C. Regulatory and statutory framework

1. Banks

1.1 Activities of the Basel Committee on Banking Supervision

In recent years, the Basel Committee on Banking Supervision (BCBS) has focused more on implementing and assessing its global prudential standards for banks and less on developing new regulations. Following completion of the so-called Basel III standards adopted in response to the 2008 financial crisis, a "regulatory hard stop" or sabbatical was introduced. The Committee has since turned its attention to new developments affecting the financial system in general and the banking sector in particular.

One such development is the emergence of crypto-assets and related banking services. Following a second industry consultation, the Committee continued its work on the prudential regulatory treatment of banks' exposures to crypto-assets. The intention remains to adopt a conservative approach. This is discussed in more detail in part E. More broadly, the Committee paid close attention to the impact of digitalisation on banks' activities and supervision.

Recent crises affecting several non-bank financial institutions (including Archegos) revealed vulnerabilities and shortcomings in the way banks manage the risks associated with their relationships and the interaction with such institutions. It was found that the risks associated with exposure to derivatives transactions with these financial actors, amongst others, had been underestimated and that concentration limits had been set too high. Following an assessment, the BCBS issued a newsletter[1] with recommendations on interaction between banks and non-bank financial institutions.

The Committee also examined the impact of the partial completion of the European banking union on the systemic importance of European banks engaged in extensive cross-border activities in the euro area, amongst others. In this context, the supervisors concerned were given discretionary powers allowing them to consider such transactions within the euro area as possibly less risky for the purpose of calculating the capital buffer for global systemically important banks (GSIBs). The Bank took a somewhat critical stance in these discussions, as this decision could lead to a reduction in the capital buffers of systemically important banks.

Climate risks also remained a priority for the Committee. Work on the subject covered both the first pillar of prudential regulation for banks, which includes the capital requirements applicable to all banks, and the second pillar of such regulation, which entails assessment of the quality of risk management by banks based on their individual risk profile. In this context, the Committee published, on the one hand, answers to frequently asked questions on the inclusion of climate-related risks in pillar 1 requirements and, on the other hand, guidance on the effective management and oversight of climate-related financial risks by banks. Section C.3.2 of this report describes the Basel Committee's climate-related activities in more detail.

In addition, the functioning of the Basel framework for prudential standards and requirements adopted in the context of COVID-19 and beyond was assessed. Although not all aspects of the Basel III framework have been implemented, a thorough review of the implications of these regulations has already been carried out. It revealed a significant positive

1 BCBS, Newsletter on bank exposures to non-bank financial intermediaries, 23 November 2022.

effect on the robustness of banks and scant evidence of undesirable consequences, particularly in terms of their lending capacity. The possibility to use capital and liquidity buffers and the pro-cyclicality of the framework were also studied. Given the current geopolitical context, the Committee continues to stress the importance of further strengthening banks' reserves gradually so as to cushion the impact of internal and external shocks, including those unrelated to the credit cycle.[1]

1.2 Developments at European level

Continued negotiations on the banking package

The Bank's previous annual report provided an overview of the various parts of the banking package launched by the European Commission at the end of October 2021, which amends the European regulations applicable to banks.[2] The package consists of a directive modifying the Capital Requirements Directive (CRD6) and two regulations, specifically an update to the Capital Requirements Regulation (CRR3) and a regulation on resolution-related subjects (see also part F of this report).

These amendments aim, on the one hand, to transpose the latest parts of the Basel III standards into European regulations and, on the other hand, to strengthen and harmonise the arsenal of supervisory tools and practices. They concern in particular the regulations applicable to branches of banks from third countries, the powers of supervisory authorities to impose sanctions, the "fit and proper" requirements applicable to directors and key function holders at institutions, and further development of the rules on the management and monitoring of environmental, social and governance (ESG) risks.

Negotiations on the banking package continued in 2022, within both the Council and the European Parliament. The Economic and Financial Affairs (ECOFIN) Council published its final position on the package in early November. Like the European Central Bank (ECB) and the European Banking Authority (EBA), the Bank has always advocated for consistent and timely implementation of the Basel III standards and regrets that the banking package continues to derogate significantly from these international standards, thereby making the rules applicable to European banks less stringent. It believes that it is in the best interest of European supervisors and regulators, as well as the banking industry, to maintain their reputation in this context. The Bank will continue to follow closely negotiations between the European Parliament, the Council and the European Commission on this regulatory package.

Completion of the banking union

Negotiations on the completion of the banking union resumed in the first half of 2022. Specifically, it was discussed whether additional steps could be taken to establish the as yet non-existent third pillar of the banking union, namely a common European deposit insurance scheme. The European Deposit Insurance Scheme (EDIS) would complement the already established first and second pillars of the banking union (i.e. the Single Supervisory Mechanism and the Single Resolution Mechanism, respectively). The prudential treatment of the risks associated with banks' sovereign exposures, the possibility of reducing local capital and liquidity buffers for subsidiaries of cross-border European banking groups, and certain adjustments to improve crisis management at the level of European banks by European authorities were also considered. As no consensus could be reached on common progress in all these areas, only the last point could form the object of an agreement. The European Commission was requested to formulate a proposal to improve the existing crisis management framework, in particular for small and medium-sized credit institutions (see also part F of this report).

1.3 Developments at national level

Developments regarding governance

Update of the governance manual

The Bank updated its governance manual for the banking sector. In recent years, governance has formed the object of several regulatory developments at the Belgian and international levels: the new Companies and Associations Code entered into force in Belgium, the EBA issued new guidelines on internal governance,[3] fit and proper assessments[4] and

1 BCBS, Newsletter on positive cycle-neutral countercyclical capital buffer rates, 5 October 2022.
2 See the Bank's 2021 annual report, section II.B.1.3.
3 EBA Guidelines of 2 July 2021 on internal governance (EBA/GL/2021/05).
4 EBA Guidelines of 2 July 2021 on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2021/06).

executive remuneration,[1] the Bank published new rules on external functions, etc.

In view of these regulatory developments, the Bank updated its governance manual for the banking sector via its communication of 11 October 2022.[2] The manual contains all regulatory texts on governance applicable at both national and international levels.

The updated manual highlights several new aspects. For example, diversity – as defined in the EBA guidelines[3] – must now be taken into account in the composition of credit institutions' management bodies and staff. The manual also includes new prudential requirements on risk management (including climate and environmental risks), risk culture, conflicts of interest and ICT security (including the appointment of a chief information security officer). Furthermore, it clarifies how to reconcile the new anti-money laundering and counter-terrorist financing rules with the general rules on governance. Finally, the manual includes a new chapter on governance requirements for financial groups, which covers, amongst other things, the management of intra-group conflicts of interest.

Transposition of the EBA guidelines on remuneration policy

The Bank published a new circular on remuneration policy. The changes to the European remuneration policy framework introduced by CRD V were transposed into law in July 2021. On 2 July 2021, the EBA also published new guidelines on remuneration policy[4] which replaced its previous guidelines issued in 2015. These new guidelines, which entered into force on 31 December 2021, were transposed into a new Bank circular on remuneration policy, namely circular NBB_2021_30,[5] which replaced circular NBB_2016_44 on the same subject.

1 EBA Guidelines of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU (EBA/GL/2021/04).
2 Communication NBB_2022_23 of 11 October 2022 on the new governance manual for the banking sector.
3 The EBA Guidelines of 2 July 2021 on internal governance (EBA/GL/2021/05) list five diversity characteristics to be taken into account in the composition of management bodies: age, gender, geographical origin, educational background and professional background.
4 EBA Guidelines of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU (EBA/GL/2021/04).
5 Circular NBB_2021_30 entitled "Remuneration policy: update of the statutory framework and transposition of the EBA Guidelines of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU (EBA/GL/2021/04)".

The new circular clarifies the changes made to the statutory framework relating to remuneration policy and addresses a number of points for attention that emerged from day-to-day supervisory practice and the horizontal analyses carried out by the Bank and the EBA of current practices within banks.

First, the circular once again draws attention to the responsibility of institutions with regard to remuneration policy. The Belgian prudential remuneration rules go beyond the general provisions in the field of labour law and company law in several respects. However, the Bank found that some institutions have not yet sufficiently integrated the priority of these stricter remuneration rules into their remuneration policy. It is the responsibility of institutions to comply with both the letter and the spirt of these specific rules.

The circular also provides further explanation on the new proportionality regime,[6] which replaces the previous regime under which employees could benefit from certain exemptions if their variable remuneration was less than or equal to € 75 000.

Moreover, the circular clarifies the application of the rules in a group context. Thus, the remuneration rules must be complied with on a consolidated or sub-consolidated basis. Foreign subsidiaries falling within the regulatory scope of consolidation must therefore comply with the Belgian rules on remuneration policy if the professional activities of their employees have a significant impact on the group's risk profile. However, in accordance with the Banking Act,[7] such subsidiaries are exempt from the remuneration requirements applicable on a consolidated basis if they are subject to such requirements based on rules specific to their sector. In this way, a priority rule was introduced, along with a prohibition on circumvention. Banking and bancassurance groups are therefore required to develop an appropriate and consistent remuneration policy at group level.

In accordance with the EBA guidelines and Annex II to the Banking Act,[8] the circular also deals with the regime applicable to severance and termination payments, as well as the related exceptional regime. The Bank's three-year horizontal analysis indeed

6 See Article 9(1) of Annex II to the Banking Act.
7 See new Article 168(1) §1 of the Banking Act.
8 See Articles 12 and 12(1) of Annex II to the Banking Act.

showed that some institutions apply the latter improperly. The circular stresses the exceptional nature of this regime and urges institutions that make use of it to do so in accordance with the spirit of the text.

Finally, the circular draws attention to the amendment of Article 67 of the Banking Act, which now explicitly states that remuneration policies must be gender neutral. This means that institutions must base their remuneration policies on the principle of equal pay for equal or equivalent work.

Furthermore, remuneration reporting was also updated. On 17 November 2022, the Bank issued two circulars[1] which transpose and implement three sets of EBA guidelines on quantitative reporting requirements regarding remuneration.[2] The main new features are, on the one hand, the extension to investment firms of the reporting requirements which consist of making a comparative analysis of remuneration practices (so-called "benchmarking reporting") and providing additional information on individuals receiving total remuneration of more than one million euros (so-called "high-earners reporting") and, on the other hand, expansion of the information expected from credit institutions to include aspects relating to the gender pay gap. These new reporting requirements entered into force with immediate effect.

Prudential expectations concerning EU regulations on derivatives and securities financing transactions

Following the global financial crisis of 2008, the European Union sought to make the market for derivatives and the market for securities financing transactions more transparent, by adopting the European Market Infrastructure Regulation (EMIR) and the Securities Financing Transactions Regulation (SFTR), respectively. One of the main requirements of these two regulations is the obligation to report on a daily basis the details of each derivative and securities financing transaction to trade repositories authorised by the European Securities and Markets Authority (ESMA). The requirements set out in these two regulations apply to any European counterparty that enters into a derivative or securities financing contract, i.e. both financial institutions (banks, insurance undertakings, stockbroking firms, etc.) and non-financial institutions (small, medium or large companies, payment institutions, etc.). In addition, the reporting requirement applies to both extra-group and intra-group transactions, regardless of the settlement currency or the trading venue in which they are executed.

The Bank clarified these requirements in 2022. Although the EMIR reporting requirements have been in place since 2014 and the quality of the reported data has improved significantly thanks to various amendments introduced to the reporting standards, the Bank has repeatedly observed that significant deficiencies still exist in reporting by a number of Belgian banks. Therefore, the Bank communicated its supervisory expectations in terms of reporting to the largest banks during the year under review.

The Bank has developed an automated process in order to collect and analyse information on the derivatives and securities financing transactions reported by the entities it supervises. This allows the Bank to effectively use the data reported in order to monitor both micro- and macroprudential risks emerging in these two markets as well as compliance with EMIR and SFTR requirements by the entities under its supervision. The Bank also uses additional tools to monitor compliance with qualitative requirements.

Under EMIR, the Bank has granted several exemptions in recent years from the central clearing requirement for intra-group derivatives contracts and from the requirement to apply risk mitigation techniques for non-centrally cleared derivatives.[3] As a national competent authority,[4] the Bank considers that entities that have been granted such exemptions should

1 Circular NBB_2022_28 of 17 November 2022 transposing the EBA Guidelines of 30 June 2022 on the remuneration and gender pay gap benchmarking exercise under the CRD and IFD (EBA/GL/2022/06 into EBA/GL/2022/07) and Circular NBB_2022_29 of 17 November 2022 transposing the EBA Guidelines of 30 June 2022 on data collection exercises regarding high earners under the CRD and the IFD (EBA/GL/2022/08).

2 Guidelines of 30 June 2022 on remuneration, gender pay gap and approved higher ratio benchmarking exercises under Directive 2013/36/EU (EBA/GL/2022/06); Guidelines of 30 June 2022 on the benchmarking exercises on remuneration practices and the gender pay gap under Directive (EU) 2019/2034 (EBA/GL/2022/07); and Guidelines of 30 June 2022 on data collection exercises regarding high earners under Directive 2013/36/EU and Directive (EU) 2019/2034 (EBA/GL/2022/08).

3 The exemptions granted by the Bank from the obligation to apply risk mitigation techniques to non-centrally cleared derivatives are limited to the exchange of initial margins. This means that Belgian counterparties entering into non-centrally cleared OTC derivative contracts are still required to exchange variation margins.

4 In Belgium, the Bank and the FSMA are responsible for ensuring compliance with both regulations by the entities subject to their respective supervision.

continue to assess and monitor closely the risks arising from their derivatives positions. Against this background, and in order to enhance its monitoring capabilities with respect to EMIR and SFTR requirements, the Bank drew the attention of the larger Belgian counterparties to its supervisory expectations regarding the procedures that are essential in order to ensure compliance with both regulations. Finally, the Bank has asked the accredited auditors to issue a report in 2023 on the degree of compliance by the banks concerned with the requirements set forth in EMIR and SFTR.

New statutory framework for stockbroking firms

The new law on the supervision of stockbroking firms[1] and the amended FSMA Act[2] completed the transposition of the Investment Firms Directive (IFD).[3,4,5] A new prudential framework designed specifically for investment firms has thus been established, complemented by the Investment Firms Regulation (IFR),[6] on the one hand, and the Markets in Financial Instruments Directive and Regulation (MiFID and MiFIR),[7,8] on the other.

1 Act of 20 July 2022 on the legal status and supervision of stockbroking firms and containing miscellaneous provisions.
2 Act of 20 July 2022 amending the Act of 25 October 2016 on access to the activity of investment services and on the legal status and supervision of portfolio management and investment advisory firms and laying down other miscellaneous provisions to transpose Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms.
3 Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU.
4 See section II.B.1.4 of the Bank's 2021 annual report.
5 It should be recalled that, under Belgian law, the term "investment firm" includes both stockbroking firms, which are supervised by the National Bank of Belgium, and portfolio management and investment advisory firms, which are supervised by the Financial Services and Markets Authority (FSMA). On this aspect, see section II.C.3.2 of the Bank's 2016 annual report.
6 Regulation (EU) No 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014.
7 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.
8 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

1) A new prudential framework designed specifically for investment firms

Prior to this reform, the prudential framework for credit institutions was to a large extent also applicable to investment firms which, under Belgian law, are authorised as stockbroking firms.

In 2019, the European legislature expressed its wish to establish a specific prudential framework for investment firms, to better take into account the particular nature of the risks faced by such firms and the risks they themselves may pose, in particular to global financial stability. Thus, the IFR now distinguishes between different classes of investment firms depending on the nature of their activities and the value of their assets. Each class is subject to appropriate and proportionate prudential requirements.

a) Class 1

Class 1 comprises investment firms that fall under the new definition of a credit institution.[1] These firms must be authorised as credit institutions. They are no longer considered stockbroking firms and are subject only to the prudential requirements applicable to banks.

b) Classes 1A and 1B

Class 1A includes investment firms that remain stockbroking firms, the total value of whose consolidated assets is equal to or in excess of € 15 billion or, under certain conditions (in particular if the competent authority deems it justified), € 5 billion. Class 1B includes stockbroking firms that are subsidiaries included in the supervision, on a consolidated basis, of a banking group, provided the supervisory authority is satisfied that application of the CRR[2] own funds requirements is prudentially sound. The investment firms concerned are subject to the CRR and most provisions of the CRD.[3]

c) Class 2

Class 2 comprises investment firms authorised as stockbroking firms or portfolio management and investment advisory firms, excluding investment firms belonging to classes 1, 1A, 1B and 3. Firms in this class that are authorised as stockbroking firms are subject to the law on the supervision of stockbroking firms (see point 2 below) and the IFR.[4]

d) Class 3

Class 3 consists of "small and non-interconnected investment firms" which are subject to less stringent prudential requirements. This class, introduced by the IFR, excludes firms that hold customer funds, safeguard and administer customer assets and/or deal on their own account. It includes only investment firms authorised as portfolio management and investment advisory firms subject to the FSMA Act and the IFR.

2) Main new features of the Act of 20 July 2022 on the supervision of stockbroking firms

Following the adoption of the new European framework governing investment firms, the Belgian legislature decided to remove stockbroking firms from the scope of application of the Banking Act and to adopt a new law on the legal status and supervision of stockbroking firms, transposing the provisions of the IFD applicable to stockbroking firms. The introduction of a law specific to stockbroking firms, in addition to the Banking Act, thus reflects the coexistence of two different prudential frameworks at European level.

Overall, the IFD was faithfully transposed, while ensuring as much continuity as possible with the framework applicable to stockbroking firms before the new European framework entered into force.

The new law singles out "large stockbroking firms", which form part of the aforementioned classes 1A and 1B,[5] for which it refers to the applicable provisions of the Banking Act in several respects.

1 See Article 1 §3 of the Banking Act of 25 April 2014.

2 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

3 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

4 Firms in this class that are authorised as portfolio management and investment advisory firms are subject to the FSMA Act and the IFR.

5 See Article 3(5).

Table C.1

Governance requirements

	Management committee	Specialised committees	Independent directors
Large stockbroking firms	Yes	4 (audit, risk, remuneration and nomination)	Minimum 2
Other stockbroking firms	No [1]	2 (risk and remuneration) [1]	Minimum 1
Small stockbroking firms	No [2]	0 [2]	0

Source: NBB.

1 Such stockbroking firms may establish a management committee and/or an audit committee or a nomination committee on a voluntary basis. The supervisory authority may require the establishment of a management committee and/or an audit committee or a nomination committee where this is justified by the size, internal organisation or activities of the stockbroking firm and may take into account committees established at group level.

2 Such stockbroking firms may establish a management committee and/or an audit committee or a nomination committee on a voluntary basis, and the supervisory authority may require the establishment of a management committee where the size, internal organisation or activities of the stockbroking firm so justify.

Other stockbroking firms, belonging to the aforementioned class 2, form the object of most of the new rules. This group includes "small stockbroking firms",[1] which are subject to less stringent requirements, as detailed below.

The provisions laying down initial capital requirements are aligned with those of the IFD, which aims to achieve maximum reconciliation of national laws, in keeping with the maximum harmonisation principle.

In terms of governance, large stockbroking firms are subject to the requirements applicable to credit institutions and are therefore required to set up a management committee as well as risk, remuneration, nomination and audit committees.

For other stockbroking firms, the new law no longer formally imposes an obligation to set up a management committee. However, these firms are required to establish a risk committee and a remuneration committee within their statutory management body. They may choose to set up a management committee and committees other than those required by law. The supervisory authority may also require the establishment of a management committee, an audit committee and/or a nomination committee when the size, internal organisation or activities of a stockbroking firm so justify.

1 See Article 23.

Small stockbroking firms are exempt from the obligation to set up specialised committees within their statutory management body and to appoint an independent director.

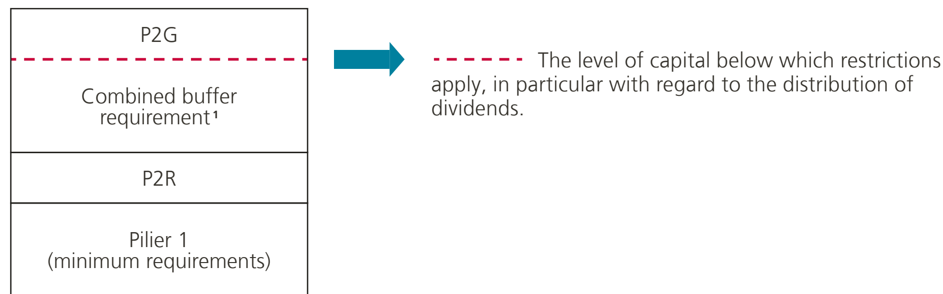
Regardless of the category of stockbroking firm, the law maintains the cap on the variable component of remuneration at the same level as that applicable to credit institutions. The aim is to maintain a level playing field with credit institutions that also engage in asset management activities.

Revision of the methodology to determine Pillar 2 recommendations (P2G)

The methodology to calculate P2G for Belgian less significant credit institutions (LSIs) was revised. As part of the Supervisory Review and Evaluation Process (SREP), the Bank determines the level of Pillar 2 Guidance (P2G) applied to each LSI. P2G indicates the level of capital individual LSIs are expected to maintain to better withstand stress. Previously, the methodology used to calculate P2G was identical to that applied by the ECB between 2017 and 2021 to significant credit institutions (SIs). The basis to determine banks' P2G levels is how they perform in stress tests conducted by the prudential

Chart C.1

P2G as an additional buffer to prudential capital requirements



Source: NBB.
1 The combined buffer requirement consists of various macroprudential requirements and the capital conservation buffer.

supervisor, which examine the impact an economic shock would have on their capital ratios.

Since 2021, the ECB has used a bucketing approach to determine SIs' individual P2G levels, which is based on the amended CRD and SREP guidelines established by the EBA.

In line with the EBA guidelines, the Bank decided to adopt the bucketing approach for Belgian LSIs. Depending on the depletion of their capital ratios as revealed by stress tests, banks are placed in one of four buckets. Each bucket has a corresponding range of P2G. Supervisors set the final P2G per bank based on the bucket to which it belongs, taking into account specificities, such as the bank's risk profile and any special circumstances (reorganisation, accounting adjustments, level of available capital, etc.).

Unlike the Pillar 2 Requirement (P2R), P2G is not legally binding. However, if an LSI considers that its level of available capital will no longer be sufficient in the short or medium term to meet P2G, it must inform the Bank and implement an action plan to restore its capital adequacy.

2. Insurance undertakings

2.1 International policy developments

International standard for capital requirements and a holistic framework

As part of 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 a common prudential framework for internationally active insurance groups (IAIGs). This includes inter alia the development of an International Capital Standard (ICS) covering several aspects: provisions on the scope of consolidation, the valuation of assets and liabilities, capital components and capital requirements.

During the period under review, ICS 2.0 was tested for the third year in a row. After a five-year observation period, this standard will be applied to all relevant insurance groups operating internationally.

In parallel with the development of the ICS by the IAIS, the United States is developing a so-called aggregation method to calculate a group's capital. The IAIS is currently working on assessment criteria to determine whether the aggregation method produces similar results to the ICS.

In late 2019, the IAIS adopted a holistic framework for the assessment and mitigation of systemic risk in

the insurance sector at the global level. This includes a set of macroprudential provisions, a targeted assessment of the implementation of these provisions and a global monitoring exercise (GME). The GME requires the Bank to submit several reports to the IAIS, for both individual insurers and at national sectoral level. These reports are followed by a discussion with the IAIS on the assessment of potential systemic risks and appropriate prudential measures. The results and conclusions are communicated to the Financial Stability Board (FSB). The GME's findings are shared annually with the general public in the IAIS Global Insurance Market Report. Based on the IAIS's input, the FSB will assess the holistic framework this year and decide whether to maintain it.

In the 2022 GME, based on supervisory priorities, three macroprudential topics were identified as posing a risk to the global insurance market: (1) the weak macroeconomic outlook, high inflation and rising interest rates, (2) the presence of private equity in the shareholder structure of insurance undertakings, combined with excessive reliance on reinsurance in the regulatory arbitrage context, and (3) climate-related risks. The identification of these themes allows national supervisors to monitor the risks in more detail and deepen future GME analyses.

2.2 European policy developments

Revision of the Solvency II Directive

Work on the revision of the Solvency II Directive continued in 2022. Solvency II, the prudential framework for European insurance and reinsurance undertakings, has been applicable since 1 January 2016. It covers a broad range of quantitative and qualitative requirements concerning the taking-up and pursuit of the business of insurance and reinsurance. The Solvency II framework also provides for review mechanisms to make regulatory adjustments based on experience. The mandate of the European Insurance and Occupational Pensions Authority (EIOPA) to provide technical advice to the European Commission by the end of 2020 on the revision of the most relevant points of the Solvency II Directive was thus directly rooted in the directive itself. EIOPA's advice was sent to the European Commission and published on 17 December 2020.

On 22 September 2021, following EIOPA's in-depth analyses, the European Commission put forward a package of legislative proposals for the revision of the Solvency II Directive. These proposals are mainly based on EIOPA's advice but derogate from it in a number of areas. In response to the proposals, EIOPA expressed concerns regarding the relaxation of certain quantitative measures, which could increase risks for insured parties.

Subsequently, the reform package proposed by the European Commission was further analysed in the Council. A policy debate was held between EU economy and finance ministers on 5 October 2021. Work at technical level was then carried out under the Slovenian presidency and continued under the French presidency. On 17 June 2022, the Member States agreed on a common position concerning the adjustments to be made to the European Commission's proposals.

While broadly agreeing with the European Commission's position on the balance of quantitative reforms, the Council considered that it would be useful to, amongst other things, reframe the proportionality principle, to extend the conditions for use of the volatility adjustment, to allow companies to make corrections in the event of artificial overcompensation in order to mitigate the equity volatility this measure could cause, and to support EIOPA's expectations regarding the development of tools or guidelines to harmonise implementation of the proposals.

Within the European Parliament, discussions and debates continued throughout 2022, in preparation for the upcoming interinstitutional negotiations which should lead in the near future to a new final agreement on the Solvency II supervisory framework.

2.3 National policy developments

New circular on liquidity risk management

In March 2022, the Bank set out its expectations for liquidity risk management in Circular NBB_2022_08.[1] These expectations include (i) developing and maintaining appropriate policies, systems, controls and processes, (ii) identifying material risk factors, (iii) developing indicators, (iv) designing and conducting forward-looking scenarios and liquidity

1 Circular NBB_2022_08 on liquidity risk management.

risk stress tests, (v) contingency planning and (vi) periodic reporting.

The circular, which is in line with the principles prescribed by the IAIS, focuses on the key principles for liquidity risk management. As the sources of liquidity risk are specific to each company and group, each entity should understand the liquidity risk factors it faces and apply the principles contained in the circular based on the scale, nature and complexity of its activities and its exposure to liquidity risk.

Periodic reports, which will be collected from 2023 onwards, will provide the Bank with qualitative and quantitative information to allow it to assess the exposure of companies to liquidity risk.

Amendment of the ORSA circular

In March 2022, the Bank updated its ORSA circular[1] to incorporate EIOPA's requirements regarding climate scenarios companies should consider in their own risk and solvency assessment (ORSA). The Bank expects companies to assess the impact of climate-related risks in their ORSA, evaluate the materiality of these risks and subject material risks to scenario analysis.

The ORSA circular was also adapted to include the requirements set out in EIOPA's Supervisory Statement on the use of risk-mitigating techniques, which, amongst other things, stresses the importance of achieving a balance between relaxation of the solvency capital requirement (SCR) and the mitigation of risks for more complex reinsurance structures. Finally, amendments were made to address some of the shortcomings identified in relation to the IAIS holistic framework, in particular the requirements to assess systemic risks through scenario analysis and stress testing.

Communication on the tasks of the actuarial function and the documentation requirements for technical provisions

In November 2022, the Bank addressed a communication[2] to the insurance sector concerning the determination of technical provisions under Solvency II. The regulations in force lay down prudential requirements for the documentation of these technical provisions and the tasks of the actuarial function. However, supervisory work had revealed that some of these prudential requirements were not always met. The Bank therefore considered it necessary to reiterate relevant aspects of the regulations and specify its minimum expectations in this area.

In its communication, the Bank stressed that technical provisions must be exhaustively and systematically documented, in particular the choices made with regard to their quantification : assumptions, expert judgment, calculation methods and the use of data. The Bank also set out its expectations regarding the work of the actuarial function. It expects a report to be produced that presents real added value for supervision, true ownership of the function, the effective implementation of adequately documented quantitative work, and precise and firm recommendations based on the work performed by the actuarial function.

Amendment of the circular on the valuation of technical provisions and the circular on contract boundaries

Based on new EIOPA reports, the Bank updated its circulars on the valuation of technical provisions[3] and contract boundaries.[4] During its review of Solvency II, EIOPA identified several discrepancies regarding the valuation of technical provisions and the determination of contract boundaries. These inconsistencies did not in themselves require changes to the existing legislation but did call for the clarification of its interpretation in certain key areas, such as the projection of expenses in calculating best estimates, cases where stochastic modelling should be used, the identification of insurance contracts that can be unbundled, and the assessment of whether a financial guarantee has a discernible effect on the economics of a contract.

The two final reports published by EIOPA on 21 April 2022 concerning the adaptation of its guidelines on the valuation of technical provisions, on the one hand, and contract boundaries, on the other,

1 Circular NBB_2022_09 on the own risk and solvency assessment (ORSA).
2 Communication NBB_2022_26 on the tasks of the actuarial function and the documentation requirements for technical provisions.
3 Circular NBB_2022_25 on the guidelines on the valuation of technical provisions under Solvency II.
4 Circular NBB_2022_24 on the guidelines on contract boundaries.

are thus in line with efforts to harmonise prudential practices in these areas. After having consulted the various stakeholders, the Bank published on 17 October 2022 an updated version of its own circulars on these guidelines, thus implementing at Belgian level the clarifications introduced by EIOPA.

Amendment of the circular on deferred taxes

The Bank amended its circular on deferred taxes in 2022. Circular NBB_2020_03 of 26 February 2020 on the impact of deferred taxes was applied for the first time to the solvency position as at 31 December 2020. The many methodological questions it raised and the differences in interpretation and implementation between companies led the Bank to carry out a cross-sectional analysis of the subject. The aim of this analysis was, on the one hand, to identify best practices and extend them to the entire market and, on the other hand, to identify and try to remedy shortcomings in the existing methodologies.

The analysis revealed that certain concepts and principles contained in Article 207 of Delegated Regulation 2015/35 needed to be clarified. After consultation with stakeholders, the Bank replaced Circular NBB_2020_03 on 2 November 2022 with a new circular, namely Circular NBB_2022_27 on the valuation of deferred tax assets and adjustment for the loss-absorbing capacity of deferred taxes.

To take into account the complexity of the subject, Circular NBB_2022_27 also introduces a proportional approach by distinguishing between, on the one hand, significant companies and/or companies for which the impact of the loss-absorbing capacity of deferred taxes (LAC DT) adjustment is significant and, on the other hand, less significant companies for which the impact of this adjustment is limited.

Proposal to amend the legislation on natural disasters following the 2021 floods

The floods in July 2021 caused enormous damage, particularly to buildings and businesses, and had a major impact on the lives of many people. Although not all the damage was insured, much of it was compensated by the insurance industry, mainly through the cover integrated into fire insurance for "ordinary risks". These include risks to residential dwellings, agricultural buildings, etc., as described in the legislation.[1] For these risks, it is compulsory for fire insurance to include flood coverage.

1 Article 5 of the Royal Decree of 24 December 1992 implementing the legislation on non-marine insurance contracts.

The legislature imposed this obligation in order to ensure that policyholders were protected against the damage caused by natural disasters.

In addition, in order to ensure the insurability of natural disasters, the legislature has in the past introduced specific mechanisms in the framework of public-private partnerships, such as a limitation on claims per insurer and per natural disaster,[1] above which the regional disaster funds intervene. After the floods in July 2021, the statutory ceiling for insurers was doubled by mutual consent of the Regions and the insurance sector. This resulted in an increase in the share of claims covered by insurance and reinsurance undertakings.

Following the floods in July 2021, discussions also started on a new statutory framework for natural disasters, taking into account the lessons learned from this recent event. The aim was to develop a more robust legislative framework, which provides greater legal certainty in the event of exceptional natural disasters. The focus was on the calibration of a new statutory ceiling for insurers and its future development. However, more than a year after the floods, there is still no statutory framework clarifying the distribution of the cost of claims related to future natural disasters. This situation is a source of legal uncertainty for all parties and has resulted in, amongst other things, a lack of clarity on the level of reinsurance intervention and, therefore, the costs related to the reinsurance of catastrophe risk for Belgian insurers. As a result, some insurers have seen their reinsurance premiums increase considerably, while others are no longer able to obtain full reinsurance cover. However, not all insurance undertakings active on the Belgian market are in the same situation. Indeed, the impact varies depending on whether a company has access to reinsurance through the international groups to which it belongs or only through Belgian companies.

From a regulatory perspective, this uncertainty could lead to a major revision of the models used to determine the level of capital requirements for insurance undertakings, which in turn could have a negative impact on their solvency. These difficulties and uncertainties could also, in the long run, increase policyholder premiums.

1 Article 130 §2 of the Act of 4 April 2014 on insurance.

In order to provide greater certainty to all parties concerned, the competent federal and regional authorities need to ensure a clear statutory framework. Clarification is needed on the distribution of the costs of future natural disasters in Belgium, the financing of regional disaster funds, the treatment of insured and uninsured claims and the robustness of the existing framework in light of climate change. Given that all Regions are liable to be affected by natural disasters in the future and that most Belgian fire insurers operate throughout the country, a consistent approach between Regions is desirable.

3. Cross-sectoral aspects

As a prudential supervisory authority, the Bank has jurisdiction over a range of fields covering multiple sectors that are not discussed in previous sections of this report. The aspects examined in this section include the Bank's initiatives concerning the prevention of money laundering and terrorist financing, the regulatory and prudential developments surrounding climate-related risks, the rules on external functions, and the update of its Fit & Proper Manual. In addition, box 9 discusses the five-year assessment of the Belgian financial sector and oversight to be conducted by the International Monetary Fund (IMF) in 2023.

3.1 Prevention of money laundering and terrorist financing

European Union

The European statutory and regulatory framework

The European legislative process initiated in 2021 continued in 2022. On 20 July 2021, the European Commission published four ambitious legislative proposals to strengthen the fight against money laundering and terrorist financing (AML/CFT) in Europe (for an overview, see section II.B.3.1 of the Bank's 2021 annual report). The legislative process, which involves both the Council and the European Parliament, continued during the year under review and is expected to be completed in 2023.

The work of the EBA

The EBA plays a leadership, coordination and monitoring role in promoting integrity,

transparency and security in the financial system by adopting measures to prevent and combat money laundering and terrorist financing in the financial system. The AML Standing Committee of the EBA continued its work at seven meetings in 2022 chaired by a Bank representative. Several milestones are highlighted below.

On 31 January 2022, the EBA launched its central database called EuReCa, which gathers information on significant deficiencies identified by national authorities in the AML/CFT arrangements of financial institutions and the measures taken to address them.[1] EuReCa helps the EBA and national authorities develop their understanding of the money laundering and terrorist financing (ML/FT) risks affecting the EU financial sector.

During the year under review, the EBA continued the work it began in response to the major AML/CFT incidents that affected the European banking sector a few years ago, assessing the effectiveness of AML/CFT supervision by individual national authorities (implementation reviews). On 22 March 2022, the EBA published[2] its conclusions following the first two rounds of assessments, conducted from 2019 to 2021, which involved 14 competent authorities, including the Bank, in 12 EU Member States (see below). The EBA listed several common challenges for individual supervisors: (i) identifying AML/CFT risks in the banking sector and at the level of individual banks; (ii) translating AML/CFT risk assessments into risk-based supervisory strategies; (iii) effectively mobilising available resources, including sufficiently pervasive off-site and on-site monitoring; and (iv) taking proportionate and sufficiently dissuasive enforcement action to address AML/CFT shortcomings.

Following Russia's invasion of Ukraine, the EBA issued a communication on 27 April 2022 to financial institutions and supervisors to do their utmost to enable Ukrainian refugees to access at least basic financial products and services.[3] The communication clarified how the EBA's AML/CFT guidance should be applied and how financial institutions can adapt their AML/CFT measures to provide a pragmatic and proportionate response to the compliance challenges they face.

Finally, the EBA published on 1 September 2022 its second report on the functioning of AML/CFT supervisory colleges in the EU.[4] The aim of these colleges, in which the Bank actively participates as lead supervisor or permanent member, is to intensify and systematise the exchange of information and co-operation between national supervisory authorities in a proportionate manner. In its report, EBA comments on good practices to help competent authorities increase their efficiency going forward and highlights several areas for improvement.

The Bank's AML/CFT actions

Throughout the year under review, the Bank's experts continued to make a significant contribution to the European Council's discussions, in particular on the proposals to establish a European AML/CFT authority, to fully harmonise AML/CFT rules at the European level and to define the AML/CFT arrangements that Member States must establish or maintain at national level. It is clear that the implementation of these proposals will fundamentally change the EU's legal and institutional AML/CFT framework.

As mentioned above, the EBA continued implementation reviews and carried out a detailed assessment in 2020 and 2021 of the Bank's internal organisation dedicated to AML/CFT supervision, its methods and concrete supervisory actions, as well as the results obtained. The EBA's final report, which was sent to the Bank on 8 February 2022, recognises the significant efforts made by the Bank in recent years, in particular through an increase in terms of the resources mobilised and the development of risk-based supervision. However, as AML/CFT supervision has now entered a more stable phase, the EBA called for further strategic thinking in several areas and made a number of recommendations, the main ones being:

- paying greater attention to the risk of terrorist financing;
- refining the methodology to assess sectoral and institution-specific risks in order to better address

1 For more information on EuReCa, see the EBA's website.

2 EBA Report on competent authorities' approaches to the anti-money laundering and countering the financing of terrorism supervision of banks (round 2 - 2020/21), 22 March 2022.

3 EBA statement on financial inclusion in the context of the invasion of Ukraine, 27 April 2022.

4 EBA Report on the functioning of anti-money laundering and counter-terrorist financing colleges in 2021, 1 September 2022.

ML/FT risks in Belgium, so that they can be integrated into the overall supervisory strategy;
- strengthening the proactive and pervasive nature of off-site monitoring and reviewing the balance between on-site and off-site monitoring;
- reviewing the approach to remedies and sanctions based on the principles of proportionality and effectiveness (including through disclosure).

In order to respond to the EBA's recommendations, the Bank's AML/CFT department has defined a number of actions to be implemented in 2022 and 2023 (e.g. further development of a comprehensive supervisory strategy and of supervisory methodology and tools). Emphasis is also placed on the deployment of additional resources for off-site and, more importantly, on-site AML/CFT monitoring. This action plan also aims to prepare the Bank for the fifth assessment of the Belgian AML/CFT regime by the Financial Action Task Force (FATF), which will take place in 2024.

At the national level, the Bank continued to support the "public-private platform" and again contributed actively to its work. This AML platform was established in June 2020 to strengthen the dialogue between public and private stakeholders, in order to enhance the effectiveness of AML/CFT actions in Belgium. In 2022, the platform was extended to the judicial and police authorities, a development which the Bank very much welcomed. The participation of these public actors has already allowed – and will continue to allow – exchanges between all parties concerned with the aim of increasing their understanding of the criminal activities taking place in Belgium and, consequently, of the money laundering risk arising from such activities which entities subject to AML obligations are likely to face.

Regarding the risk of money laundering in connection with serious tax fraud, the Bank continued to clarify in 2022 its expectations in terms of the due diligence to be exercised by financial institutions as to the origin of large sums repatriated from abroad. In line with its circular of 8 January 2021,[1] the Bank has implemented a specific action plan to verify that this circular is effectively applied by all financial institutions engaged in private banking or the issuance of single premium life insurance policies, as they are particularly vulnerable to the risks associated with the repatriation of funds with potentially unclear tax origins. The Bank thus ascertained that each such institution had effectively instructed its internal audit team to review past due diligence measures and to formulate, if necessary, suitable recommendations to remedy any weaknesses and shortcomings found. The Bank also ensured that these recommendations had been translated into appropriate action plans including, if necessary, a re-examination of repatriated funds. In the future, it will verify that these action plans are being effectively implemented. The Bank's actions showed that financial institutions are paying greater attention to examining the origin of large repatriations of funds.

In line with the EBA's work to mitigate the impact of de-risking, on which it published an opinion and report on 5 January 2022,[2] the Bank also made its expectations in this area known through its circular of 1 February 2022.[3] The Bank's guiding principle in this circular is that a decision to refuse to enter into a business relationship or to terminate such a relationship for AML/CFT-related reasons should be based on an individual assessment of the ML/FT risks associated with the relationship in question, taking into account the specific characteristics. This means that such decisions cannot be based solely on an assessment of the generic risks associated with the category of customers to which the person concerned belongs, without taking into account possible risk mitigating factors that would emerge from an individual analysis. Institutions should also consider the measures they can take to mitigate the ML/FT risks associated with a business relationship, so that they can still enter into or maintain a relationship where appropriate. Following the publication of this circular, the Bank took individual actions to raise financial institutions' awareness of the adverse effects of de-risking and is carrying out supervisory actions to identify and remedy bad practices in this area.

More generally, the Bank has stepped up its AML/CFT efforts in recent years. To this end, it has developed a risk-based approach, combining remote supervision with on-site inspections, as well as tools

1 Circular NBB_2021_12 on due diligence obligations regarding the repatriation of funds from abroad and taking into account tax regularisation procedures when applying the Anti-Money Laundering Act, 8 June 2021.

2 EBA Opinion and Report on 'de-risking' and its impact on access to financial services, 5 January 2022.

3 Circular NBB_2022_03 on prudential expectations on de-risking, 1 February 2022.

to assess financial institutions' compliance with their statutory and regulatory obligations in this area and the effectiveness of their AML/CFT mechanisms. The Bank has also gradually allocated more staff to carry out these checks. These intensified checks have allowed it to identify – in some cases worrying – weaknesses in a significant number of financial institutions, which must be addressed effectively and decisively. When it finds such weaknesses, the Bank generally requires the financial institution concerned to draw up a detailed action plan to remedy them systematically and sustainably. However, where warranted by the seriousness of the findings, the Bank may use its statutory powers to take formal and pervasive administrative measures in order to compel financial institutions to take the necessary steps to correct weaknesses. In particular, the Bank may set strict deadlines by which the required remedial measures must be implemented or it may partially suspend an institution's authorisation to do business, preventing it from entering into business relationships with new customers until the statutory or regulatory due diligence requirements have been effectively and efficiently implemented. Given the strict procedures to be followed, such coercive processes require the Bank to commit significant human resources. While the Bank regards such measures as necessary, it hopes that they will lead to positive developments within financial institutions so that they will be needed less frequently in the future.

3.2 Regulatory and prudential policy developments concerning climate-related risks

The Bank pays particular attention to climate-related risks. Critical and chronic climate events (physical risks), as well as the necessary transition to a more sustainable, low-carbon economy (transition risks) pose structural economic changes and thus risks to financial stability.

Initiatives by the Bank

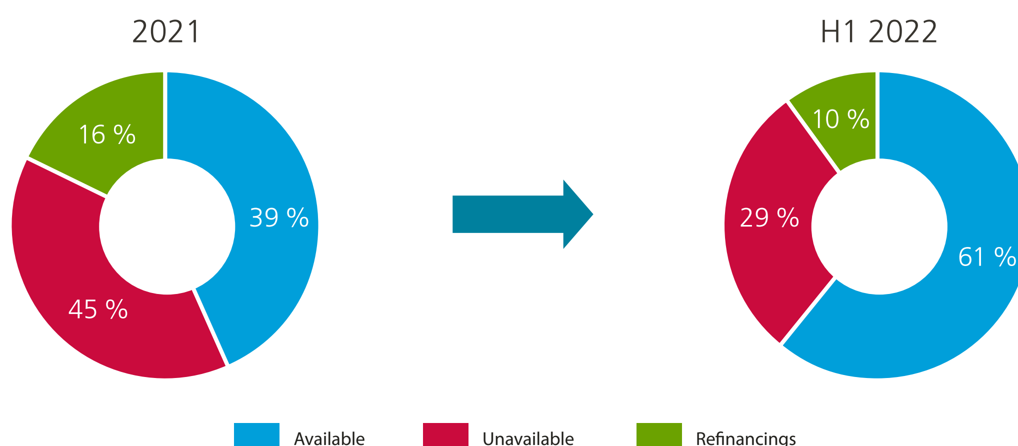
One of the main risks to the financial sector identified by the Bank in this regard is the transition risk associated with energy-inefficient buildings. As explained in detail in the Bank's Financial Stability Report 2020,[1] the energy inefficiency of buildings is an important driver of transition risk and credit risk for credit institutions. The energy inefficiency of a building affects its value[2] and therefore the collateral for mortgages in the event of borrower default. This correlation is likely to increase as regulations to reduce greenhouse gas emissions increase and buyers

1 Van Tendeloo, B. (2020), "Climate-change related transition risk associated with real estate exposures in the Belgian financial sector", NBB, *Financial Stability Report*, pp. 141-150.

2 See Reusens, P., F. Vastmans and S. Damen (2022), "The impact in changes in dwelling characteristics and housing preferences on Belgian house prices", NBB, *Economic Review*.

Chart C.2

Availability of information on the energy performance of buildings for new residential mortgage loans granted by Belgian banks [1]



Source: NBB.
1 For refinancings, banks are not obliged to provide the Bank with information on the energy performance of buildings.

become more aware of the importance of the energy performance of buildings. The current energy crisis has already contributed to increasing this awareness. In addition, the higher costs associated with energy-inefficient buildings can affect repayment capacity.

To this end, the Bank issued a circular at the end of 2020 outlining its expectations for the collection and integration of energy efficiency data for real estate exposures into risk management. Such data must be reported to the Bank for new residential mortgage loans.

During the year under review, the Bank analysed the data reported and the actions taken by the banking sector. As shown in chart C.2, banks are increasingly able to collect such data, at least for new mortgages. For existing loans, however, it appears more difficult to do so. For this reason, the Bank has been actively supporting the banking sector's efforts to access regional databases on energy performance certificates (EPC) for buildings. For the time being, however, financial institutions have to request these certificates from their customers, provided they are available. The first reports have provided the Bank with useful information on the difficulties encountered by banks in collecting this information and the solutions some of them have found to remedy this situation.

The monitoring of these data, as well as their integration into banks' risk management and risk appetite, is constantly being strengthened and improved. For example, when financing the purchase of an energy-inefficient property, the possible consequences for the value of the building and the higher energy costs are taken into account. In addition, banks are increasingly providing advice to their customers to help them improve the energy efficiency of their properties. The Bank has provided information to the industry on good practices in this area which it has observed at some banks, so that other institutions can learn from them.

The Bank applies a proportionate approach to smaller banks. In mid-2021, the Bank sent out a questionnaire to smaller institutions (LSIs) subject to its direct supervision. This questionnaire allowed them to assess for themselves how well they are meeting climate and environmental risk expectations. For large institutions (SIs), the ECB published expectations at the end of 2020.[1] The Bank based its expectations for LSIs on this foundation, but taking into account the nature, scale and complexity of their activities.

1 ECB (2020) Guide on climate-related and environmental risks, Supervisory expectations relating to risk management and disclosure, November 2020.

In 2022, institutions were personally informed of the main areas for improvement. In 2023, a new information session on this subject will be organised for the banking sector.

For the insurance sector, the Bank updated its circular on the own risk and solvency assessment (ORSA)[1] in March 2022, to incorporate the EIOPA requirements on climate change scenarios. The Bank expects companies to take into account the impact of climate-related risks in their ORSA (see section D.2 on operational supervision of insurance undertakings).

Since November 2022, the Bank has published a dashboard on its website[2] containing a series of economic and financial indicators informing the general public about the consequences for the economy and the financial system of climate change and the transition to a net-zero economy. Through this initiative, the Bank emphasises its focus on climate change and the related challenges and wishes to inform relevant stakeholders. By means of greater transparency, the Bank aims to facilitate the transition to a carbon-neutral economy. The dashboard is updated regularly.

European and international initiatives

At the European and international levels, regulators and supervisors are taking various initiatives to integrate climate and environmental risks into reporting obligations (Pillar 3 and other reporting requirements), company-specific risk assessments (Pillar 2) and minimum capital requirements (Pillar 1).

Pillar 3 and other reporting obligations

One of the major challenges facing financial institutions and regulators is the lack of high-quality, uniform and internationally comparable data to assess climate and environmental risks. The new Corporate Sustainability Reporting Directive (CSRD),[3] which requires banks and large companies to report on sustainability in accordance with the European Sustainability Reporting Standards (ESRS),[4] is therefore very important. This directive was adopted in 2022 and will enter into force in 2024. In order to ensure globally harmonised reporting, it was ensured that the European sustainability standards were aligned insofar as possible with the international sustainability reporting standards drawn up by the International Sustainability Standards Board (ISSB), whose first proposals have been published.[5] BCBS supports the development of these international reporting standards and is also examining the need for additional specific reporting requirements on climate-related risks for banks (Pillar 3). At the European level, the EBA published a Pillar 3 reporting requirement[6] for environment, social and governance-related risks (ESG risks) in 2022. From 2023, banks with listed securities will have to report on their ESG risks. In addition, the European supervisory authorities (EBA, EIOPA and ESMA) have also published details of the reporting required by the Sustainable Finance Disclosure Regulation (SFDR).[7]

Pillar 2

With regard to the assessment of institution-specific risks (Pillar 2), the Basel Committee has established a set of principles for the effective management and control of climate-related risks by banks.[8] At the European level, the EBA published a similar report in June 2021,[9] but on ESG risks. In October 2022, it published an extension to this report for investment firms. The European Commission's CRD6 and CRR3 proposals (part of the banking package, see section C.1.2) provide that the EBA, based on this report, will issue more explicit guidelines for the management and

1 Circular NBB_2022_09, own risk and solvency assessment (ORSA), 23 March 2022.

2 NBB Climate Dashboard.

3 EUR-Lex – 32022L2464 - EN – EUR-Lex (europa.eu).

4 The new reporting requirements should be published by mid-2023. A first set of standards, which have already formed the object of a consultation round, has been published by EFRAG (Public consultation on the first set of Draft ESRS).

5 ISSB Exposure Drafts General Sustainability Standards and Climate-related Disclosures .

6 Commission Implementing Regulation (EU) 2022/2453 of 30 November 2022 amending the implementing technical standards set out in Implementing Regulation (EU) 2021/637 as regards the disclosure of information on environmental, social and governance risks.

7 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability disclosure in the financial services sector.
– Final Report on draft RTS regarding fossil gas and nuclear energy investments, September 2022.
– Joint ESAs' Report on the extent of voluntary disclosure of principal adverse impact under the SFDR, July 2022.
– Clarifications on draft RTS under SFDR, June 2022.
– Updated Joint ESA Supervisory Statement on the application of SFDR, March 2022.

8 BCBS (2022), Principles for the effective management and supervision of climate-related financial risks, June 2022.

9 EBA (2021), EBA Report on management and supervision of ESG risks for credit institutions and investment firms, June 2021.

BOX 8

ECB climate risk stress test

In 2022, the ECB conducted a stress test on significant institutions (SIs). The exercise proved informative for both banks and supervisors, but it cannot yet be considered a real test. Too much information is still missing and the methodologies, models and scenarios need to be further developed. Therefore, the results cannot currently be used to determine additional capital requirements.

The ECB's stress test consisted of three parts. In the first part, the ECB examined how advanced banks were in conducting climate stress tests and scenario analyses. The ECB expects the banks it supervises to conduct their own stress tests and scenario analyses to assess climate risks. Most banks do not presently do so: 59 % have not yet integrated climate-related risks into their stress tests. All major Belgian banks report having a framework for climate risk stress testing. However, the methodologies and data used require improvement.

In the second part, banks were asked to calculate indicators specifying the extent to which their assets and income are linked to counterparties with high greenhouse gas emissions. This allowed the ECB to measure the transition risks to which banks are exposed, as such counterparties are likely to be more affected by measures taken to mitigate the effects of climate change. In the third part, the ECB formulated scenarios for the stress test itself, for both physical and transition risks, which then had to be assessed by the banks.

However, these risk assessments most likely underestimate potential impacts. The climate scenarios do not appear to have been highly unfavourable. The heat and drought scenario, for example, looked only at the impact of such events on productivity. Other consequences, such as possible migration flows, higher food prices or even food shortages due to crop failures, were not taken into account. Furthermore, banks' current models are designed to calculate losses during periods of recession, while the scenarios did not cover a slowdown in economic growth. Consequently, the models are not adequately adapted to the scenarios.

supervision of ESG risks, as well as for the preparation of specific prudential reporting of ESG risks to the supervisory authorities. The proposals also include an obligation for banks to establish transition plans. The proposals empower supervisors to require banks to take action if the transition plans deviate from the EU's 2050 net zero emissions targets and if banks fail to manage the associated risks. The ECB conducted an in-depth thematic analysis of the extent to which significant institutions (SIs) meet the expectations set out by the ECB in its guidance on climate and environmental risk management and reporting, as a follow-up exercise to the 2021 self-assessment. The results were published in November 2022, along with certain good practices identified during the analysis.[1,2] Like other major institutions in the SSM, major institutions under Belgian law still have a long way to go to fully meet all expectations and to adequately manage climate and environmental risks. Nevertheless, it can be said that the practices of some Belgian institutions are already relatively well developed. In addition, the ECB carried out a climate stress test (see box 8). In July 2022, it published the

1 ECB Banking Supervision (2022), Walking the talk – Banks gearing up to manage risks from climate change and environmental degradation, November 2022.

2 ECB Banking Supervision (2022), Good practices for climate-related and environmental risk management, observations from the 2022 thematic review, November 2022.

results of this test.[1] However, due to the limitations still associated with this type of exercise, too much importance should not be attached to the results; it should be seen primarily as a learning opportunity for both credit institutions and supervisors. All major Belgian banks appear to have a framework in place for climate stress testing, which is not the case for most SSM banks. However, the methodologies and data needed to perform these tests must still be improved. At the end of December 2022, the SSM released a set of best practices[2] intended to allow banks to improve their practices in this area.

For the insurance sector, as of 2022, climate risks are included in the IAIS Global Monitoring Exercise (GME).[3] At the European level, in August 2022 EIOPA published guidance on climate change materiality assessments and the use of climate change scenarios in ORSA.[4] This guidance, which follows EIOPA's opinion of April 2021 on the supervision of the use of climate change risk scenarios in ORSA,[5] aims to facilitate the application of this opinion and to help reduce implementation costs for insurance undertakings, especially small and medium-sized ones. In December 2022, EIOPA launched a dashboard on the natural catastrophe insurance protection gap for five different perils (windstorms, floods, coastal flooding, earthquakes and wildfires) in the 30 EEA countries.[6] This dashboard provides a current overview of the protection gap based on a modelling approach, a historical view based on historical loss data, and information on how natural catastrophes are covered per country.

Pillar 1

With regard to minimum capital requirements (Pillar 1), the BCBS published a series of clarifications at the end of 2022 on how climate risks should be treated in the current supervisory framework.[7] In addition, the BCBS is considering the need to adapt the framework for minimum capital requirements. In this regard, the EBA launched a discussion in May 2022 on how climate and environmental risks should be included in Pillar 1 of the prudential framework for credit institutions and investment firms.[8] The con-

1 ECB Banking Supervision (2022), 2022 Climate Risk Stress Test, July 2022.
2 ECB Report on good practices for climate stress testing, December 2022.
3 IAIS, Global Insurance Market Report, December 2022.
4 EIOPA, Application guidance on climate change materiality assessment and using climate change scenarios in the ORSA, August 2022.
5 EIOPA, Opinion on the supervision of the use of climate change risk scenarios in ORSA, April 2021.
6 EIOPA (2022) Dashboard on insurance protection gap for natural catastrophes.
7 BCBS,2022), Frequently asked questions on climate-related financial risks, December 2022.
8 EBA (2022), Discussion paper on the role of environmental risks in the prudential framework, May 2022.

sultation document revisits key elements such as the time horizon, the inclusion of forward-looking aspects in the prudential framework and the general calibration of capital requirements. EIOPA also published a report in December 2022 which considers the extent to which Pillar 1 could be adapted to better reflect climate-related risks.[1]

The ESRB and the ECB are jointly exploring how macroprudential measures can contribute to addressing climate-related risks to the financial sector as a whole. In this context, they have published a report[2] on how climate shocks could affect the European financial system. The report also includes initial reflections on potential macroprudential measures to address sectoral and cross-border risks to complement and reinforce microprudential efforts.

3.3 External functions and update of the Fit & Proper Manual

External functions

The Bank updated its rules on the exercise of external functions by managers of financial institutions through its Regulation of 9 November 2021, approved by the Royal Decree of 8 February 2022,[3] and its Communication of 12 July 2022,[4] which applies to all financial institutions subject to its prudential supervision. The previous rules were amended in a number of respects. For example, the rules on external functions now also apply to the persons responsible for independent control functions. In addition, the requirements regarding conflicts of interest were strengthened: whereas managers were previously only required to refrain from engaging in discussions about existing or future relationships between the supervised institution and the company in which the external function is performed, they are now also prohibited from influencing these discussions in any way, regardless of the stage and level of decision-making. Changes were also made to the way in which the Bank should be notified of new external functions performed by serving managers.

Update of the Fit & Proper Manual

The various supervisory provisions applicable to financial institutions require directors, senior managers (including members of the management committee) and persons responsible for an independent control function in these institutions to have the expertise and professional integrity required for their positions. The assessment of the suitability of such persons is often described as a fit & proper assessment.

Suitability has formed the object of several recent regulatory developments at the international level, including by the EBA and ECB.[5] The Bank's policy in this area has also evolved (with regard to independent directors, the age of information, the treatment of external functions, etc.) since the publication of its Fit & Proper Manual in 2018.

Consequently, at the end of 2022, the Bank deemed it necessary to update its Fit & Proper Manual, which sets out the prudential standards to be followed by all financial institutions under its supervision for the fit & proper assessment of their managers and persons responsible for independent control functions. One of the main changes was the restructuring of the suitability assessment criteria into five categories: expertise, professional integrity, time commitment, independence of mind and collective suitability. In addition, the updated manual strengthens prudential expectations on time commitment by specifying that members of the statutory management body should dispose of the time necessary to cover all important topics, including risk strategy and management, in depth. Expectations in terms of collective suitability have also been clarified: the statutory management body should collectively possess the necessary knowledge, skills and experience to understand the institution's business, including the main risks to which it is exposed. Particular attention is now paid to information technology and security risks, environmental and climate

1 EIOPA-BoS, Prudential treatment of sustainability risks, Discussion Paper, November 2022.
2 ECB/ESRB (2022), The macroprudential challenge of climate change, July 2022.
3 Royal Decree of 8 February 2022 approving the Regulation of the National Bank of Belgium of 9 November 2021 on the exercise of external functions by managers and persons responsible for independent control functions of regulated companies and repealing the Regulation of 6 December 2011 on the exercise of external functions by managers of regulated companies (Belgian Official Gazette of 25 February 2022).
4 Communication NBB_2022_19 of 12 July 2022 on the exercise of external functions by managers and persons responsible for independent control functions of regulated companies.
5 EBA Guidelines of 2 July 2021 on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2021/06) and SSM Guide to fit & proper assessments of December 2021.

risks, and the need to have specific knowledge on the prevention of money laundering and terrorist financing, etc. Furthermore, the concept of independence of mind has been clarified: members of the statutory management body must be able to take decisions completely objectively and independently in the interest of the company and its stakeholders, without being subject to conflicts of interest. At the organisational level, a number of new requirements were defined, including the development of a suitability and diversity policy, the establishment of procedures and processes for the selection and succession planning of managers, the development of a policy and procedures for the induction and training of members of the statutory management body, etc. The manual now also includes a list of events that should trigger a reassessment of the individual or collective suitability of managers. Finally, it confirms that persons newly appointed to the statutory management body under an early intervention or resolution procedure should also be subject to a suitability assessment, but that this assessment may take place after the person takes office.

BOX 9

Analysis of the Belgian financial sector and IMF review of the sector (FSAP)

The next Financial Sector Assessment Program (FSAP) for Belgium is scheduled for 2023. This is a periodic in-depth analysis of the local financial sector, financial stability and supervision, conducted by IMF experts. Belgium is one of about 30 countries that have to participate in an FSAP every five years. The last FSAP took place in 2017, with the results published in 2018.

In practice, the FSAP consists of an exploratory phase (conducted remotely) and two main phases of about three weeks (on site in the country). The exploratory phase aims to define the scope of the FSAP and familiarise the IMF experts involved with the sector, institutions, institutional framework and regulations.

During the FSAP, due attention is paid to banking and insurance supervision as well as to the financial situation of Belgian banks and insurers and the risks to which they are exposed. In this respect, stress tests are also organised for banks and insurers. For banks, these tests will coincide with the EBA's biennial stress test planned for 2023, with which the FSAP will be aligned. In addition, non-bank financial intermediation (NBFI) and links between financial institutions are examined in detail.

Supervision of financial market infrastructures is also a key theme of the Belgian FSAP. The IMF will assess the implementation of international principles[1] for risk management and the supervision of financial market infrastructures by Euroclear, the Belgium-based clearing house.

Another recurring theme is crisis management and the financial safety net, with the following main subthemes: the functioning and financing of the deposit guarantee scheme, operational aspects of crisis

1 Principles for Financial Market Infrastructures, Committee on Payment and Settlement Systems and International Organization of Securities Commissions (IOSCO), April 2012.

management, bank recovery and resolution plans, the role and functioning of the resolution authority, and emergency liquidity assistance.

Finally, the FSAP also analyses money laundering prevention policies and the oversight thereof by the Belgian authorities.

The Bank is the Belgian coordinator and contact point for the FSAP, but many other institutions and authorities are obviously also closely involved, including (1) Belgian public authorities such as the FSMA, the Federal Public Service Finance, the Cabinet of Finance and the Guarantee Fund, (2) European authorities such as the SSM, the ECB and the Single Resolution Board (SRB), and (3) Belgian financial and academic institutions. The IMF also organises an FSAP at the level of the euro area.

The FSAP for Belgium will result in a public report with an overall risk assessment and specific recommendations on the approach to certain points for attention. In addition, a series of technical documents will be published at the end of 2023 on sub-topics to be explained in more detail.