sector on account of the obligations on reporting to the supervisory authorities. Thus, the EBA has to report on how the administrative burden on these institutions can be made more proportionate, and it must make recommendations on how the average cost of complying with the rules can be reduced for small institutions. In addition, the EBA in cooperation with all the competent authorities is to produce a feasibility report on the development of a consistent, integrated system of collecting statistical data, resolution data and prudential data from all banks. That should ultimately lead to a more efficient reporting framework with proportionately lower costs for the financial sector.

The Bank, too, pays close attention to this issue. During the year under review, it took note of a number of concerns prevalent in the sector regarding proportionality in the legislation and supervision, and – taking account of the European context – it took a range of measures to respond to these concerns expressed by the sector.

1.5 New rules on outsourcing

Given that a growing number of banks outsource certain critical or important functions or activities, and in view of the ensuing risk of concentration at sectoral level, it was necessary to adapt the regulatory framework relating to outsourcing. That adjustment is particularly relevant on account of the growing importance of FinTech and digitalisation (see chapter E). In that context, the revised EBA guidelines on outsourcing were published on 25 February 2019.

The new guidelines aim at European harmonisation of the prudential framework relating to outsourcing. In particular, they serve as a guide for defining the concepts of outsourcing and critical and important functions. In addition, the guidelines require institutions to maintain an outsourcing register. They also specify the information that must be recorded in that register for every outsourcing arrangement. In that regard, access and audit rights relating to service providers are likewise a key point for attention.

The Circular dated 19 July 2019 implemented the full text of the EBA guidelines unchanged in Belgian legislation[1]. The guidelines came into force on 30 September 2019. All outsourcing contracts concluded, renewed or amended after that date must conform to the guidelines. Existing, current outsourcing contracts must be adapted by 31 December 2021 if they do not conform to the new guidelines.

1.6 Monitoring of EMIR data quality

The Bank has the power to check on compliance with Regulation No. 648/2012[2] (European Market Infrastructure Regulation: EMIR) by institutions subject to its supervision. The three main requirements defined in EMIR are the obligation to centralise the clearing of certain transactions in derivatives, the obligation to apply risk mitigation techniques to non-centralised derivatives, and the obligation to supply detailed information on transactions in derivatives. In order to fulfil this last part of its mandate, the Bank launched a project for collecting and analysing the EMIR data of institutions subject to its supervision.

This project comprises three pillars. The first pillar concerns creation of an IT infrastructure for collecting, storing and analysing the vast quantities of data reported each day. For that purpose, an IT platform was set up and became operational in June. The second pillar concerns the checking process, to be developed and applied during 2020. The aim of this process is to check the quality of the data reported by institutions subject to the Bank's supervision. An important characteristic of the process of checking the data quality will be the use of machine learning. The project's final pillar concerns the use of data on derivatives for micro- and macroprudential risk analysis, which will help to monitor the impact on financial institutions of significant developments on the derivatives markets.

1.7 Integration of aspects of the fight against money-laundering and terrorist financing in prudential banking supervision

On 4 December 2018, following a number of recent money-laundering scandals involving several European banks, the Council of the European Union decided to set up an action plan to deal more effectively with money-laundering practices and terrorist financing[3].

Under Directive 2018/843[4] (5th Anti-Money-Laundering Directive) the regulatory framework governing the interaction between the prudential supervisory authorities and the supervisory authorities in charge of combating money-laundering and terrorist financing (AML/CFT) has already been clarified and extended to a considerable degree, notably by the introduction of the obligation on the ECB and the AML/CFT supervisory authorities to conclude an MoU for the mutual exchange of confidential prudential information on institutions subject to their supervision. In fulfilment of that obligation, the Bank as the AML/CFT supervisory authority concluded an MoU with the ECB.

The Council's action plan is based on that approach and puts forward a number of specific objectives in that respect. For instance, the Council states that a framework should be devised so that AML/CFT concerns are better integrated into all aspects of prudential supervision, and that there is a need to pursue the operational implementation of the channels created by Directive 2018/843 for the international exchange of information between prudential and AML/CFT supervisory authorities.

During the past year, the various European players have taken initiatives to put this plan into practice.

1 Circular NBB_2019_19 on the European Banking Authority (EBA) Guidelines on outsourcing arrangements of 25 February 2019 (EBA/GL/2019/02)
2 Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.
3 See also section C.3.1. for measures taken by the Bank in this connection.
4 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

For instance, the European Supervisory Authorities (ESAs, i.e. the EBA, EIOPA and ESMA[1]) drew up guidelines for the creation of AML/CFT colleges – modelled on the prudential colleges – in order to ensure a more structured exchange of information for cross-border financial groups. Here it should be noted that the prudential supervisors may also be invited to attend these colleges as observers.

As the banking supervisor, the ECB also adopted a range of measures on the subject. Thus, it established a horizontal AML/CFT coordination function internally, which operates as the central contract point and centre of expertise on AML/CFT aspects. A permanent network was also set up in which the competent national supervisory authorities are represented and which will conduct more structured monitoring of the work on policies relating to integration of AML/CFT aspects in prudential supervision. During 2019, this network has already drawn up a first set of guidelines in the following four main areas:

I. the prudential licensing phase: in this area, the guidelines on the grant and withdrawal of licences and the assessment of the suitability of directors and shareholders were adapted;

II. the SREP exercise;

III. on-site supervision; and

IV. cooperation: in this area, arrangements were defined for the management of the operational and practical aspects relating to the exchange of confidential information between prudential and AML/CFT supervisory authorities.

Finally, it is noteworthy that the Basel Committee on Banking Supervision has embarked on a revision of its Guidelines on the sound management of risks related to money-laundering and financing of terrorism, in order to clarify the expectations concerning the interaction between prudential and AML/CFT supervisory authorities.

In Belgium, the fact that – for credit institutions – the Bank is both the competent authority for AML/CFT supervision under the anti-money-laundering Law

1 European Securities and Markets Authority (ESMA).
2 Law of 18 September 2017 on the prevention of money-laundering and terrorist financing and limits on the use of cash.

of 18 September 2017[2] and the competent national authority for prudential supervision (taking part in the operation of the SSM), facilitates the exchange of information between supervisors and the practical implementation of these new policies and guidelines.

2. Insurance undertakings

The legal framework for insurance undertakings was revised during the year under review. At international level, the work included preparations for the revision of Solvency II, the approval of a new international standard for capital requirements, and development of a specific framework for systemic risks. At national level, initiatives concerned in particular the low interest rate environment and clarification of various points in the legislation.

No revolutionary changes but the regulatory framework is evolving

2.1 International work

Revision of the Solvency II Directive

Solvency II, the prudential supervision framework for European insurance and reinsurance undertakings, has applied since 1 January 2016. It covers a broad range of quantitative and qualitative requirements concerning the taking-up and the pursuit of the business of insurance and reinsurance. The Solvency II framework also provides for a series of transitional measures to ensure a gradual transition from Solvency I to the new regime, and revision mechanisms to permit any necessary regulatory adjustments on the basis of experience gained since its entry into force.

The revision of the Solvency II Directive in 2020 forms part of that. It is a broad and extensive process which may be regarded as the principal revision opportunity offered by the Directive. One of the cornerstones of this work is the opinion of EIOPA on the revision of long-term guarantee measures and measures relating to the equity risk; that opinion is to be presented to the European Commission by the end of June 2020. At the beginning of 2019, the European Commission also asked EIOPA for a technical opinion on the possible revision of a number of other elements and an analysis of the impact of the alternative options and approaches.

A significant step towards global capital standards for insurers

Many points in Solvency II are undergoing revision. For instance, the valuation of the long-term guarantees or the appropriate capital requirements for long-term investments are being reviewed. In these analyses, the experience that the supervisory authorities have gained since the Directive entered into force plays a key role, e.g. in relation to the further refinement of the supervision of insurance activities pursued under freedom to provide services, group supervision and prudential reporting. Additional instruments are also being proposed to provide an appropriate response to the macroprudential challenges or to regulate firms' recovery and resolution plans. Although more than twenty elements altogether are being analysed in depth, the revision is expected to lead to evolution of the regulatory framework, rather than revolutionary changes. The aim of the revision is in fact to refine the current regime rather than to make major structural alterations.

During 2019, in cooperation with the national supervisory authorities, EIOPA made several requests to a number of insurers, asking for information and impact analyses. These exercises provided a better idea of the impact of each of the options being considered. A detailed analysis of all the proposals was presented for consultation to the stakeholders and the broader public. EIOPA will finalise its opinion for the European Commission on the basis of the response to that consultation.

International Capital Standard

In connection with the global convergence of prudential standards for the insurance sector and the promotion of financial stability, the International Association of Insurance Supervisors (IAIS) is working on the design of a common prudential framework for internationally active insurance groups. That framework includes development of an international standard for capital requirements (International Capital Standard – ICS), comprising several elements: rules on the consolidation scope, the valuation of assets and liabilities, the capital components and the capital requirements.

During the period under review, following a final field test the international capital standard ICS 2.0 was

approved by the IAIS annual meeting. After a five-year observation period, the standard will apply to all the internationally active insurance groups concerned.

Holistic Framework for systemic risks in the insurance sector

The IAIS has developed a new framework for assessing and mitigating systemic risks in the insurance sector (Holistic Framework). This framework will enter into force at the beginning of 2020 and will support global financial stability. The Holistic Framework recognises that systemic risks can arise both from activities and exposures specific to the insurance sector as a whole, and from a concentration of those activities and exposures in individual insurers.

The framework strengthens the existing regulatory regime and extends it with a series of macroprudential provisions designed to improve the sector's resilience and prevent certain risks from becoming systemic. The new regulatory framework makes provision for additional intervention measures permitting an appropriate response if any potential systemic risks are identified.

The Holistic Framework also provides for the annual monitoring and assessment of trends and developments in the insurance sector, and the identification of potential systemic risks at the level of both individual insurers and the sector as a whole. This is an annual exercise conducted on a global scale by the IAIS, stimulating collective discussion within the IAIS on potential systemic risks in the insurance sector and possible ways of responding to them. This process should enable the IAIS to report to the FSB on potential systemic risks in the insurance sector.

2.2 National activities

Initiatives in the context of the low interest rate environment

In recent years, the low interest rate risk has materialised, creating a very challenging macroeconomic environment for insurers. The steep and rapid fall in the EIOPA risk-free yield curve, bringing much lower and more negative yields on much longer maturities since the beginning of 2019, points to a further increase in the interest rate risk in the insurance sector.

In addition, analyses relating to the revision of Solvency II showed that the capital requirement for interest rate risk may be seriously underestimated in the standard formula: the current rules specify that the yield curve used in calculating the capital requirement must not drop below 0 %; the amount by which the capital requirement for interest rate risk is underestimated therefore increases the larger the part of the yield curve located below 0 %. Also, the recent movements in the yield curve far exceed the figures to be used in calculating the capital requirement.

The very low interest rates and the possible serious underestimate of the capital requirement for interest rate risk in the standard formula prompted more stringent conditions for granting exemption from the obligation to allocate funds to the supplementary provision for the year 2019. Insurers seeking exemption must achieve – as at 30 September 2019 – coverage of at least 125 % of the solvency capital requirement specified in the Law on supervision[1], without recourse to the transitional measures referred to in Articles 668 and 669 of that Law (see box 2).

The Bank keeps a close eye on the trend in the interest rate risk, e.g. by means of annual horizontal analyses and stress tests. In 2020, the Bank is also considering revising and refining the exemption policy described in Circular NBB_2016_39[2] in order to take account of changing market conditions and the underestimate of the capital requirement for interest rate risk in the standard formula.

Amendment of the Law of 13 March 2016

The Law of 2 May 2019 containing miscellaneous provisions on the economy made some amendments to the insurance supervision Law. Apart from some minor adjustments, such as the clarification of procedural aspects concerning portfolio transfers, updating of the references and a number of terminological clarifications, three subjects can be highlighted.

The most important concerns access to the Belgian market for reinsurers established in a country which is not a member of the European Economic Area and whose supervisory regime is not deemed equivalent to that under the Solvency II Directive. In future, these reinsurers like those located in equivalent third

1 Law of 13 March 2016 on the legal status and supervision of insurance and reinsurance undertakings.
2 Circular NBB_2016_39 of 5 October 2016 on exemption from the obligation to allocate funds to the supplementary provisions.

countries will have access to the Belgian market without needing to complete any formalities and without requiring any authorisation. Nonetheless, the Bank may take various risk reduction measures in relation to firms using these reinsurers (ceding undertakings), e.g. by requiring the reinsurer to deposit a sum in the accounts of the ceding undertaking or by disregarding the risk mitigation effects of reinsurance contracts.

The other two changes concern measures that the Bank may take concerning an undertaking in difficulties. The first is the possibility of suspending or staggering the redemption of life insurance contracts. The second enables the Bank, when ordering an undertaking to transfer its portfolio, to require the simultaneous transfer of the corresponding reinsurance contracts.

Clarification of the regulations

Circular on the LAC DT

The regulatory provisions on the adjustment for the loss-absorbing capacity of deferred taxes (LAC DT) were amended by European Commission Delegated Regulation (EU) 2019/981[1] . The content of the report intended for publication and the report intended for the supervisor concerning the LAC DT was also specified in more detail.

Against that backdrop, the Bank considered it necessary to update its recommendations for calculating the LAC DT on a number of points, both to explain the practical implications of the new principles introduced in the legislation and to end the upper limit on the LAC DT, which was no longer compatible with the approach of the implementing Regulation. The Bank therefore produced a new Circular on the LAC DT in which it also spelt out its expectations regarding reporting.

Circular on the look-through approach

The scope of the look-through approach was also changed by Regulation 2019/981. In future, this approach also applies to investments in related undertakings that have as their main purpose the holding or management of assets on behalf of the investing undertaking, such as firms investing in property, a traditional investment for insurers in Belgium.

At the same time as this change in the legislation, the Bank published a Circular[2] on the guidelines for the look-through approach. In particular, Guideline 9 in that Circular describes the methodology for calculating the solvency capital requirement in the case of a debt-financed investment vehicle.

Circular on the ORSA

The Own Risk and Solvency Assessment (ORSA) forms the basis for risk management by insurers under Solvency II. The ORSA Circular provides a framework which they can use as the basis for devising their risk management. The Bank found that the stress tests which undertakings carry out do not always adequately reflect the possible crisis scenarios. Moreover, the free format of the ORSA report hampers horizontal comparison. The Circular[3] was therefore amended to strengthen the stress test framework for undertakings and to facilitate horizontal comparisons between undertakings.

1 Commission Delegated Regulation (EU) 2019/981 of 8 March 2019 amending Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

2 Circular NBB_2019_16 of 9 July 2019 on the guidelines concerning the look-through approach in the calculation of the solvency capital requirement in the standard formula.

3 Circular NBB_2019_30 of 3 December 2019 on the own risk and solvency assessment (ORSA).

3. Cross-sectoral aspects

As a prudential supervisory authority, the Bank has jurisdiction over a range of spheres which cover multiple sectors and are therefore not discussed in the sections of this Annual Report on banking, insurance and financial market infrastructures. Aspects covered in this section include the Bank's initiatives on the prevention of money-laundering and terrorist financing, governance, the approval of auditors for the payment and electronic money institutions sector, and the preparations for Brexit.

3.1 Prevention of money-laundering and terrorist financing

Prevention policy

Communication of the Bank's expectations to the financial institutions

Since the entry into force of the new Belgian legal and regulatory framework for the prevention of money-laundering and terrorist financing (AML/CFT)[1], the Bank has used a specific section on its website[2] to inform financial institutions subject to its supervisory powers of all the explanations and recommendations that it deems necessary to promote the full and effective implementation of these legal and regulatory obligations.

On 6 November 2019, the Bank held a seminar to raise financial institutions' awareness of AML/CFT issues and the supervisory authority's expectations

Having covered all the subjects that it felt necessary for that section by December 2018, the Bank made use of the flexibility of this communication tool in 2019 to refine and adjust its comments and recommendations by two website updates. The changes made at the time of each update are announced on a special page on the website, where all successive published versions of the comments and recommendations can be consulted.

In addition, in view of the significant number of branches and subsidiaries of foreign financial institutions located in Belgium, the Bank posted an unofficial English translation of the whole AML/CFT item on its website in 2019.

As a complement to this permanent communication channel which the Bank uses, and in view of the vital importance which it attaches to this subject, plus the recent discovery of serious defects in AML/CFT mechanisms in the European banking sector, the Bank held an information meeting on 6 November 2019 for the senior management and anti-money-laundering compliance officers (AMLCOs) of financial institutions, to heighten their awareness of the absolute necessity of implementing effective risk-based mechanisms to prevent ML/TF. 288 people attended this meeting. The Bank was thus able to explain its expectations on numerous topical subjects relating to AML/CFT, such as the temptation of de-risking, the use of new technologies in connection with AML/CFT, the risks associated with the repatriation of funds, and questions relating to the group approach on this subject. It informed the participants of the main aspects of the development of its internal organisation, its tools and its supervision policy on that subject, and told them about the first lessons learnt from its examination of the general ML/TF risk assessments conducted by financial institutions in accordance with the legal and regulatory requirements. An EBA representative also informed the participants of the recent developments in the European authorities' efforts to take account of AML/CFT. Finally, a representative of the Belgian Financial Intelligence Processing Unit (CTIF-CFI) also spoke about the Unit's expectations concerning the reporting of suspicious transactions by financial institutions.

Transposition of the 5th European AML/CFT Directive[3]

The Member States are required to transpose the 5th European AML/CFT Directive by no later than 10 January 2020. In 2019, in association with all the public authorities concerned, the Bank therefore took part in preparing a provisional draft Law for the purpose of that transposition. That provisional draft

1 Law of 18 September 2017 on the prevention of money-laundering and terrorist financing and limits on the use of cash, and NBB Regulation of 21 November 2017 on the prevention of money-laundering and terrorist financing.

2 See https://www.nbb.be/fr/supervision-financiere/prevention-du-blanchiment-de-capitaux-et-du-financement-du-terrorisme.

3 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.

also proposes various technical improvements to the Belgian legal framework in order to eliminate certain defects identified in practice when the Law was implemented, or forming the subject of comments by the Financial Action Task Force (FATF) in June 2018 at the time of its review of the technical conformity of the Belgian legislation with its 40 Recommendations, and by the European Commission in January 2019 following examination of the correct transposition of the 4th European Directive[1] into the national law of the EU Member States. In this connection, the Bank paid particularly close attention to formulating proposals for improvements to the legal framework for the exchange of information and cooperation with other competent authorities, and for strengthening the vigilance obligations imposed on the entities in question in accordance with the 5th European Directive.

The Bank has endeavoured to strengthen the cooperation and exchange of information between supervisory authorities responsible for AML/CFT and the prudential regulators, and with the CTIF-CFI

Cooperation and exchange of information between supervisory authorities

On 11 January 2019, the Bank signed with the European Central Bank, acting within the framework of the SSM, the agreement required by the EU anti-money-laundering Directive, setting out the practical arrangements for the exchange of information between the ECB and all national supervisory authorities responsible for AML/CFT.

In addition, the serious shortcomings identified in the European banking sector in recent years highlighted the need to step up the cooperation and exchange of information between the competent authorities. To that end, the Bank played an active part in the work of the ECB, the EBA and the Basel Committee on Banking Supervision aimed at taking greater account of the ML/TF risks in the context of prudential supervision and promoting an appropriate and proportionate exchange of information between the prudential regulators and the supervisory authorities responsible for AML/CFT matters[2].

Cooperation and exchange of information between the Bank and the CTIF-CFI

At Belgian level, on 17 September 2019, the Bank signed a Protocol with the CTIF-CFI defining the arrangements for mutual cooperation and the exchange of information, in order to improve the performance of their respective responsibilities regarding AML/CFT. Among other things, the Protocol means that, in assessing the ML/TF risks associated with each financial institution, the Bank can take account of both quantitative and qualitative information held by the CTIF-CFI on the institutions' reporting of suspicious transactions (see below).

Supervision methodology and tools

In line with the updating of the "periodic questionnaire" on AML/CFT which all financial institutions subject to the Bank's supervisory powers had to complete by 30 June 2019, the Bank developed an internal instrument for the automatic analysis and rating of the answers submitted. On the basis of predefined rating criteria, this instrument can assign to each financial institution the risk profile ("high", "medium high", "medium low" or "low") that corresponds to its answers to the periodic questionnaire. It also makes it easy to visualise and compare the financial institutions' answers and thus to conduct transversal analyses.

However, the risk profiles proposed automatically by this instrument are based exclusively on each financial institution's answers to the periodic questionnaire. In order to refine these profiles, it is also necessary to take account of a range of other relevant information, such as the other information which these same financial institutions have supplied to the Bank, notably as regards their overall risk assessments or in their AMLCOs' annual reports. Account must likewise be taken of the overall picture relating to the situation of the financial institution concerned as assessed by the team responsible for the supervision (the "supervisory judgement").

1 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

2 See section C.1.

For that purpose, the Bank therefore developed an additional IT tool so that the risk profiles initially assigned automatically can be refined where necessary.

The Bank has also formalised its supervision policy concerning AML/CFT on the basis of the powerful supervision instruments now available to it. That policy permits differentiation of its supervision measures on the basis of its assessment of the ML/TF risk profile of each financial institution. The differentiation concerns both the intensity (or intrusiveness) of the supervision measures to be carried out and their frequency, nature (individualised or standardised) and purpose. The four risk categories assigned via the risk assessment methodology (see above) thus correspond to four different levels of supervision ("intensive", "stricter", "normal" and "lighter").

Scope of the supervision powers and supervision personnel

A specific characteristic of AML/CFT concerns the territorial scope of the anti-money-laundering legislation. The Belgian Law and regulations on the subject apply not only to Belgian institutions but also to branches located in Belgium of financial institutions governed by the law of other EU Member States or third countries, and other forms of establishment in Belgium (such as European financial institutions established in Belgium via agents).

Table 24

Entities subject to the Bank's AML/CFT supervision

(end-of-period data)

Financial activities	Number of entities subject to the Bank's supervision	
	2018	2019
Credit institutions	87	85
Life insurers	42	42
Electronic money institutions	14	13
Payment institutions	46	51
Investment firms	31	33
Central securities depositaries licensed in Belgium	2	2
Mutual guarantee societies	5	5
Total	227	231

Source: NBB.

The scope of the Bank's supervisory powers thus covers around 230 financial institutions:

It is noteworthy that the number of payment and electronic money institutions within this population has been rising rapidly for a number of years, mainly as a result of Brexit and the emergence of new categories of payment institutions resulting from the transposition of the 2nd European Payment Services Directive[1] into Belgian law (payment initiation and account information service providers).

According to the risk assessment methodology applied by the Bank, there are high risks associated with 14 % of the financial institutions subject to the Bank's supervision.

The number of staff that the Bank allocates to the performance of this statutory power of supervision has been rising steadily since 2015. When the Bank first set up a specialist unit for remote supervision and participation in the definition of the anti-money-laundering policy, it allocated a total of around 7 full-time equivalents (FTEs) to handle all its work on this subject, including on-site inspections, legal support and sanction procedures. Since then, that number has constantly increased, and came to 16.6 FTEs as at 31 December 2019.

Remote supervision measures in 2019

The first element of the remote AML/CFT supervision exercised by the Bank comprises the prior checks on licence applications and applications concerning the establishment of new branches or new agency networks in Belgium, in order to ensure that these new establishments will have the required internal organisation to ensure that they actually fulfil their legal and regulatory obligations concerning AML/CFT in Belgium.

In 2019, the number of applications for new licences or for the registration of new Belgian establishments was still particularly high, primarily owing to the prospect of Brexit, so that the Bank also had to devote significant resources to examining these applications from the AML/CFT angle. This mainly concerned licence applications for new payment institutions and applications for the establishment of new branches of European credit institutions.

1 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, and repealing Directive 2007/64/EC.

Nevertheless, the bulk of the remote supervision activities concerning AML/CFT continued to focus on the individualised, constant monitoring of existing financial institutions. This remote supervision begins with analysis of all the available relevant information, by means of the supervision instruments described above, in order to assign the appropriate risk profile to each financial institution and to determine which aspects of its AML/CFT mechanisms do not adequately meet the legal and regulatory requirements or those which exhibit weaknesses, notably in regard to their effectiveness. On the basis of this assessment, the Bank – applying the supervision policy also described above – determines and implements the remote supervision measures which it deems most appropriate in order to ensure that the financial institution concerned deals with the weaknesses and shortcomings found. This continuous remote monitoring also makes it possible to ascertain which financial institutions require on-site inspections, and to prioritise those inspections. Once the inspections have been conducted, remote monitoring verifies whether the expected measures to rectify the weaknesses and shortcomings found are actually implemented according to the agreed timetable.

On the basis of both the remote monitoring and the on-site inspections, the Bank's Board of Directors may, where appropriate, resort to the powers of constraint or even powers of sanction accorded to it by the anti-money-laundering Law.

In 2019, as part of this ongoing monitoring of financial institutions, the Bank continued the large-scale operation which it had begun in 2018 aimed at ensuring that all financial institutions have carried out a "business-wide risk assessment" (BWRA) in accordance with the statutory requirements, and drawn all the expected conclusions with a view to adjusting their internal AML/CFT mechanisms in line with the risks. Thus, in 2019, the Bank continued to analyse a large number of BWRAs and the weaknesses in the preventive mechanisms which they had detected, plus the remedial measures taken or planned. That analysis was conducted using the risk-based approach, according priority to the BWRAs of financial institutions deemed to face the highest ML/TF risks. To assess the quality of these BWRAs, the points examined included the methodology applied by the financial institution concerned, the general consistency of the BWRA with other information available to the Bank, notably the answers to the periodic questionnaire on AML/CFT and the annual reports of the AMLCOs, the extent to which the risk assessment process covers all the activities pursued, the relevance of the risk factors considered, the appropriateness of the remedial measures envisaged and the reasonableness of the planned timescale for implementing these measures. The Bank's comments based on these checks were notified individually to the financial institutions concerned so that they could take them into account, if appropriate, in improving their BWRAs and the ensuing measures. In addition, the Bank will take its comments into consideration in current or planned inspections.

The Bank also informed the financial institutions of the initial, general conclusions derived from its analysis of the BWRAs during the seminar held on 6 November 2019 (see above). Furthermore, it set out those conclusions in a written Communication at the beginning of 2020.

3.2 Impact of the new company law on the principles of good governance in the financial sector

The new Company Code does not influence the specific character of the governance model in the financial sector

The new Belgian Companies and Associations Code (CSA/WVV), which came into force on 1 May 2019 and also applies to existing companies from 1 January 2020, replaces the 1999 Company Code. This new Code offers offers – specifically for public limited companies – a choice of different governance models although the one-tier system[1] remains the standard model. Optionally, there is now the possibility of choosing certain other systems, including a full two-tier system comprising two completely separate statutory management bodies[2], with no overlap between individuals.

1 Under the one-tier system, the company is managed by a single statutory management body, namely the board of directors (1-tier board).

2 These two statutory management bodies are the supervisory board and the executive board, which both act separately and within the limits of the powers accorded to them, without any overlapping of people (2-tier board).

As stated in the Code's explanatory memorandum, in regard to the management of financial institutions the legislator rightly opted for a cautious approach by deciding to retain the existing governance model. That decision is seen in the reproduction of Articles 524 *bis* and 524 *ter* of the previous Company Code in the sectoral laws, so that the former rules on the executive committee are now included in full in the prudential legislation, which operates as *lex specialis*.

In this connection, it should be remembered that the governance of credit institutions in Belgium is traditionally subject to specific rules which deviate from ordinary company law and are derived from the "principle of the autonomy of the banking function". Those special rules, which back in the 1960s formed the subject of a protocol concluded between credit institutions and the supervisory authority, were intended among other things to limit the interference of shareholders in the management of the institution. In the ensuing years, this protocol was modified on several occasions, resulting in further refinement of the governance balance. For instance, the duties of the board of directors were restated in order to step up involvement of the non-executive directors. The said protocol rules were then incorporated in the banking law, which obliges credit institutions to form a management committee with full management powers.

Over the years, the governance model applicable to credit institutions was also extended to other financial institutions, such as stockbroking firms, insurers, (mixed) financial holding companies, etc.

The above account illustrates the long history of *sui generis* governance rules applicable to financial institutions. This singularity is justified by the particular economic role that these institutions perform in society, which also concerns the public interest. However, this *sui generis* regime is also largely based on European legislation, which generally puts forward a "neutral" form of governance that cannot be reduced to a simple one-tier or two-tier system but tries to combine the strengths of both systems[1].

1 For example, see the EBA Guidelines on internal governance EBA/GL/2017/11 in which paragraphs 21 and 22 state that there should be a distinction between the duties of the management function and those of the supervisory function (a natural feature of dual-board structures), but also stipulate that there should be effective interaction and transmission of information between all members of the management body (a constant feature of one-tier systems).

The current hybrid governance model for financial institutions permits correct and – above all – efficient implementation of the many – frequently complex – balances and requirements stipulated by the European legislation. For instance, the current model successfully combines collective responsibility for policy with clear separation between the supervisory function and the management function.

The fact that the general policy and strategy – i.e. the institution's DNA – are determined by all the directors jointly is an essential feature of the governance model. Thus, executive and non-executive directors act together and on an equal footing in defining the institution's commercial policy, for instance, as well as many other fundamental elements such as the risk policy, risk tolerance, the framework for risk management and internal control, essential aspects of capital adequacy and business continuity, remuneration policy, etc. In addition, the board of directors' meetings offer a periodic, natural forum where executive and non-executive directors can together engage in direct dialogue and discuss and mutually challenge each other's views on all essential aspects of policy. Furthermore, this last point is an important guarantee of the substantial involvement of all the directors, which also means that they must be of a certain quality (i.e. level of professional competence). The Bank also considers that this institutionalised dialogue between all the directors is an essential element of the sound and prudent management of the institution.

As things stand, it can be said that fully maintaining the so-called "1.5-tier board" for financial institutions is a good decision: this *sui generis* hybrid model is the outcome of a long and carefully considered development process, it has a long and successful track record, enjoys very widespread support in the sector, and in particular it permits the practical and consistent implementation of the European legislation.

3.3 Accreditation of auditors for the payment and electronic money institutions sector

In view of the societal importance of the supervised institutions, auditing duties can only be entrusted to auditors approved for that purpose by the Bank. The Bank grants auditors accreditation for a six-year period on the basis of the NBB's accreditation Regulation of 21 December 2012. This Regulation was amended during the year under review to introduce a new form of accreditation specifically

for auditors wishing only to take on assignments for payment institutions and electronic money institutions. That accreditation is additional to the existing approvals for auditors wishing to fulfil assignments for either financial institutions or insurance undertakings.

The accreditation for financial institutions, including payment and electronic money institutions, still exists but the amendment to the accreditation regulation offers interested auditors the option of obtaining approval solely for payment institutions and electronic money institutions. This means that the Bank can organise an examination focusing exclusively on aspects concerning that type of institution. A call for candidates in that connection was published in the *Moniteur belge / Belgisch Staatsblad* of 29 October. The first accreditation programme of this type will end in the first half of 2020.

3.4 Brexit

Preparations and contingency measures

During the year under review, the Bank continued its preparations for Brexit, in close cooperation with the competent national and European institutions, as regards both its task of maintaining financial stability and in monitoring the Brexit preparations of individual institutions.

At European level, the Bank chairs jointly with the ECB a working group of European central banks for the exchange of analyses concerning Brexit from the point of view of central banks and with a focus on the economic, commercial and financial implications of Brexit in the euro area, the EU and the EU Member States.

At Belgian level, the Bank also plays a key role in the High Level Group chaired by Count Buysse, responsible for preparing the Belgian economic world for Brexit. Together with FPS Economy and the Federal Planning Bureau, it produces the quarterly "Monitoring Brexit" report, and it also assists FPS Foreign Affairs, particularly in the sphere of financial services. The Bank contributes to the thematic Council of Ministers on "Measures relating to the United Kingdom's withdrawal from the European Union".

The Bank repeatedly warned Belgian financial institutions of the risks inherent in a "hard Brexit

The Bank works with the European Commission, authorities such as the EBA and EIOPA, and the ECB to define expectations concerning institutions' preparations for Brexit and to monitor its economic impact.

During 2019, the Bank repeatedly warned Belgian financial institutions of the risks inherent in a disorderly, "hard Brexit"[1]. On the basis of the activities and possible implications concerning each institution, it arranged bilateral contacts with the institutions in order to monitor progress with the preparations.

The Bank finds that Belgian institutions have made progress in their preparations and that the risks have therefore diminished. Thus, most institutions have taken the necessary steps to ensure their business continuity. For example, they have replaced certain British service providers with counterparts located in the EU 27 for reporting their derivatives transactions to the trade repositories. In addition, some institutions have arranged alternative access to a clearing house located in the EU 27 with the aim of reducing their dependence on British clearing houses and mitigating the adverse implications if these market infrastructures lose their European approval under the EMIR Regulation.

The Belgian financial sector has taken steps to reduce the potential risks

Although the activities of Belgian financial institutions in the United Kingdom are relatively limited, a "hard Brexit" could have indirect effects in the form of greater volatility in the value of financial assets, or in the event of an economic recession in the United Kingdom.

The Bank maintains a close watch on the activities of British payment and insurance institutions which have been set up in Belgium on account of Brexit and which have been granted a licence. In 2019, the Bank approved three new applications for licences in the case of payment institutions set up in Belgium on account of Brexit.

The Bank also contacted British undertakings providing banking services in Belgium, to warn them that they risk losing the European passport giving them freedom to provide those services in Belgium. These undertakings were asked to take the necessary steps to avoid any interruption in their services.

Furthermore, the Bank and the Financial Services and Markets Authority (FSMA) prepared temporary contingency measures for spheres in which it was not possible to rule out a detrimental impact on private individuals in the event of a hard Brexit. Those measures guaranteed the continuity of services relating to existing insurance contracts and investment services. The European Commission considers that all players must adapt to the legislative framework that will apply after Brexit. Consequently, the contingency measures must be limited in both scope and time. The ESMA has also taken contingency measures to ensure the continuity of the services of major British clearing houses in the event of a disorderly Brexit.

Exchange of information between supervisory authorities

At the end of November 2018, in view of Brexit and in consultation with the European Commission, the EBA launched discussions with the British supervisory authorities to decide with them on a framework for future cooperation and the exchange of information between the European and British banking supervision authorities. In that connection, a template was created for bilateral cooperation agreements which,

1 See https://www.nbb.be/fr/articles/lautorite-bancaire-europeenne-et-la-banque-nationale-appellent-les-etablissements.

though not binding, should as far as possible form a basis for European banking supervision authorities wishing to conclude a bilateral MoU with their British counterparts. On 10 April 2019, the Bank signed a bilateral MoU based on that principle with the Bank of England's Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

In accordance with the said bilateral MoU, a second document, known as the "Split of Responsibilities", was signed by the Bank and the PRA. That document supplements the general MoU and relates specifically to the exchange of information and cooperation concerning the supervision of Belgian and British branches.

The MoU and the "Split of Responsibilities" enter into force on the date on which the European Treaties and secondary EU legislation cease to apply in the United Kingdom.